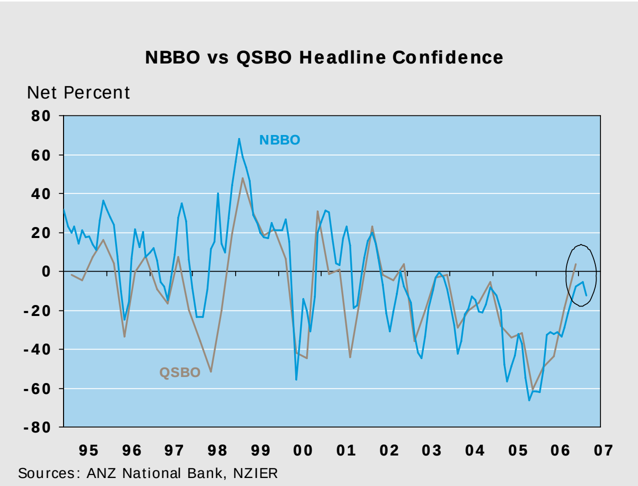
Quarterly Survey of Business Opinion – March 2007 Quarter
(due Tuesday 10 April 10:00am)

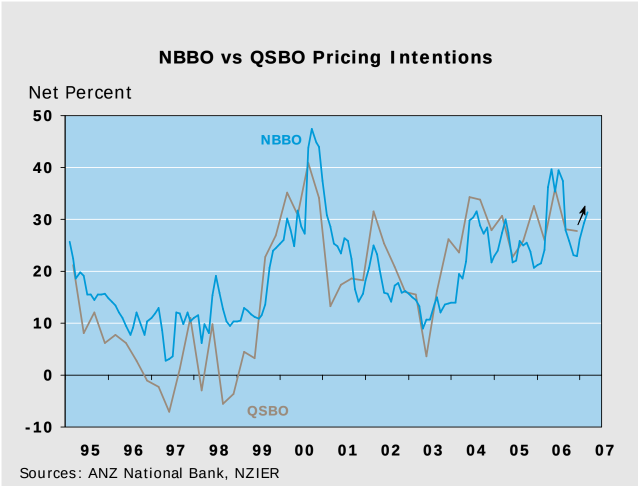
	ANZ National	Previous
Business Confidence	**-5.0**	3.5
Capacity Utilisation	**91.3**	91.7
Pricing Intentions	**28.5**	27.7

Key points

- **Capacity utilisation and other indicators of resource pressure to remain elevated.**
- **More worryingly for the Reserve Bank, pricing intentions are expected to tick up.**
- **We believe forward indicators for Q2, which will capture part of the impact of the higher NZD and lending rates, are the key gauges to assess. We expect headline business confidence to drop and possibly head back into negative territory with growth expectations for Q2 to be pared back, weighed down by higher interest rates and currency.**
- **The collective picture is expected to be one of strength regarding the existing position, ongoing pressure on resources and inflation stickiness, but signs of softening growth going forward.**



Sources: ANZ National Bank, NZIER



Sources: ANZ National Bank, NZIER

Trading activity indicators for Q1 are expected to show solid growth, pointing to some of the momentum in growth from Q4 last year flowing into Q1 this year. This is expected to be reflected in a slight improvement in the experienced Domestic Trading Activity indicator and reinforced by an elevated reading in the capacity utilisation measure.

Forward indicators for Q2, which are the key gauges to watch, are expected to show activity easing. The December QSBO survey's experienced Domestic Trading Activity indicator pointed towards the rebound in Q4 GDP growth that we experienced, and also hinted at some of that momentum spilling over into Q1. We expect the March survey to show that expectations for Q2 activity are easing.

Domestic Trading Activity	Q1 06	Q2 06	Q3 06	Q4 06	Decade average
Experienced	-7	-5	0	6	8
Expected	2	2	5	13	14

Headline business confidence is expected to decline in Q1, in line with the recent falls in the monthly *National Bank Business Outlook* survey. Interest rates and the currency will be the two main factors weighing on general business confidence.

Pricing intentions to rise as firms attempt to pass on rising input costs. Margins have been under pressure over the past two years from rising wage and input costs. Despite a competitive environment, we suspect firms will be trying to pass on some of the cost increases onto their customers. If this is indeed the case, such a strategy will see further inflationary pressure in the pipeline, which will be a source of concern for the Reserve Bank.

We suspect that there has been a structural shift towards a higher capacity utilisation measure – as inefficient firms (with large space capacity) close down and existing firms seek to run their plants closer to full capacity. Given that Q4 GDP came in slightly weaker than what the Reserve Bank had expected, their estimate of the output gap will be revised slightly lower. However, other indicators of resource pressure, such as difficulty in finding labour, will show an economy that is still stretched and pose upside risk to non-tradable inflation over the coming year.

Market Implications

The overall QSBO survey will not provide much new information that we did not already glean from the *National Bank Business Outlook*. The survey will paint a picture of strength regarding the existing position, continued resource pressure in the economy, inflation remaining sticky, but signs of softening growth going forward. We expect the activity indicators such as employment and investment intentions to edge down slightly following Q4's surge. We doubt the QSBO survey will provide sufficient justification for a April hike, but it will keep the market pricing biased towards the risk of a move at some stage.

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