

Getting on with the job

NZIER Quarterly Survey of Business Opinion, June 2016

- Business confidence rebounded over the June quarter, as firms appeared to overcome their earlier concerns about the impact of the dairying downturn.
- The survey results were consistent with the economy maintaining its recent pace of growth over the near term.
- But even with continued solid growth and a tightening labour market, there is little to suggest that inflation is on the verge of breaking higher again.

Key results – forward looking (seasonally adjusted)

| | Mar-16 | Jun-16 |
|--|--------|-----------|
| General business sentiment, next 6 mths | -2 | 18 |
| Trading activity, next 3 mths | 6 | 19 |
| Pricing intentions, next 3 mths | 11 | 11 |
| Cost expectations, next 3 mths | 23 | 18 |
| Profitability, next 3 mths | 14 | 17 |
| Employment intentions, next 3 mths | 11 | 14 |
| Building investment intentions, next 12 mths | 2 | 9 |
| Plant investment intentions, next 12 mths | 11 | 17 |

Key results – backward looking (seasonally adjusted)

| | Mar-16 | Jun-16 |
|---|--------|--------------|
| Trading activity, past 3 mths | 18 | 22 |
| Pricing, past 3 mths | -4 | 1 |
| Costs, past 3 mths | 27 | 18 |
| Profitability, past 3 mths | -6 | 3 |
| Employment, past 3 mths | 9 | 11 |
| Ease of finding skilled labour, past 3 mths | -32 | -38 |
| Ease of finding unskilled labour, past 3 mths | -8 | -15 |
| Capacity utilisation | 93.2% | 92.9% |

Firms are feeling more confident about the near future, having overcome some nervousness at the start of the year, according to the NZIER *Quarterly Survey of Business Opinion*. The strong activity indicators in the survey suggest that the economy is continuing to grow at a solid pace. But, as has been the case for some time, there is little sign that economic growth is translating into greater inflation pressures.

In seasonally adjusted terms, general business sentiment rose from a net -2% to +18%, while firms' own-activity expectations for the next three months jumped from +6% to +19%. These measures had fallen sharply in the March quarter survey, which we had put down to concerns about the ongoing weakness in farmgate milk prices. While the agricultural sector isn't surveyed directly, it was reasonable for other sectors to expect an impact from the drop-off in dairying incomes.

It's not that the outlook for dairying has improved since then. Recent GlobalDairyTrade auctions have been a bit more positive, but Fonterra's starting forecast of a \$4.25/kg milk price for this season was lower than expected, and confirmed that the industry is facing a third straight season of very weak returns.

Rather, what seems to have happened is that firms have seen their own results hold up, helping to allay fears about the knock-on effect from the dairying downturn. Firms' reported activity for the past three months was steady at a net +18% in the March quarter, and improved further to a net +22% in the June quarter. This measure is a useful early indicator of quarterly GDP, and the latest read suggests that GDP growth over the June quarter should match or beat the 0.7% increase seen over the March quarter.

The details of the survey generally supported the strong activity story. Firms reported more hiring and stronger profitability over the last three months, and employment and investment intentions also rose.

But the survey also highlighted that one of the great puzzles about the New Zealand economy remains in effect: strong growth in activity is not leading to any meaningful lift in inflation pressures. Fewer firms reported cost increases, and pricing intentions remained at a relatively low +1.1% for the third straight quarter. There was a slight increase in the number of firms reporting price increases in the last three months, but the result was in line with our forecast (and the RBNZ's) that annual inflation will tick up from 0.4% to a still very low 0.6% in the June quarter.

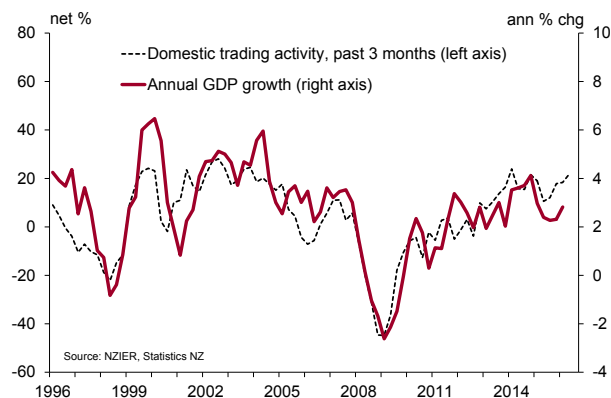
Some of the softness in inflation is no doubt related to the growth in the economy's capacity – strong net migration has boosted the growth in the labour force, resulting in only a gradual drop in the unemployment rate and muted upward pressure on wages. But that can't be the whole story, as firms have reported a persistent tightening in capacity constraints. The difficulty of finding workers continues to rise, and the share of firms reporting that supply factors (as opposed to demand) were the biggest constraint on growth had reached its highest since 2005.

The conundrum is most apparent in the construction sector, where confidence surged in the latest quarter. That optimism is understandable in light of the growing pipeline of building work across the country, even if the level of quake rebuild activity in Canterbury has peaked. Builders report that the difficulty of finding workers, both skilled and unskilled, is close to its highest levels in the history of the survey. Yet fewer firms are reporting cost increases than at almost any time in the last decade. We suspect that something will eventually have to give – if the industry is going to deliver the volume of work it expects, it will need to bid up wages to attract more workers. But it's notable that this tension has persisted for several years already.

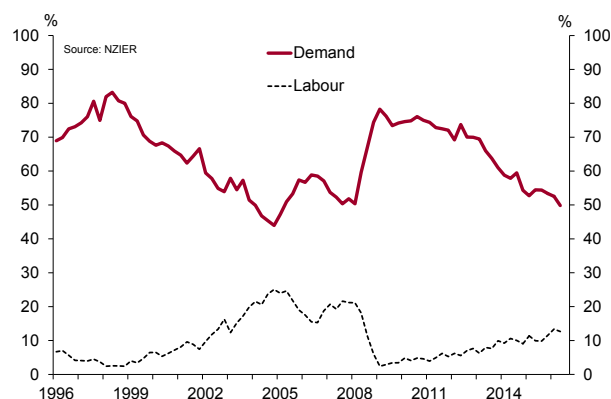
We should acknowledge that the June quarter survey closed before the Brexit vote in the UK, which has since added to the uncertainty around the outlook for the world economy. That said, the fact that the next survey is almost three months away makes it more likely that we'll see a considered response from New Zealand firms.

Michael Gordon
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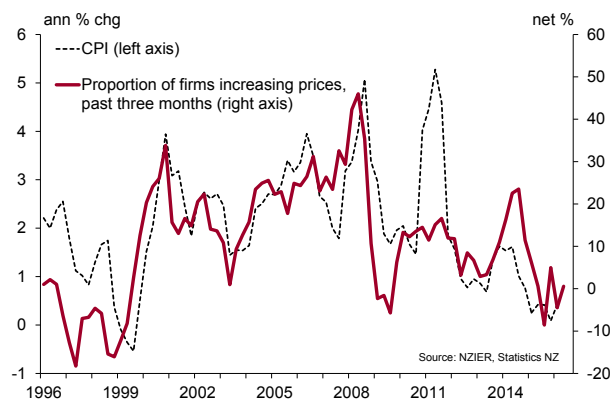
QSOB domestic trading activity and GDP growth



Biggest constraint on growth



Businesses' costs and CPI inflation



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