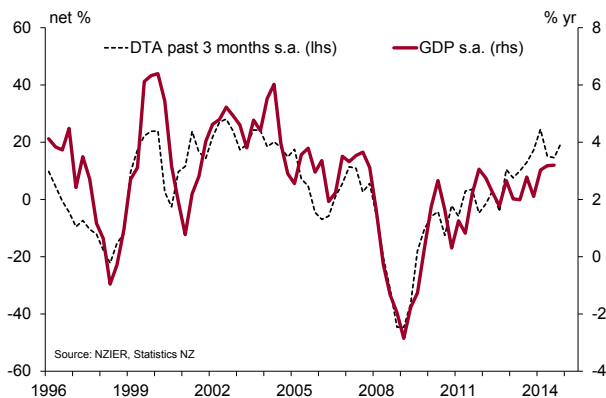


Sweet spot

NZIER Quarterly Survey of Business Opinion, December 2014

- General business confidence remains at above average levels and businesses' reported own activity has increased.
- While expectations for the coming three months are down slightly, they remain consistent with healthy growth through late-2014 and early 2015.
- Price and cost increases in the economy remain limited, consistent with softness in inflation over the coming quarters.

Domestic trading activity and GDP growth



Business confidence was largely unchanged in the December quarter, with the *Quarterly Survey of Business Opinion* showing that a net 21% of businesses expect conditions to improve over the coming six months. While business confidence has pulled back from the lofty levels reached in mid-2014, the domestic economy is still looking robust. Businesses' confidence in the general economic environment remains at above average levels. Importantly businesses' reported own activity increased over the past few months, signalling that GDP growth remained robust in the final part of 2014.

The details of the survey showed that conditions in the building industry remained robust, particularly in Auckland and Canterbury. There were also solid increases in activity in the manufacturing and services sectors, and a particularly large increase in the retail sector. Strengthening activity in these sectors is helping to offset softer conditions in the agricultural sector (which are not captured in the survey).

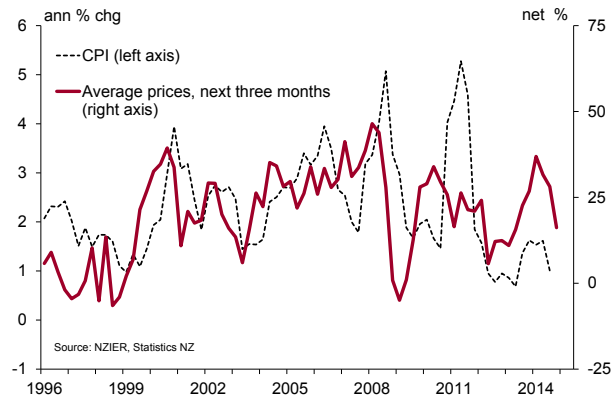
Expectations for the coming three months did pull back modestly, but remain consistent with the economy continuing to expand at a healthy pace. In addition, the number of businesses planning on increasing capital expenditure remains at above average levels, and there was a sharp increase in hiring intentions.

Inflation looking tame, but not because of low demand

There was a modest increase in the number of businesses reporting increases in costs in December, however this remains low. In addition, increases in costs do not appear to be passing into higher output prices at this stage. In fact, the number of business planning to increase prices over the coming months fell sharply, down from a net 28% in September to 16% in December. This is consistent with expectations for very low inflation through the first half of 2015. We expect that tomorrow's CPI will be flat for the quarter, which will push the annual rate down to 0.9% - below the RBNZ's target band. Inflation is expected to fall further over the coming year.

But while inflation may be low, it's notable that the survey did show a pick-up in capacity pressures across the economy. This will be worth watching over the coming year as it helps put the softness in inflation in context. Rather than reflecting weakness in demand, low inflation in New Zealand is a reflection of low costs, particularly the sharp declines in petrol prices in recent months. And if demand remains resilient, it's likely that domestic inflation will push higher over the coming year. This will make the RBNZ feel a little more comfortable with keeping interest rates on hold in the face of headline inflation that is outside its target band.

Businesses' pricing intentions and CPI inflation



Satish Ranchhod
Senior Economist

Key results – forward looking

	Dec-14	Sep-14
Business confidence, next 6 mths	21	21
Trading activity, next 3 mths	25	29
Pricing intentions, next 3 mths	16	28
Cost expectations, next 3 mths	25	21
Profitability, next 3 mths	4	11
Employment intentions, next 3 mths	20	16
Building investment intentions, next 12 mths	9	6
Plant investment intentions, next 12 mths	16	17

Key results – backward looking

	Dec-14	Sep-14
Trading activity, past 3 mths	20	15
Pricing, past 3 mths	11	23
Costs, past 3 mths	25	22
Profitability, past 3 mths	-9	-9
Employment, past 3 mths	15	3
Ease of finding skilled labour, past 3 mths	-33	-27
Ease of finding unskilled labour, past 3 mths	-12	-7
Capacity utilisation	91.90%	90.57%

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