

# Economic Review

New Zealand

6 October 2009

## NZIER Quarterly Survey of Business Opinion – September 2009 quarter

### Key points

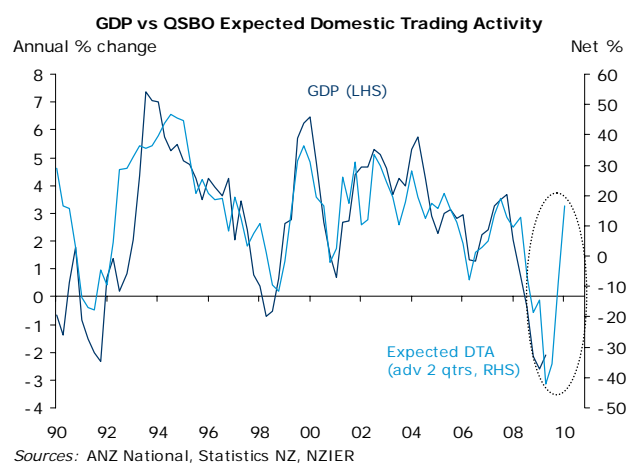
- > **A solid rise in business confidence is another piece of evidence pointing to the economy strengthening.**
- > **But cautiousness remains. There is a large disconnect between what firms are experiencing and their future expectations. Employment and investment intentions remain subdued, although at a less extreme level.**
- > **On the whole, we see little in today's survey to change our core views. While the economy is encouragingly regaining forward momentum, the recovery path looks set to be a protracted one.**

### Assessment

**Today's QSBO is another piece of evidence suggesting the economy has turned a corner.** Headline business confidence rose to a net 27 percent (seasonally adjusted) expecting better times ahead – the highest level in 10 years. Firms' expectations of their own domestic trading activity also rose strongly, with a net 17 percent expecting improvement over the coming quarter, from a net 9 percent expecting a fall last quarter. This is consistent with growth in Q4 of 1 percent. These themes are very similar to those present in recent NBNZ *Business Outlook* surveys.

	Headline business confidence		Domestic trading activity – next 3 mths		CUBO	Avg selling price – next 3 mths
	actual	s.a.	actual	s.a.		
Q3 2007	-27	-35	15	10	0.9134	34
Q4 2007	-26	-39	14	13	0.9204	35
Q1 2008	-64	-54	-10	-7	0.9262	45
Q2 2008	-64	-53	-23	-19	0.9237	49
Q3 2008	-19	-28	-8	-15	0.9079	28
Q4 2008	-64	-78	-41	-42	0.8878	-3
Q1 2009	-65	-54	-39	-36	0.8633	-6
Q2 2009	-25	-14	-13	-9	0.9070	7
Q3 2009	36	27	23	17	0.8842	13

**The nuances from the survey need to be respected.** Domestic trading activity has had an excellent relationship with actual GDP growth in the past. Today's results suggest the economy is heading for 3 percent plus growth next year – a solid result. The improvement in confidence was across all regions and sectors (albeit to varying degrees) suggesting that momentum is building. As we have stated in the past, confidence is a very important component of an economy and can quickly unleash pent-up demand.

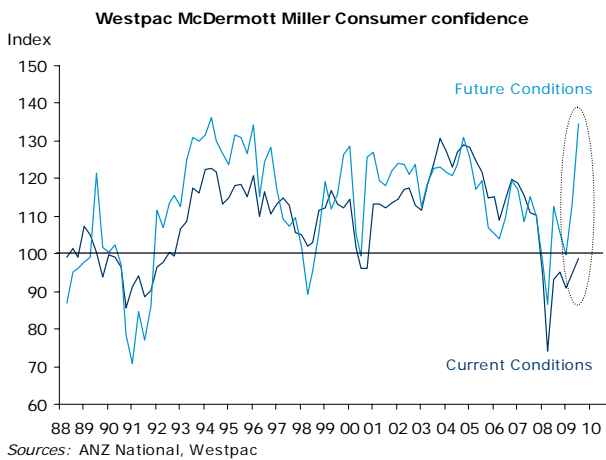
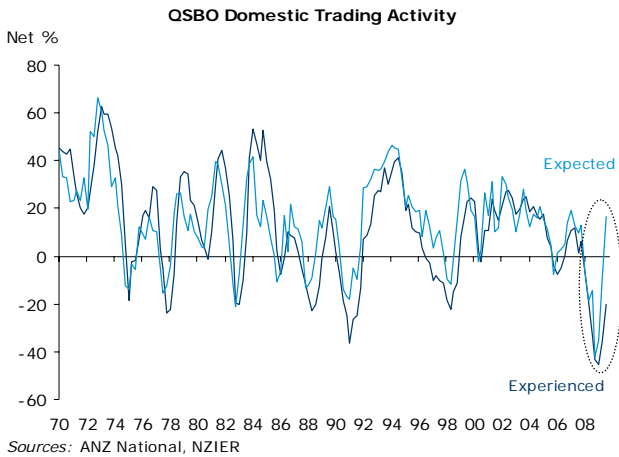


**Interestingly though, there is a large disconnect between what firms are experiencing and what they are expecting.**

The experienced domestic trading activity indicator remains mired in negative territory. A net 20 percent of firms reported a fall in their own activity in the past three months (though we need to acknowledge that this was still an improvement on Q2's reading of -35 percent).

**This disconnect is in part natural – there will always be some sort of lag between what is experienced and expected when the economy is at a turning point. However, the divergence between the expected and experienced readings is the widest it has ever been in the history of the survey.** This is telling, and mirrors the divergence between the current and future conditions readings in recent consumer confidence surveys, with the latter rebounding but the former unchanged and it is the former that drives the actual spending decision. Hence, while a better feel-good factor is percolating there are aspects that appear to lack substance and are based on expectations as opposed to reality. This dichotomy

will be key to watch going forward.



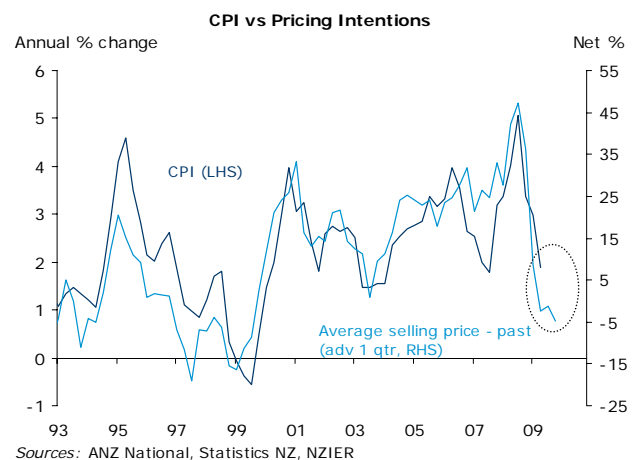
**Within an improving trend, there remains a clear undertone of cautiousness.** Employment, profit expectations and investment intentions have all recovered off nadirs. Yet all remained firmly negative in Q3 suggesting underlying pressure remains. In fact, builders reported laying off more staff in the past quarter than in Q2 – bucking the trend across other sectors. Perhaps an indication that while residential construction is set to pick up, commercial construction faces a step-down in activity in the year ahead. Retailers are not yet confident enough to rebuild stock levels, with overseas orders up only marginally on the previous quarter (-32 percent from -43 percent). Sales remains the key factor restraining growth, with 74 percent of firms stating that it is their biggest constraint. However, we also note that there was a reasonable increase (from 6 to 10 percent) stating that finance was a constraint and this is something we will be watching closely going forward.

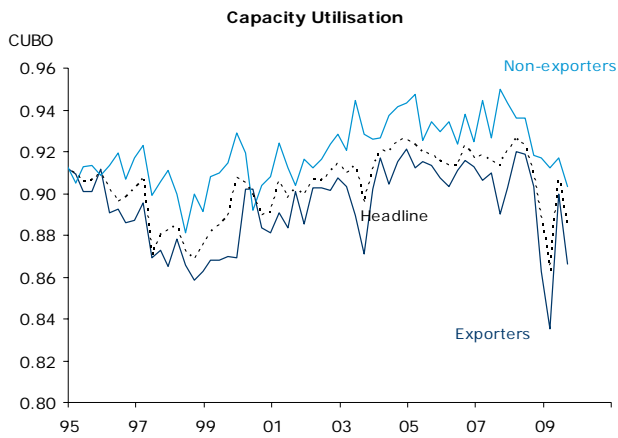
**We respect what leading indicators such as today's numbers are telling us and expect economic momentum to begin to build over the latter part of this year and into 2010.** We have pencilled in a solid recovery in H2 and particularly Q4.

**Yet today's survey also portends of considerable caution.** This is in part a reflection

of the natural lagging relationship between some key indicators such as employment and growth. But the magnitude of the gap is flagging deeper forces at work. Profits remain under pressure, and in that environment firms are naturally reticent to commit to investing and hiring. Sectoral divergences will still be present and this is no better shown than by architects' expectations for the coming two years with government work in positive territory, housing flat, and commercial lagging. It is also interesting to see that those manufacturers and builders reporting stock levels too high has only eased back to long-run average levels, which may imply that a pending inventory cycle in NZ may not be as pronounced. Time and time again confidence surveys have proven to be accurate barometers and we need to respect the nuances. However, it remains to be seen how much of the improvement in confidence (a decade high) merely reflects the fact that the economy is looking up from a deep hole in the first place.

**For the RBNZ, we see the survey as reinforcing their September MPS message. Inflation does not look to be a near-term concern.** Gauges of resource pressure remain soft. The CUBO eased from 90.7 percent in the previous quarter, to 88.4 percent. Recent volatility looks to be a consequence of changes in exporters' capacity. Firms continue to report it easy to find skilled and unskilled staff (25 and 48 percent respectively), suggesting wage growth will continue to moderate. While cost pressures are slowly rising, with a net 19 percent experiencing higher costs over the past three months, the economic backdrop appears to be making it difficult for firms to pass these on. A net 5 percent of firms reported lower selling prices in the past three months. **With uncertainty high and cautiousness remaining, we see the RBNZ holding pat on their low for an extended period view on interest rates.**





	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Decade Average
Business Confidence – actual	-64	-19	-64	-65	-25	<b>36</b>	-18
– s.a.	-53	-28	-78	-54	-14	<b>27</b>	-17
Experienced domestic trading activity – actual	-22	-34	-39	-45	-38	<b>-21</b>	4
– s.a.	-19	-33	-43	-45	-35	<b>-20</b>	4
Expected domestic trading activity – actual	-23	-8	-41	-39	-13	<b>23</b>	10
– s.a.	-19	-15	-42	-36	-9	<b>17</b>	10
Capacity Utilisation (CUBO)	0.9237	0.9079	0.8878	0.8633	0.9070	<b>0.8842</b>	0.9048
Average selling price – past 3 months	47	36	9	-2	-1	<b>-5</b>	16
Average selling price – next 3 months	49	28	-3	-6	7	<b>13</b>	22
Costs – past 3 months	68	59	42	29	25	<b>19</b>	31
Costs – next 3 months	71	52	27	21	17	<b>16</b>	30
Profitability – past	-45	-44	-49	-51	-44	<b>-39</b>	-15
Profitability – expected	-40	-23	-46	-45	-24	<b>-3</b>	-6
Difficulty finding labour – skilled	-19	-5	20	42	42	<b>25</b>	-27
Difficulty finding labour – unskilled	6	16	43	63	67	<b>48</b>	-5
Investment intentions – Buildings	-18	-20	-42	-46	-29	<b>-16</b>	-11
Investment intentions – Plant & Machinery	-17	-16	-39	-44	-23	<b>-8</b>	-2
Employment intentions – past 3 months	-3	-11	-21	-34	-31	<b>-29</b>	-2
Employment intentions – next 3 months	-6	-7	-32	-36	-19	<b>0</b>	2

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