

# NEW ZEALAND ECONOMICS DATA REVIEW

## NZIER QSBO – JUNE 2010 QUARTER

6 July 2010

### CONTRIBUTORS

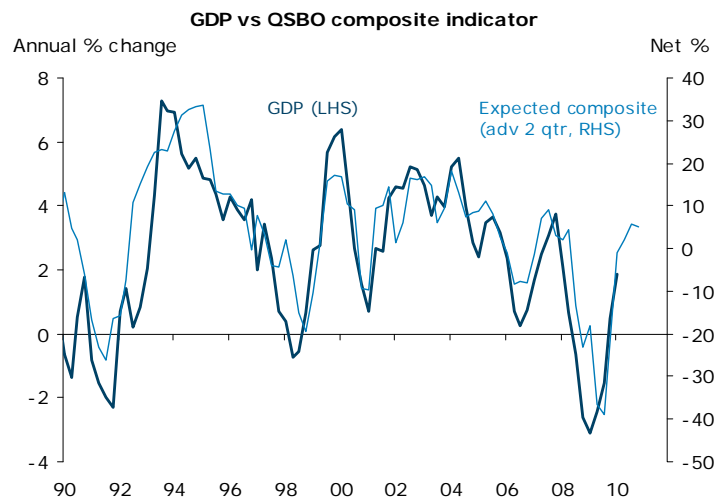
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## LEVELING OUT IN THE RECOVERY

### KEY POINTS

- The overall tone of the QSBO was weaker than what we were anticipating. Headline confidence fell but remains at high levels. The domestic trading activity readings were mixed, with the forward looking expectations component falling but the experienced activity measure improving, though remaining in negative territory. Large firms are faring better, at the expense of small ones.
- Activity in the manufacturing and building sectors looked to have weakened in the quarter. The latter is not surprising given the soft housing market and still weak building consents numbers. But the weakness in manufacturing is surprising, perhaps a sign that the inventory rebuild has already run its course. The drop in export sales could be an early indication of easing global demand.
- A positive sign is that demand for labour remains robust, with employment intentions, while off slightly, are still suggestive of net employment gains. Firms are finding it more difficult to find skilled labour, which is indicative of a still falling unemployment rate.
- Our composite growth indicator from the key QSBO indicators is still consistent with 3 percent year-on-year growth by the end of this year. While not a sign of an economy that is off to the races, it still points to an ongoing recovery though at a moderate pace.
- **Given today's QSBO and increased downside risks on the global scene, we have made some minor changes to our OCR view.** We believe the RBNZ will still increase the OCR by 25bps at the end of this month, and have pencilled in one more for September, but with only a 60 percent probability on that. We then see a pause before the next stage of policy stimulus removal begins in March next year.



Sources: ANZ, National Bank, Statistics NZ, NZIER

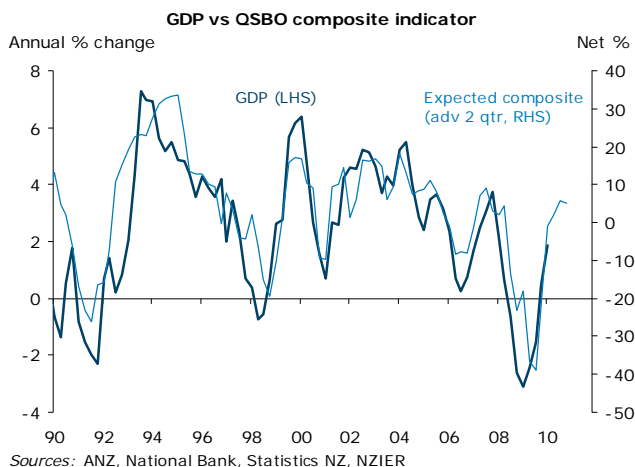
## DATA REVIEW

## DATA WRAP

**The Q2 Quarterly Survey of Business Opinion (QSBO) was a mixed bag, but the overall survey was softer than what we were expecting.** The headline seasonally adjusted business confidence reading may have fallen from +34 to +28, but the level remains high by historical standards (long run average is -8). The domestic trading activity (DTA) readings, which is a better gauge of GDP growth, was mixed with the expected DTA falling from +19 to +16 but the experienced DTA improving from -6 to -3. The expectations vs reality gap in the DTA is closing, but is still at a high level.

	Headline business confidence		Domestic trading activity s.a.		CUBO		Avg selling price – next 3 mths
	actual	s.a.	past	expected	actual	actual	
Q1 2008	-64	-53	-6	-6	0.9262	45	
Q2 2008	-64	-53	-19	-19	0.9237	49	
Q3 2008	-19	-33	-33	-18	0.9079	28	
Q4 2008	-64	-72	-44	-40	0.8878	-3	
Q1 2009	-65	-53	-45	-34	0.8633	-6	
Q2 2009	-25	-14	-35	-9	0.9070	7	
Q3 2009	36	21	-20	13	0.8842	13	
Q4 2009	31	23	-10	12	0.9107	24	
Q1 2010	22	34	-6	19	0.9054	27	
Q2 2010	18	28	-3	16	0.9076	40	

**The survey shows that it is the large firms that are faring better**, with activity picking up, at the expense of small firms, which continue to struggle. We think this trend will persist throughout the recovery as larger firms take market share off the smaller ones.

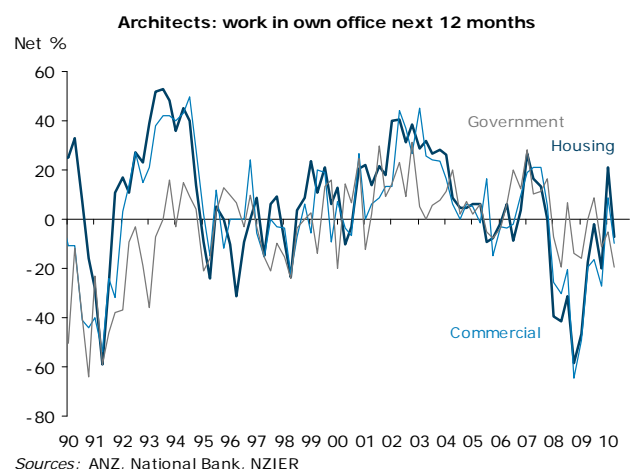


**Our composite growth indicator from the QSBO is consistent with 3 percent year-on-year growth by the end of this year.** This suggests that the recovery remains in progress as opposed to stalling. But it continues to be a rather muted

recovery compared to past cycles, and certainly when you consider the sharp contraction in economic activity during the recession. So while it is not a sign of an economy that is off to the races, it still points to an ongoing recovery albeit at a moderate pace.

**It is the details of the survey that were disappointing.** Investment intentions fell despite capacity utilisation running at a high rate. Experienced profitability improved slightly but expected profitability fell, with both at near long run average levels. The building sector is experiencing renewed weakness and manufacturing activity looked to have hit somewhat of a wall after a good run. Looking at the sectoral split in the DTA, manufacturers and builders experienced the biggest decline in both experienced (down 10 points) and expected (down 11 points) activity. Ironically, merchants' DTA readings showed the biggest improvement despite a still challenging retail environment (experienced up 14 points and expected up 7 points). Services sector DTA has effectively stalled.

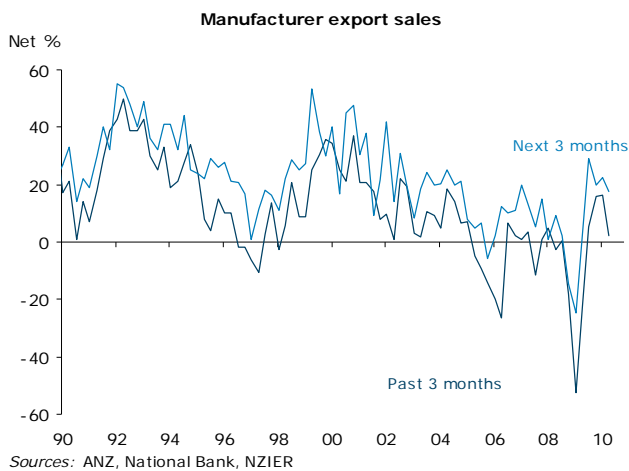
**Weakness in the building sector is to be expected given the soft housing market and still weak building consents.** And it seems to be broad based, with architects reporting that the work in their own office over the next 12 months and in 12-24 months all falling for housing, commercial and government. As an indication of the pipeline of work available, this is not a positive sign. While we still expect residential investment to undergo a cyclical recovery off lows, the rebound may not be as much as what we have anticipated.



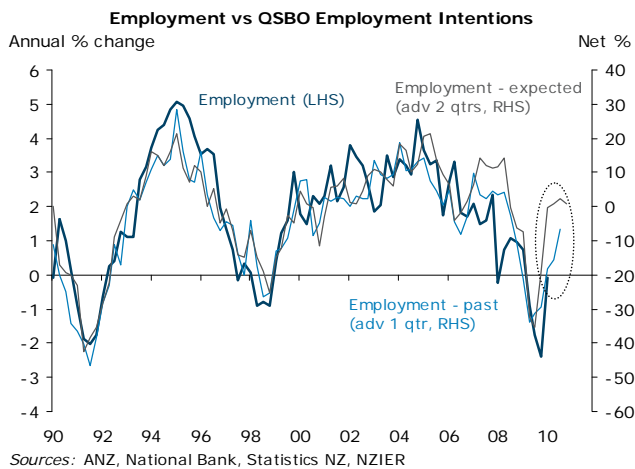
**The weakness in manufacturing activity is a surprise.** After expanding in Q4 last year and Q1 this year based on the official manufacturing GDP data, the QSBO survey suggests that manufacturing

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activity may have stalled or even contracted in Q2. New orders over the past 3 months fell from +3 to -11, output eased from +22 to +15, deliveries in NZ fell from -9 to -17, and inventories rose. This could be an indication that the inventory rebuild cycle has run its course. Of more concern is the fall in experienced export sales from +16 to +2. While not as dramatic as the plunge seen in this reading post the Lehman collapse, this is an area to watch closely given recent concerns over the global recovery story.

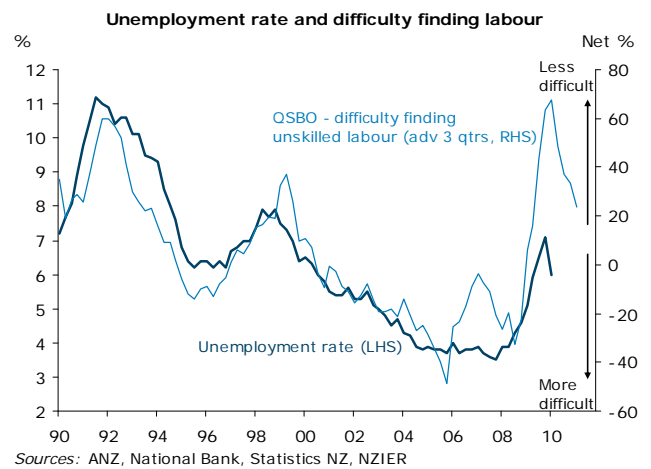


**On a bright note, labour demand still remains robust.** Employment expectations may have eased back, but more firms increased their workforce in the past three months while less firms downsized. These readings point to positive jobs growth ahead, with annual employment growth of around 2 percent expected.

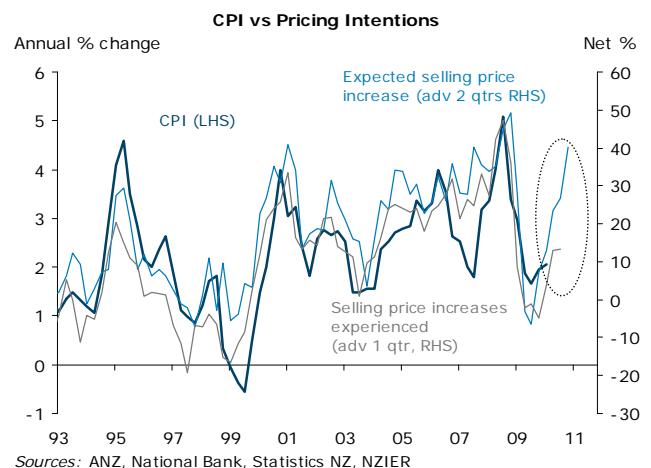


**Firms report that it is becoming more difficult to find both skilled and unskilled labour, though more so for the former.** This suggests that the unemployment rate will continue to trend lower, though at a modest rate. But for the

economy to start hitting labour capacity pressures at this early stage in the cycle is a concern. Firms are clearly opting to utilise labour in order to expand output, as opposed to investing in new plant and machinery. But the risk is that the lack of investment limits the productive capacity of the economy, while continuing to source labour for expansion mean that productivity performance will be negatively impacted. This in turn means that capacity pressures will emerge much earlier, limiting the extent that the economy can expand without generating inflation pressure.

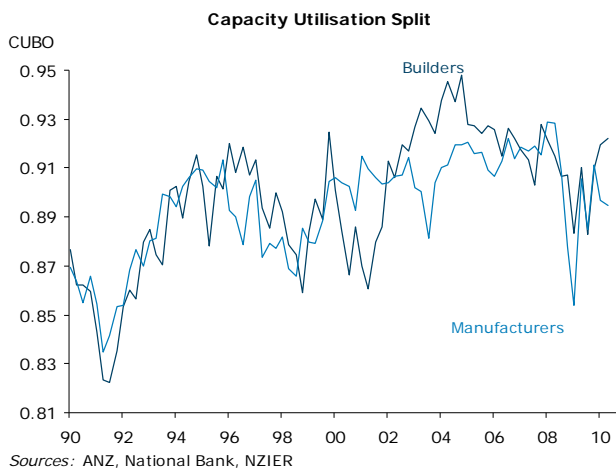


**Unsurprisingly, pricing intentions rose from +27 to +40, largely due to government policy changes.** But actual price increases in the past three months were stable at +13. With GST rising from 1 October, headline inflation is set to move beyond 5 percent. Still muted price increases over the past month suggests competitive pressures are holding firms back from pushing through increases. However, this may not rule out firms trying to pass more through when setting new prices under the new GST rate.



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**Capacity utilisation rose from 0.9054 to 0.9076.** This was driven by a rise in capacity utilisation for building materials firms, while capacity utilisation for manufacturers fell. The level of capacity utilisation is high compared to historical average, and based on past correlation with non-tradable inflation, is pointing towards an acceleration in domestic inflation pressures. Certainly, weak investment will only result in capacity pressures building as the economy recovers. However, an alternative gauge of capacity pressures (capacity as a limiting factor) suggests that it is not as acute. For the RBNZ, which measure proves the more accurate gauge for underlying domestic inflation pressure will be important.



## ASSESSMENT

**We would characterise today's QSBO results as the reality of a slower recovery dawning on businesses, as opposed to the recovery itself coming under threat.** We still expect the NZ economy to expand, but the growth rate will be lower compared to past recoveries as deleveraging acts as a huge headwind. As the Q1 GDP data made clear, a year out of the recession, and we are only half way through recouping the output lost during the recession. We continue to make inroads, but it remains a challenging environment for businesses. Hence, the drop in headline business confidence and expected DTA should be read in that light. **Overall, our view is that the economy continues to expand but at a moderate pace.**

**We still expect the RBNZ to increase the OCR by 25bps at the end of this month.** But given today's QSBO and increased downside risks on the global scene, we have made some minor changes to our OCR view further out. We have pencilled in one more 25bp hike for September, taking the OCR to 3.25 percent, but with only a 60 percent probability on that. We then see a pause before the next stage of policy stimulus removal begins in March next year.

	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	Average
Business Confidence – actual	-65	-25	36	31	22	<b>18</b>	-8
– s.a.	-53	-14	21	23	34	<b>28</b>	-8
Experienced domestic trading activity – actual	-45	-38	-21	-5	-7	<b>-7</b>	11
– s.a.	-45	-35	-20	-10	-6	<b>-3</b>	11
Expected domestic trading activity – actual	-39	-13	23	11	15	<b>11</b>	15
– s.a.	-34	-9	13	12	19	<b>16</b>	15
Capacity Utilisation (CUBO)	0.8633	0.9070	0.8842	0.9107	0.9054	<b>0.9076</b>	0.8889
Average selling price – past 3 months	-2	-1	-5	4	13	<b>13</b>	28
Average selling price – next 3 months	-6	7	13	24	27	<b>40</b>	33
Costs – past 3 months	29	25	19	15	20	<b>24</b>	46
Costs – next 3 months	21	17	16	21	25	<b>36</b>	45
Profitability – past	-51	-44	-39	-14	-19	<b>-16</b>	-18
Profitability – expected	-45	-24	-3	-2	-2	<b>-6</b>	-7
Difficulty finding labour – skilled	42	42	25	13	9	<b>-2</b>	-16
Difficulty finding labour – unskilled	63	67	48	37	33	<b>23</b>	16
Investment intentions – Buildings	-46	-29	-16	-15	-5	<b>-8</b>	-15
Investment intentions – Plant & Machinery	-44	-23	-8	-2	9	<b>0</b>	-2
Employment intentions – past 3 months	-34	-31	-29	-18	-15	<b>-7</b>	-6
Employment intentions – next 3 months	-36	-19	0	1	2	<b>1</b>	-2

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- Associate Member of Investment Savings & Insurance Association of NZ;
- Financial Markets Operations Association; and
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- Placed in statutory management or receivership.

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- Equity securities such as listed and unlisted shares;
- New Zealand and overseas unit trusts;
- Share in a limited partnership;
- Superannuation schemes and bonds;
- Group investment funds;
- Life insurance products;
- Derivative products including interest rate and currency forward rate contracts and options; and
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Any investment money lodged with the Bank for the purchase of securities offered by the Bank, its subsidiaries or any third parties will be deposited in accordance with your instructions, to your nominated account or investment. Such money will be held by the Bank according to usual banking terms and conditions applying to that account or the particular terms and conditions relating to the investment and will not be held by the Bank on trust unless explicitly accepted by the Bank on those terms. Any investment money or property accepted by the Bank on trust will be so held until disbursed in accordance with your instructions. Any investment property lodged with the Bank will be held by the Bank as bailee according to the Bank's standard terms and conditions for holding your property.

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