

# The next step

## NZIER business confidence rises in Q4

- Business sentiment was overwhelmingly positive in the December *Quarterly Survey of Business Opinion*, reinforcing the sense that the economy's upturn strengthened over the course of 2013.
- Price pressures have remained subdued to date. But with a growing number of firms running short of spare capacity, the stage is set for a pickup in home-grown inflation pressures over the next couple of years.
- With that in mind, the Reserve Bank will feel justified in starting to raise interest rates this year. We continue to expect the first OCR hike in March.

### Key results – forward looking

	Q3 survey	Q4 survey
Business confidence sa, next 6 mths	33	52
Trading activity, sa, next 3 mths	24	32
Pricing intentions, next 3 mths	24	24
Cost expectations, next 3 mths	26	18
Profitability, next 3 mths	12	16
Employment intentions, next 3 mths	17	12
Building investment intentions, next 12 mths	3	7
Plant investment intentions, next 12 mths	8	18

### Key results – backward looking

	Q3 survey	Q4 survey
Trading activity, sa, past 3 mths	12	15
Pricing, past 3 mths	8	10
Costs, past 3 mths	22	21
Profitability, past 3 mths	-8	1
Employment, past 3 mths	1	7
Ease of finding skilled labour, past 3 mths	-29	-30
Ease of finding unskilled labour, past 3 mths	-5	-10
Capacity utilisation	90.99%	90.18%

The marked improvement in business sentiment over the last year or so took another leg up in the December 2013 quarter. The latest *Quarterly Survey of Business Opinion (QSBO)* showed that the share of firms expecting better conditions over the next six months was the highest in nearly 20 years. Actual and expected activity both accelerated over the quarter, suggesting that the economy may be picking up even faster than our forecasts, and certainly faster than the Reserve Bank expected.

The idea that the New Zealand economy has entered a substantial upswing has been thoroughly advertised by now, and probably doesn't require much more elaboration. The next phase of the cycle to watch for is a re-emergence of inflation pressures, which have been fairly subdued to date, partly due to the dampening effect of the strong New Zealand dollar. But as firms find themselves running out of idle capacity, home-grown price pressures are likely to build up over time. This is a gradual process, but also one that the Reserve Bank will be able to anticipate and address.

### Details

General business sentiment jumped in the December 2013 quarter from already-high levels, with a net 52% of firms expecting an improvement over the next six months. The own-activity measures, which tend to be better correlated with near-term GDP, were also substantially stronger. A net 32% of firms expect better results over the next three months, the highest proportion since March 2002.

The survey results were strong across all of the broad industries covered in the survey (note that agriculture and government are excluded). Retailers were a net 48% positive (from 33% in September), reporting particularly strong results over the previous three months. Manufacturers were also very positive (+49% from +27%); exports held up well despite the strong NZ dollar and the slowing Australian economy, while domestic sales surged.

While confidence has generally been buoyant over the last few years, it's only in the last few quarters that businesses have expressed much of a need to expand – the severe recession in 2008-09 left many of them with a substantial amount of spare capacity. But there is growing evidence that that spare capacity is now being used up. Firms' intentions to invest in buildings and equipment are the highest since 1994; hiring intentions have also been strong recently, although they were slightly less positive in the December quarter. And compared to the depths of the recession, when around 80% of firms said that lack of demand was the main constraint on their growth, that proportion is now down to around 60%, with supply-side constraints steadily becoming more prominent.

Price pressures have remained subdued, with only a net 10% of firms reporting that they were able to raise prices in the last three months, and with cost pressures remaining low relative to pre-recession levels. Pricing intentions have lifted in the last three quarters, but they are still only around their long-term average.

## Market implications

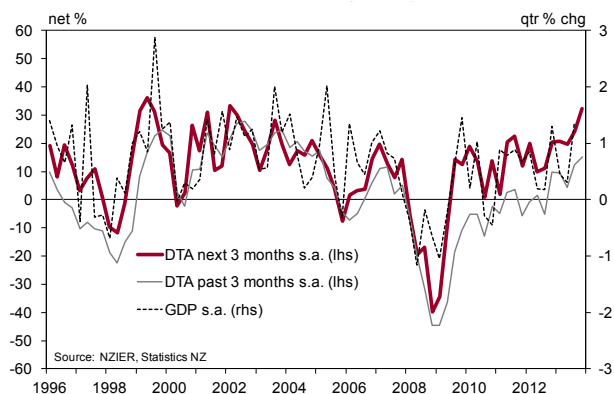
The *QSBO* provides more evidence that New Zealand's economic upturn accelerated over the course of 2013. The results for the latest quarter suggest some upside risk to our forecast of 1.0% growth in December quarter GDP. Even that would be an impressive result, given that there were no obvious one-off factors such as the post-drought recovery that lifted September quarter GDP by 1.4%.

Inflation is likely to remain in check over the short term, with the strong NZ dollar continuing to depress the prices of internationally tradable goods – we expect annual inflation to remain below 2% over 2014. But with a growing number of firms running out of spare capacity, the stage has been set for home-grown inflation pressures to re-emerge over the next year or two. This effect takes some time to build up (and to dissipate), so the Reserve Bank doesn't appear to be in great danger of falling behind the curve if it carries through with its plan to gradually raise the OCR over the next couple of years.

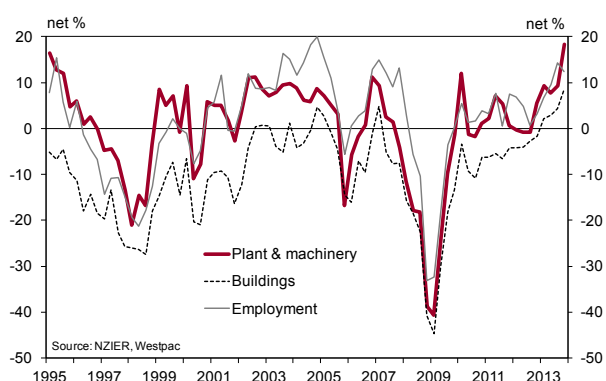
We continue to expect the first OCR increase in March, which is consistent with the timing that the RBNZ signalled in its December *Monetary Policy Statement*. Interest rate markets are more than fully pricing such a move, and are even giving 40% odds of a hike in the next OCR review at the end of January. We acknowledge that such a move is possible, but for various reasons we expect that the RBNZ will prefer to give the public fair warning before they act.

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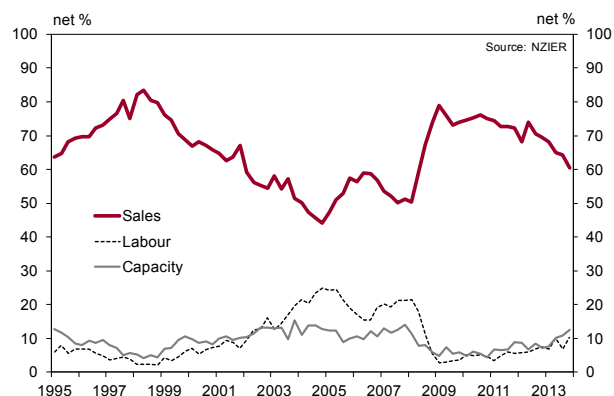
## Domestic trading activity



## Investment and employment intentions s.a.



## Factors constraining growth s.a.



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