

# Economic Note

Quarterly Survey of Business Opinion

7 July 2020

## Business activity contracts in Q2

- The Q2 NZIER QSBO confirmed a fall in business activity over Q2 as businesses took stock of trading conditions over recent months.
- Firms have reduced employment and signal more job cuts to come. We expect the unemployment rate to peak near 8% later this year.
- We will continue to place more emphasis on the monthly ANZ survey for the time being, as it is more timely and better able to capture this volatile, unusual and rapidly-changing economic backdrop.

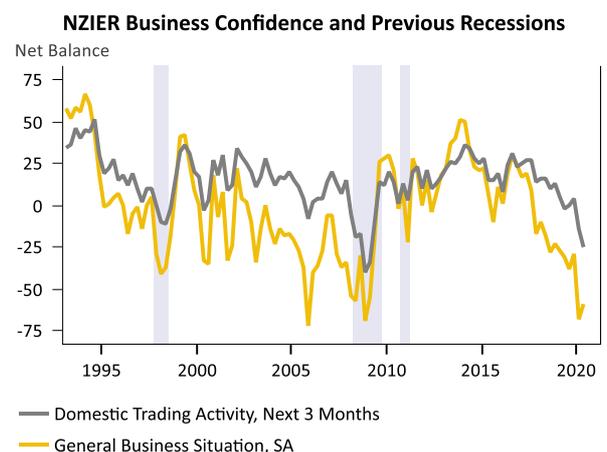
KEY INDICATORS	Jun-20	Mar-20	Hist ave
Business Confidence (seasonally adjusted)	-58.8	-68.0	-5.2
Own Activity (actual, s.a.)	-37.1	-11.7	6.1
Own Activity (expected, s.a.)	-24.8	-13.9	13.3
Number Employed (Past 3 Months, s.a.)	-16.6	-4.5	0.1
Investment Intentions (plant)	-36.9	-6.2	2.8
Selling Prices (Past 3 Months, s.a.)	-10.3	4.8	11.7

## Summary & implications

**The fall in business activity in the Q2 NZIER Quarterly Survey of Business Opinion were foreshadowed in the monthly ANZ business survey.** Given the volatility over the quarter – as NZ transitioned from Alert Level 4 all the way back to ‘normal’ Level 1, along with the heightened uncertainty which prevailed over the quarter – we feel the monthly survey better illustrates business confidence that prevailed over each month, rather than a quarterly snapshot.

By design the survey is unable to predict GDP movements with its usual accuracy given the highly unusual circumstances over Q2. We expect GDP to contract 17% in Q2, followed by a 15% rebound in Q3. **We will continue to place more emphasis on the monthly ANZ survey for the time being** as it is more timely and better able to capture this volatile, unusual and rapidly-changing economic backdrop.

The QSBO confirmed a plunge in economic demand, signalled a reduction in employment and investment and indicated rising deflation risk. While recent activity indicators (such as traffic volumes and retail sales) signal a faster



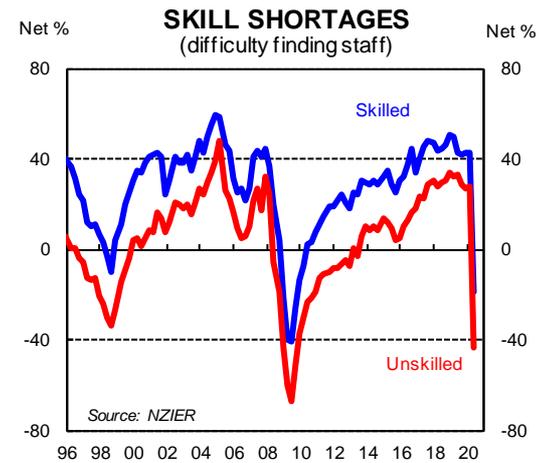
Source: Macrobond, ASB

recovery from lockdown than expected, **the economic outlook remains very challenging. We expect that at the end of 2020 the unemployment rate will rise to around 8% and economic activity will be 5% below year-earlier levels.**

## Services sector to feel the brunt of this year's recession

**Firms' experienced own activity fell most for the services sector**, as this sector was most heavily impacted by trading restrictions imposed to control the spread of COVID-19. Under Alert Level 4 only essential business could operate, and even under Alert Level 2 health and safety reasons meant many services either had to remain closed or be subject to material operating restrictions.

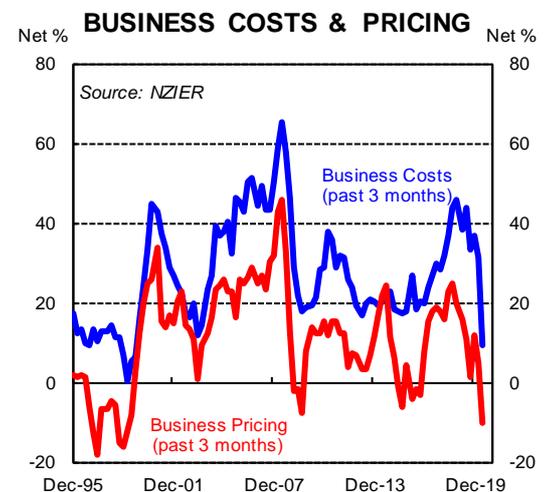
Net 61% of businesses in the services sector reported a fall in activity over Q2, compared to just a net 19% of merchants reporting a fall in activity (many retailers were able to operate online) and a net 30% of builders and manufacturers reporting a decline (with the latter likely including those whose activity was considered essential). Expectations for activity going forward remain lowest for the services sector. **With borders closed to international visitors in order to control the spread of COVID-19, the tourism and hospitality sector will feel the brunt of this year's recession.**



## Labour demand plunges, deflation risks rise

The labour market is a key area we are watching over the coming year, as limiting the deterioration in labour market conditions will be key to limiting the severity of this year's recession. We expect the unemployment rate to rise to around 8%, and that by Q4 of this year economic activity will be 5% below year-earlier levels. **The QSBO points to a contraction in employment over Q2 and for further declines to take place in Q3.** According to the QSBO, the pandemic has seen reported skill shortages disappear overnight, and points to considerable slack in the labour market prevailing over the second half of 2020.

Consistent with the plunge in demand, inflation pressures have also evaporated. Pricing intentions are the weakest since 1998, and (just) weaker than the lows reached during the 2008/09 Global Financial crisis.



**Inflation indicators point to a looming deflation risk and justify any and all means necessary from the Reserve Bank of New Zealand to ensure its medium-term inflation and employment targets are met.**

## Construction activity disrupted by supply chains, demand falling

**The QSBO survey suggests the pandemic impact on the building sector may be impacting earlier than we expected.** Anecdotally, post lock-down construction activity has been fairly busy as activity resumed on projects which were already underway prior to the COVID-19 pandemic outbreak. However, going forward, we expect to see a sharp drop in construction demand as the recession impacts investment appetites. 51% of the building sector now reports weak demand as a factor limiting expansion: this compares to a low of 26% in 2016. Labour shortages appear to no longer be factor holding back the construction sector, or the lack of spare operating capacity. **The QSBO survey has also confirmed that the pandemic has disrupted building sector supply chains, with 9% of builders reporting supplies as a key constraint to activity, compared to 0% typically reported.** Interestingly, builders are the only respondents reporting a material lift in supply disruption constraining output. Expected activity for architects has plunged, as expected, with expectations most pessimistic for commercial building projects.

GROWTH INDICATORS	Jun-20	Mar-20	Hist ave
Business Confidence (seasonally adjusted)	-58.8	-68.0	-5.2
Own Activity (actual, s.a.)	-37.1	-11.7	6.1
Own Activity (expected, s.a.)	-24.8	-13.9	13.3
Investment Intentions (building)	-32.6	-17.7	-6.7
Investment Intentions (plant)	-36.9	-6.2	2.8
Profitability (past 3 Months)	-60.8	-27.3	-13.9
Profitability (next 3 Months)	-44.2	-32.4	-2.2

LABOUR MARKET INDICATORS	Jun-20	Mar-20	Hist ave
Number Employed (Past 3 Months, s.a.)	-16.6	-4.5	0.1
Number Employed (Next 3 Months, s.a.)	-25.2	-13.3	4.1
Labour Shortages (Skilled)	-18.6	43.3	27.3
Labour Shortages (Unskilled)	-43.9	28.0	4.5
Factor Constraints (Labour)	7.5	17.8	0.0

INFLATION INDICATORS	Jun-20	Mar-20	Hist ave
Capacity Utilisation (%)	92.8	92.1	90.2
Costs (Past 3 Months, s.a.)	9.4	31.5	27.4
Costs (Next 3 Months, s.a.)	16.6	28.3	27.0
Selling Prices (Past 3 Months, s.a.)	-10.3	4.8	11.7
Selling Prices (Next 3 Months, s.a.)	-7.5	5.9	19.5

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