

### Quarterly Survey of Business Opinion: March 2008 quarter

#### Key points

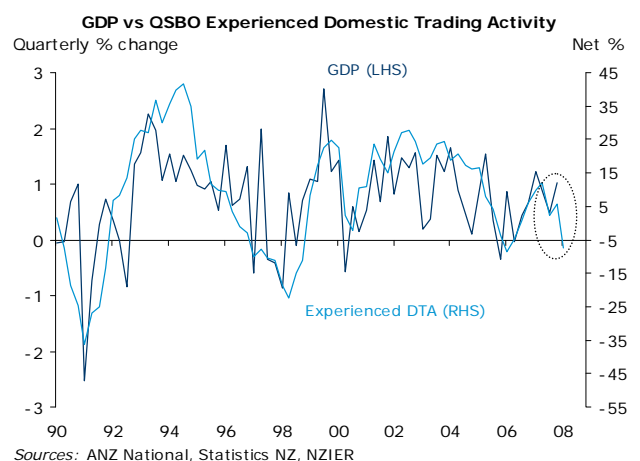
- > As expected, headline business confidence and domestic trading activity fell sharply in Q1, mirroring the recent National Bank *Business Outlook* survey.
- > All the forward looking activity measures declined, with investment and hiring intentions down, and are consistent with a sharp slowdown in economic activity over the first half of 2008.
- > However, capacity utilisation and pricing intentions rose (strongly in the case of the latter) and remain a major sticking point for the Reserve Bank as they portend of further inflation pressures.
- > Although there is now a consistent theme on the slower growth profile for the economy, the inflationary risks will keep the Reserve Bank on alert. The Q1 CPI report (due next week) is shaping as a very important read ahead of their April *OCR Review*.

#### Assessment

**As expected, headline and own activity business confidence deteriorated sharply in the March quarter.** A net 64 percent of firms expect general business conditions to deteriorate over the coming six months, down from a net 26 percent in the December quarter and is the lowest level since December 1974. On a seasonally adjusted basis, headline business confidence fell from -39 in December to -56 in March. The more important domestic trading activity measure also fell sharply with a net 10 percent of firms expecting their own activity to deteriorate in the next three months compared with a net 14 percent expecting an increase in December. All of these results are consistent with recent readings from the National Bank *Business Outlook* survey. There was very little variation across sectoral and regional business confidence, with all experiencing a sharp fall. Nonetheless, the largest decline in confidence was in the building sector for the second consecutive quarter.

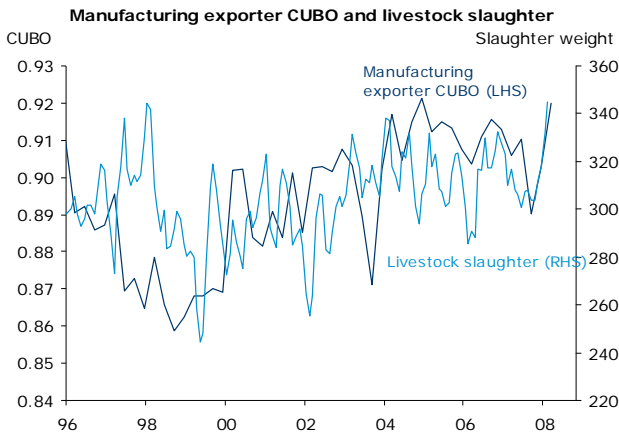
**There are early signs the labour market may be starting to ease.** A net 0 percent of firms intend to increase staff over the next three months, a sharp decline from the net 14 percent saying they were planning to hire in the last quarter. However, a net 4 percent said they did increase staff levels in the past three months, unchanged from the previous survey. Firms are also reporting that it is easier to find labour than in the December quarter, with difficulty in finding skilled and unskilled staff going from -46 percent and -33 percent respectively in the December quarter to -36 percent and -22 percent respectively in March.

	Headline business confidence		Domestic trading activity – next 3 mths		CUBO	Avg selling price – next 3 mths
	actual	s.a.	actual	s.a.		
Q1 2006	-49	-41	-2	-1	0.9137	26
Q2 2006	-44	-37	-1	3	0.9136	36
Q3 2006	-19	-21	10	8	0.9230	28
Q4 2006	3	-9	15	13	0.9171	28
Q1 2007	-15	-7	16	17	0.9182	40
Q2 2007	-37	-29	9	13	0.9156	35
Q3 2007	-27	-29	15	13	0.9134	34
Q4 2007	-26	-39	14	12	0.9204	35
<b>Q1 2008</b>	<b>-64</b>	<b>-56</b>	<b>-10</b>	<b>-8</b>	<b>0.9262</b>	<b>45</b>



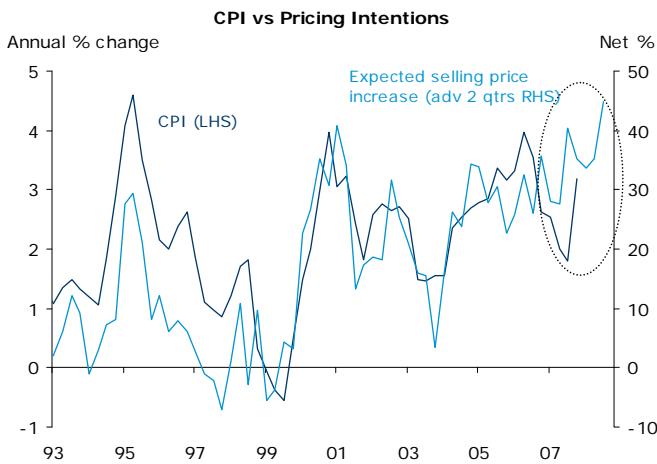
**However, capacity pressures have intensified.** Somewhat of a surprise in this survey was that despite the signs of waning demand (and expectations of this to continue) capacity utilisation rose to 0.9262, an equal record high with the December 2004 quarter. The increase was wholly attributable to a rise in manufacturing exporters' capacity utilisation, with builders and non-exporting manufacturers recording a drop in their capacity utilisation (although still at elevated levels). We suspect that the increase in

manufacturing exporters' capacity utilisation in the quarter is a result of increased meat processing as livestock are sent to slaughter early due to dry weather conditions. Recent livestock slaughtering statistics are consistent with this, and we have seen similar occurrences in the past. Therefore, the possibility of a reversal is likely in the coming quarters. Nevertheless, abstracting from this, the elevated capacity utilisation measure among non-exporters still portends of near-term inflation pressure.



Sources: ANZ National, Statistics NZ, NZIER

**Pricing intentions and cost pressures continue to rise.** The number of firms intending to increase their prices in the next three months rose strongly from a net 35 percent in the December survey to a net 45 percent in March – the highest level since March 1987. Cost pressures also rose strongly, with a net 62 percent of firms expecting cost increases, up from a net 49 percent in December – again the highest level since March 1987.



Sources: ANZ National, Statistics NZ, NZIER

**Despite strong capacity constraints, investment intentions are falling, likely due to a dire profitability outlook.** With demand conditions softening and cost pressures increasing sharply, firms' profitability expectations have unsurprisingly taken a hit. A net 33 percent of firms expect profitability to decline over the next three months – the lowest figure since March 1983. Investment intentions have also fallen, with a net 18 percent and 15 percent expecting a decline in buildings and plant and machinery

investment respectively. This is down from a net 8 percent and 3 percent respectively in the December survey. Also of some interest in this quarter's survey was the sharp increase in firms reporting overdue debtors, which is approaching the levels reached over the 1997/98 period.

**Implications**

**Today's survey results are consistent with economic activity coming to a grinding halt in the first half of 2008.** All forward looking indicators deteriorated sharply in the March quarter. The experienced domestic trading activity indicator suggests March quarter GDP could be flat to slightly negative – consistent with other business and consumer confidence gauges released recently. A negative gloom appears to have descended over businesses in recent months and it is quite easy to list the negative factors weighing on sentiment. Financial conditions are extremely tight through high interest rates, the NZD, and international cost of credit. Equity markets are under pressure, the housing market is weak and looks to be broadening into the retail sector, and petrol prices continue to hit new record highs. The positives provided by the corporate tax rate lowering to 30 cents in the dollar and the strong likelihood of further tax relief in this year's budget, are being dwarfed at present.

**The main sticking point for the Reserve Bank remains elevated pricing intentions and capacity pressures.** Despite signs that economic momentum is waning by more than what the Reserve Bank was expecting, resource pressures and pricing intentions portend of further near-term inflation pressure. The CPI, which is already above the Reserve Bank's target band of 3 percent, looks set to remain elevated for the rest of 2008. It suggests that the Reserve Bank will require an even more protracted slowdown in economic activity in order for these inflationary pressures to ease.

**On balance, there are mixed messages in today's survey for the Reserve Bank.** With a lack of inflation headroom, the Bank will want to see hard evidence of a slowdown in growth and more importantly see it translate into easing inflation pressures. We are starting to get a consistent theme on the former (and the activity indicators in this survey are testament to that), but the latter is still lacking at this stage. Next week's March quarter CPI report is now shaping as a key read ahead of the April OCR Review.

	Q1 2007	Q2 2007	Q3 2007	Q4 2007	Q1 2008	Decade Average
Business Confidence	-15 (-7 s.a.)	-37 (-29 s.a.)	-27 (-29 s.a.)	-26 (-39 s.a.)	<b>-64</b> <b>(-56 s.a.)</b>	-15 (-15 s.a.)
Domestic trading activity – past 3 months	11 (10 s.a.)	8 (12 s.a.)	0 (2 s.a.)	10 (6 s.a.)	<b>-7</b> <b>(-7 s.a.)</b>	10 (10 s.a.)
Domestic trading activity – next 3 months	16 (17 s.a.)	9 (13 s.a.)	15 (13 s.a.)	14 (12 s.a.)	<b>-10</b> <b>(-8 s.a.)</b>	14 (14 s.a.)
Capacity Utilisation (CUBO)	0.9182	0.9156	0.9134	0.9204	<b>0.9262</b>	0.9061
Average selling price – past 3 months	27	25	33	28	<b>42</b>	16
Average selling price – next 3 months	40	35	34	35	<b>45</b>	23
Costs – past 3 months	49	46	46	45	<b>59</b>	30
Costs – next 3 months	50	48	44	49	<b>62</b>	29
Difficulty finding labour – skilled	-41	-42	-41	-46	<b>-36</b>	-34
Difficulty finding labour – unskilled	-21	-26	-19	-33	<b>-22</b>	-12
Investment intentions – Buildings	2	-5	-6	-8	<b>-18</b>	-9
Investment intentions – Plant & Machinery	7	3	3	-3	<b>-15</b>	2
Employment intentions – past 3 months	3	2	5	4	<b>4</b>	1
Employment intentions – next 3 months	12	11	12	14	<b>0</b>	3

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