ANZ RESEARCH

NEW ZEALAND ECONOMICS
DATA REVIEW
NZIER QSBO – September 2011 quarter

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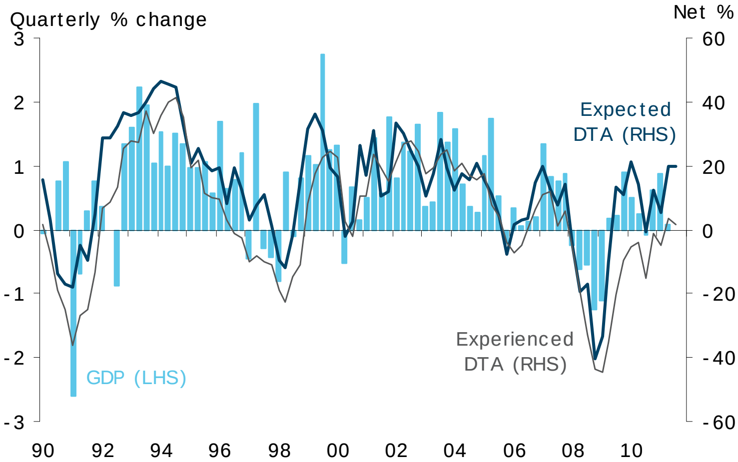
BUSINESS CONFIDENCE SHOWS RESILIENCE

KEY POINTS

- QSBO headline business confidence and expected domestic trading activity readings held up much better than expected in the face of recent global turmoil. This may be partly attributable to the timing of this survey.
- The level of the main gauges remains consistent with a respectable economic performance in H2, with the Rugby World Cup helping out. The real challenge will come early next year, when we see the risk of a soft patch between the Rugby World Cup and the Christchurch rebuild.
- As is typical for a modestly growing economy, there was a mixed bag across sectors. Building and construction are outperforming. Domestic sales for manufacturers eased back. Retailing finally caught a break, with a significant pick-up in expectations likely to be courtesy of the Rugby World Cup. Services (particularly financial) remain subdued. Encouragingly, building/construction confidence and intentions remained high, despite anecdotes suggesting the Christchurch rebuild will be delayed.
- QSBO readings for employment suggest a further tightening in the labour market. Firms reported greater difficulty in finding labour. Investment intentions were flat – not a bad outcome given the global situation.
- Of some concern for the RBNZ, capacity measures did not ease. The CUBO measure of capacity utilisation remains near its historical average, but this will pick up as the reconstruction effort kicks into a higher gear. Capacity as a limiting factor also rose, suggesting resource bottlenecks remain.
- Pricing intentions eased, with a net 22 percent expecting to increase prices (previously +31). The net balance experiencing higher average costs also fell, and experienced profitability rose, nearing historical averages.

GDP vs QSBO Expected and Experienced Domestic Trading Activity



Sources: ANZ, National Bank, Statistics NZ, NZIER

DATA REVIEW

DATA WRAP

	Headline business confidence		Domestic trading activity s.a.		CUBO	Avg selling price – next 3m
	actual	s.a.	Past	exp.	actual	actual
Q1 2010	22	37	-6	21	0.9054	27
Q2 2010	18	25	-4	14	0.9076	40
Q3 2010	6	-7	-15	-1	0.9039	30
Q4 2010	8	-1	-1	12	0.8900	22
Q1 2011	-27	-11	-5	5	0.8938	14
Q2 2011	27	31	4	20	0.8873	31
Q3 2011	25	13	2	20	0.8963	22

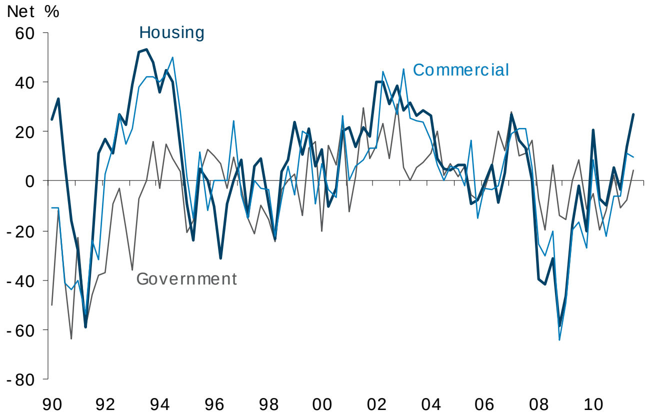
The decline in general business confidence had been flagged by the National Bank Business Outlook (NBBO). While some slippage in the NZIER survey was evident, the level remains surprisingly resilient given recent events. **The timing of the survey is likely to have been a factor, with 85 percent of responses received prior to September 15th.** They missed the downbeat September *MPS* assessment, and an increasingly bleak spate of global headlines.

Once again, past domestic trading activity (at +2 s.a.) failed to live up to the promise suggested by the Q2 QSBO survey. Past trading activity at current levels is still consistent with the economy moving forward in Q3, albeit at a slower pace than we would have expected, given the pending boost of the Rugby World Cup (RWC). Encouragingly, experienced domestic trading activity held firm and is consistent with a strong Q4 rate of quarterly growth. Whether activity will follow, of course, remains to be seen, and we are conscious of the "head fakes" provided by the confidence measures in Q2 and much of 2010.

There were regional differences. Past domestic trading activity recovered in Canterbury (to +10 from -2 s.a.), while sentiment in the rest of the country was flat. Canterbury was the star performer, with experienced hiring, building investment intentions, and plant and machinery intentions outperforming the rest of NZ. Key to this is the belief by respondents is that the earthquake reconstruction work will forge ahead, with architects more optimistic over the next 12 to 24 months. Of concern, there were increasing signs of softness in the upper North Island, which had driven much of the recent recovery.

The QSBO highlighted sector divergences. We were expecting construction sector sentiment to move lower considering the delays caused by frequent aftershocks and insurance issues. But while output slowed, new orders and profitability are improving. Hiring has rebounded in Canterbury, which is a positive sign that the pending boost will occur sooner rather than later. Expected housing work by architects over the next 12 and 24 months lifted strongly, portending good times ahead. Merchants' expectations moved to near-record highs, possibly due to the expectation of a sizeable Rugby World Cup (RWC) boost. Whether expectations will be met by reality remains to be seen. Given very low rates of credit growth, services sector sales volumes eased and remain a weak spot in the economy.

Architects: work in own office next 12 months

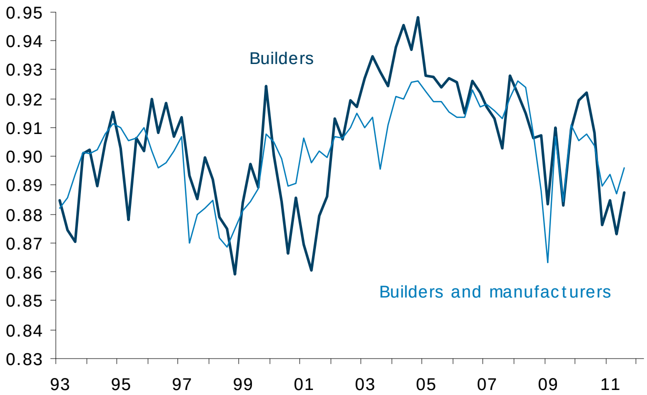


Sources: ANZ, National Bank, NZIER

Labour market indicators were broadly unchanged. New hiring improved, but intentions eased. Canterbury outperformed the rest of the country. This is consistent with the messages we have been getting from the ANZ job ads series, and we will continue to watch this to ascertain the degree to which the current lull persists.

Investment intentions eased a touch, with building investment down to -6, and plant and machinery easing to 6. **It could have been much worse, and importantly investment intentions remain above** long-run averages (-14 for buildings and -2 for plant and machinery). Construction intentions remain upbeat, with architects most optimistic over residential work, followed by commercial then government work.

Capacity Utilisation



Sources: ANZ, National Bank, NZIER

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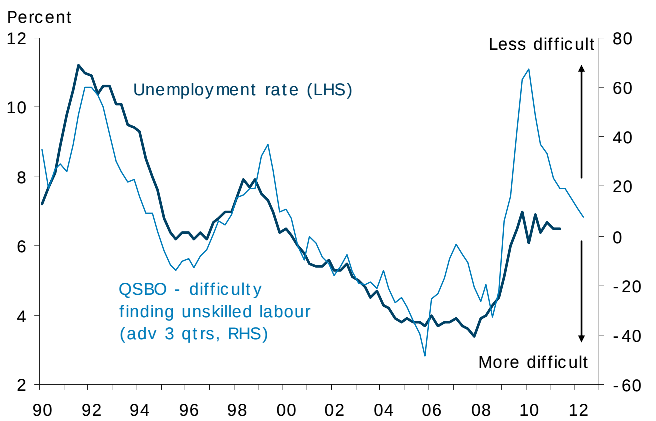
Capacity measures failed to ease, which will not please the RBNZ. The RBNZ noted in their September *MPS* that constraints on production seemed surprisingly tight given only moderate growth. Surveyed QSBO capacity utilisation increased in Q3 for both builders and manufacturers. Capacity as a limiting factor ticked up from +6 to +7, largely as a result of pressures on Canterbury capacity. All-up, today's QSBO release did nothing to buy the RBNZ time on the capacity front. Given the scale of the task in Christchurch, a major bottleneck is clearly coming. But that's tomorrow's story. The RBNZ's eyes are fixed firmly on the global situation at present, with fine-tuning inflation not a current priority with a potential global recession looming.

One area where capacity pressure is already becoming more marked is in the labour market. Measures of skilled labour shortages continue to become more acute (a net 20 percent of firms are finding it more difficult to find skilled labour, compared to 15 percent last quarter, and the unskilled market also tightened). Labour market pressure is likely to intensify over the next year or two given the reconstruction requirements and increased demand for labour as the economy strengthens.

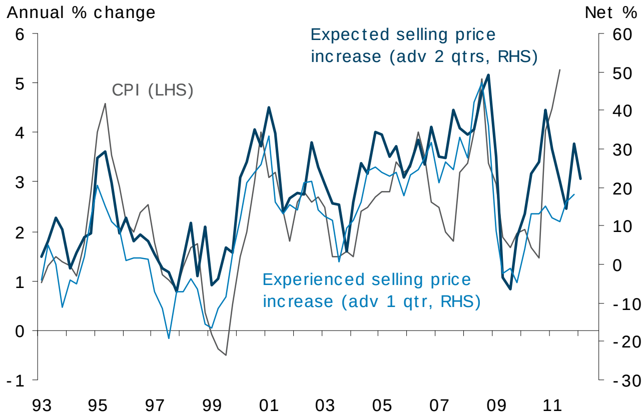
Unemployment rate and difficulty finding labour



Sources: ANZ, National Bank, NZIER

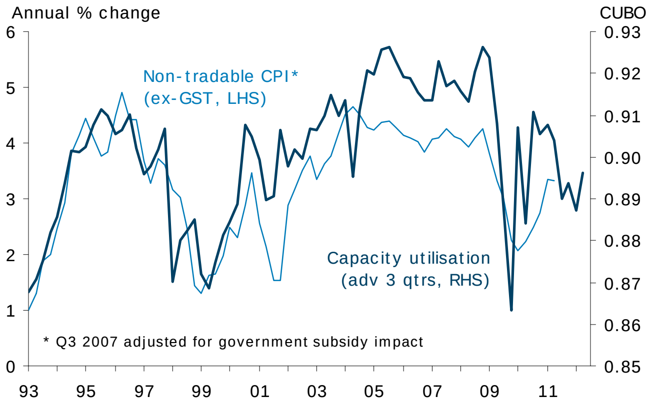
Pricing gauges eased but remain at high levels. A net 18 percent of firms increased their prices in the last 3 months (s.a., vs. +16 in Q2). However, expected selling prices eased, with a net 22 percent of respondents intending to increase prices, versus +31 last quarter. Average costs eased but remained well off their recession lows, with a net 30 percent of firms reporting higher average costs in the previous 3 months. Profitability is slowly improving, with a net 14 percent of firms experiencing lower profitability over the last 3 months, versus 28 percent in Q1 of this year. The generally soft domestic demand environment continues to keep price increases restrained, but there are limits to how long this can last. The construction sector is one to watch, with prices charged turning positive for the first time in three years, and their expected profitability rising sharply. Given the boom time ahead, this sector could give the Reserve Bank a real headache in years ahead.

CPI vs Pricing Intentions



Sources: ANZ, National Bank, Statistics NZ, NZIER

Non-tradable Inflation vs Capacity Utilisation



Sources: ANZ, National Bank, Statistics NZ, NZIER

We expect confidence measures to ease in coming quarters as the realities of a bleak global growth picture hit home. However, the New Zealand economy has positive offsetting factors that will help us ride through the storm. Christchurch reconstruction will keep us busy for years. The rural sector continues to outperform, and New Zealand commodity prices are (so far) holding up better than hard commodities. Financial conditions are providing considerable support (especially with the NZD coming off), and the Rugby World Cup is providing a feel-good factor. On the other side, there are credit downgrades, a fiscal straitjacket, the spectre of higher bank funding costs feeding into borrowing rates, and weaker growth in our trading partners. There's a rough road ahead, but the NZ economy has strong shoes.

DATA REVIEW

	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	*Average*
Business Confidence – actual	22	18	6	8	-27	27	**25**	*-7*
– s.a.	37	25	-7	-1	-11	31	**13**	*-8*
Experienced domestic trading activity – actual	-7	-7	-16	4	-6	2	**0**	*11*
– s.a.	-6	-4	-15	-1	-5	4	**2**	*11*
Expected domestic trading activity – actual	15	11	9	11	-2	18	**30**	*15*
– s.a.	21	14	-1	12	5	20	**20**	*14*
Capacity Utilisation (CUBO)	0.9054	0.9076	0.9039	0.8899	0.8938	0.8873	**0.8963**	*0.8891*
Average selling price – past 3 months	13	13	15	12	11	16	**18**	*27*
Average selling price – next 3 months	27	40	30	22	14	31	**22**	*33*
Costs – past 3 months	20	24	29	26	39	37	**30**	*46*
Costs – next 3 months	25	36	38	32	44	40	**28**	*45*
Profitability – past	-19	-16	-30	-21	-28	-23	**-14**	*-18*
Profitability – expected	-2	-6	-14	-5	-22	-1	**10**	*-7*
Difficulty finding labour – skilled	9	-2	-4	-7	-10	-15	**-20**	*-16*
Difficulty finding labour – unskilled	33	23	19	19	15	11	**8**	*16*
Investment intentions – Buildings	-5	-8	-10	-8	-7	-4	**-6**	*-14*
Investment intentions – Plant & Machinery	9	0	0	0	0	9	**6**	*-2*
Employment intentions – past 3 months	-15	-7	-12	-3	2	-6	**-4**	*-6*
Employment intentions – next 3 months	2	1	5	4	0	7	**4**	*-1*
Capacity as a limiting factor	5	5	5	5	7	6	**7**	*8*

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