

Economic Note

Quarterly Survey of Business Opinion

3 July 2018

Business confidence falls as economic momentum slows

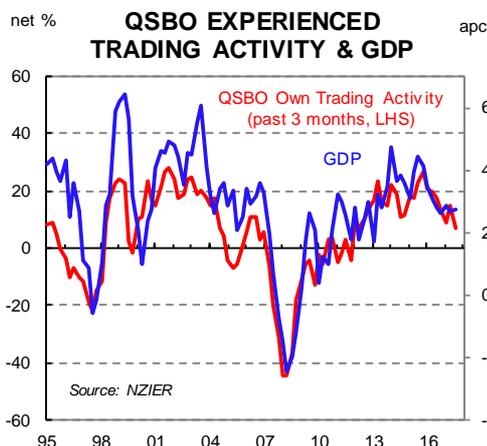
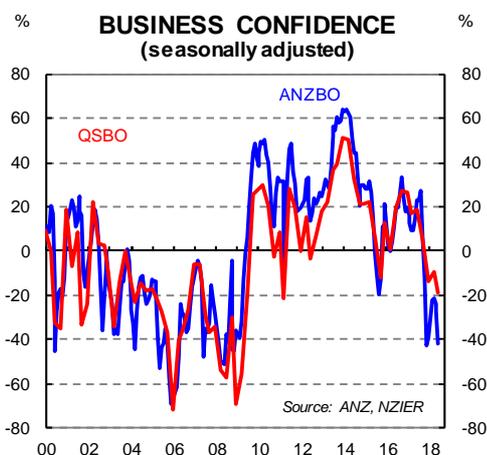
- NZIER QSBO business confidence fell in line with the monthly ANZ survey, with indicators confirming a slowdown in underlying economic growth.
- Business intentions were mixed, with investment intentions plunging but employment intentions holding firm.
- From here, we will be watching closely to see how well economic activity holds up, given the continued tension between supportive economic fundamentals but low business confidence.

KEY INDICATORS	Jun-18	Mar-18	Dec-17
Business Confidence (seasonally adjusted)	-18.8	-9.8	-13.7
Own Activity (expected, s.a.)	12.8	15.7	17.2
Number Employed (Past 3 Months, s.a.)	13.8	9.6	10.6
Investment Intentions (plant)	1.1	16.5	11.2
Selling Prices (Past 3 Months, s.a.)	23.5	16.5	18.6

Summary & implications

The **QSBO survey confirms underlying economic activity has slowed**. Beyond this, some of the indicators were mixed. While investment intentions plunged, **employment intentions remain elevated** and point to ongoing growth in labour demand. Growing labour incomes is a key assumption underpinning our own view of stronger household spending growth in our economic forecasts.

Despite a pessimistic general outlook on the economy, **details buried within the QSBO survey show there is continuing support for some sectors**, particularly export-related activity and services. We expect the RBNZ will take note of the fall in business confidence, and like us, will consider revising its H2 2018 GDP growth outlook lower. But beyond that, the **RBNZ will take a cautious approach, placing more emphasis on how measures of economic activity evolve from here, notably retail demand, employment and investment**. We continue to expect the RBNZ will next lift the OCR in November 2019. However, weak business confidence and the risk it presents to GDP growth over the rest of 2018 suggests the odds of a rate cut (rather than a hike) are growing.

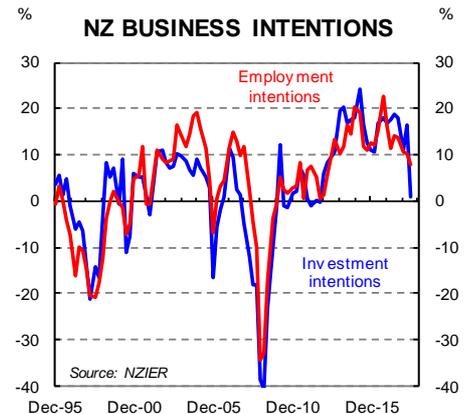


Confidence down, economic growth slowing

NZIER business confidence fell over the June quarter, in line with the plunge seen in the ANZ Business Outlook Survey. Furthermore, **indicators within the survey confirm a slowing in economic momentum**. Seasonally-adjusted experienced own activity fell in Q2 – this series is a good guide to the underlying momentum in growth and **points to an underlying quarterly growth rate of 0.6% - well below the 0.9% per quarter growth rate we had been predicting over H2 2018**.

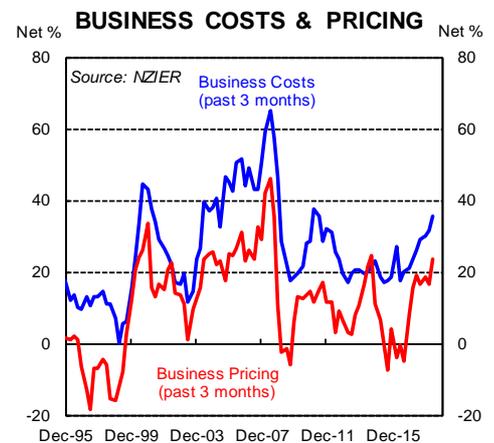
Investment intentions plunge, but employment intentions holding up

Business intentions were mixed, with plunging investment intentions pointing to a slowdown in investment activity over the rest of the year. However, employment intentions remained elevated. This creates some uncertainty around how businesses will respond to perceptions of weak economic activity, and in turn, how much business decisions themselves will drive economic activity. As we have been saying for some time, NZ economic fundamentals (such as high Terms of Trade and low interest rates) remain supportive of above-trend economic growth.



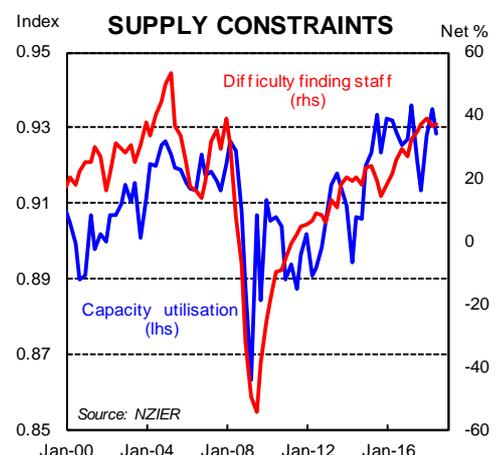
Cost pressures chewing into profits

The number of businesses reporting cost increases continues to creep higher, suggesting a reasonable amount of cost pressure building in the economy. This has pushed pricing intentions higher, although price increases appear to be lagging the rise in costs and businesses are reporting declines in profitability. **This cost pressure complicates the inflation and interest rate outlook somewhat for the RBNZ**. A cost-push led increase in prices may lift inflation in the near term, but in the medium term may see inflation fall back below target if economic demand is not strong enough to tolerate higher prices.



Capacity pressures still tight, for now

Measures of capacity constraints (i.e. difficulty finding labour and capacity utilisation) **were largely stable over Q2, but remained elevated**. The concerning development was a **slight pick-up in firms reporting a lack of demand** as being the key factor constraining activity growth (rather than supply-related factors). Some of this **may be due to a slowing in the construction sector**. Nonetheless, this is the sort of development seen in the mature phase of the economic cycle. The RBNZ may be mindful that growth momentum may be running out of steam, and if it wishes to see growth remain above trend (in order to lift demand-pull inflation) further policy stimulus may be required. **Ultimately, however, the RBNZ is unlikely to rush to any conclusions and will take the business confidence surveys with a grain of salt, given some of the mixed messages within the results**. Furthermore, given the firmer short-term inflation outlook, this suggests the hurdle to an OCR cut is still reasonably high.



Construction peaked, but services activity growth remains firm

- **Confidence among builders has fallen**, following a slowing in growth in this sector. Furthermore, a fall in architects' activity points to further weakness ahead, **confirming we are likely at the peak of NZ construction activity**. The manufacturing sector is closely linked to the NZ construction cycle and it appears momentum is

waning in this industry also.

- **Activity among merchants was mixed**, with domestic demand appearing to be slowing but overseas orders still growing strongly.
- The **services sector was one area we were particular interested in**, in light of the sharp fall in the monthly ANZ survey. **While general confidence was pessimistic in the services sector, activity indicators suggest services sector demand is still growing at respectable rates** (albeit slower than over 2016). Employment demand remains strong in the services sector, although investment intentions have declined.

GROWTH INDICATORS	Jun-18	Mar-18	Dec-17
Business Confidence (seasonally adjusted)	-18.8	-9.8	-13.7
Own Activity (expected, s.a.)	12.8	15.7	17.2
Investment Intentions (building)	-4.4	0.7	1.3
Investment Intentions (plant)	1.1	16.5	11.2
Profitability (past 3 Months)	-14.9	-8.8	-8.7
Profitability (next 3 Months)	-9.8	-1.4	-4.2

LABOUR MARKET INDICATORS	Jun-18	Mar-18	Dec-17
Number Employed (Past 3 Months, s.a.)	13.8	9.6	10.6
Number Employed (Next 3 Months, s.a.)	8.0	10.2	10.6
Labour Shortages (Skilled)	44.1	44.9	48.2
Labour Shortages (Unskilled)	30.3	28.2	30.2
Factor Constraints (Labour)	18.4	19.8	19.8

INFLATION INDICATORS	Jun-18	Mar-18	Dec-17
Capacity Utilisation (%)	92.8	93.5	92.8
Costs (Past 3 Months, s.a.)	35.6	31.8	30.2
Costs (Next 3 Months, s.a.)	39.9	33.1	40.9
Selling Prices (Past 3 Months, s.a.)	23.5	16.5	18.6
Selling Prices (Next 3 Months, s.a.)	28.9	20.0	30.5

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