

Economic Note

Q3 Quarterly Survey of Business Opinion

3 October 2017

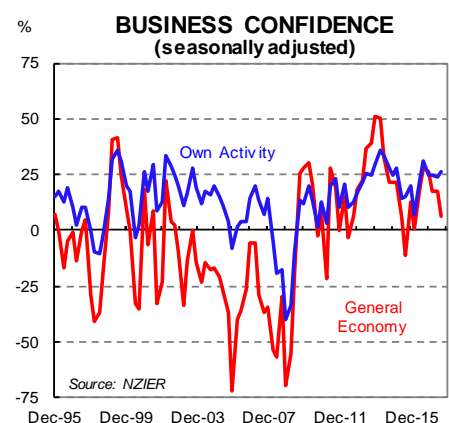
QSBO reveals the building sector's constraints

- General confidence fell, as expected, due to election uncertainty. Broader and more accurate measures of economic activity remained firm.
- Labour is now the key factor holding back the building sector's expansion. Meanwhile, there are some further indications that building sector demand may be peaking.
- The entire labour market continues to tighten, which points to stronger wage inflation over the coming year.

Summary & implications

Business confidence fell due to election uncertainty, but firms' own activity expectations suggest activity should recover after the election. **The QSBO confirms continued tightening in the labour market** and steady inflation pressures. **The overall tone of the QSBO is consistent with the RBNZ's outlook**, suggesting the economy is continuing to expand at a moderate rate and capacity pressures are tightening. Nonetheless, rate hikes remain some time away.

KEY INDICATORS	Sep-17	Jun-17	Mar-17
Business Confidence (seasonally adjusted)	6.7	17.3	17.2
Own Activity (expected, s.a.)	26.5	24.3	25.1
Number Employed (Past 3 Months, s.a.)	17.9	13.8	11.8
Investment Intentions (plant)	17.7	19.1	17.7
Selling Prices (Past 3 Months, s.a.)	18.1	18.5	14.8



Election uncertainty weighs on business confidence

General business confidence fell in Q3, as expected due the increased **uncertainty of the 2017 General Election outcome in September**. However, expectations for own activity actually increased, while employment and investment intentions also held up at relatively high levels. The latter measures, rather than general business confidence, tend to correlate better with GDP growth and **businesses' continued confidence in their own outlook suggests growth is likely to pick up once the election uncertainty has passed**. In saying that, the **QSBO has over-predicted economic growth over the past year**, while the ANZ monthly business outlook survey has been a better guide and is not quite as optimistic as the QSBO.

Labour market tightens

The **QSBO showed further tightening in the labour market** with the difficulty of finding labour increasing in Q3. The steady increase in the difficulty of finding labour suggests the unemployment rate is likely to continue to fall, and we expect this to feed through to a **lift in wage growth over the coming year**.

Labour crimping building activity expansion

With construction activity proving weaker than expected over the first half of 2017, we scrutinised the building sector results to gain some insight. **The building sector now reports labour as the main factor that is constraining output expansion.** Furthermore, reported overtime remains high and retaining labour remains a challenge with labour turnover also remaining high (but lower than 2016 levels). **However, building demand may be at a peak.** Residential building consents are trending sideways, rather than growing. **Architects’ housing -related activity is starting to ease off** (although still consistent with expansion) **and new orders growth also appears to be slowing.** This slowdown in demand growth may allow the construction sector some breathing room for capacity to catch up and over time may slow the pace of construction sector inflation.

Inflation pressures steady

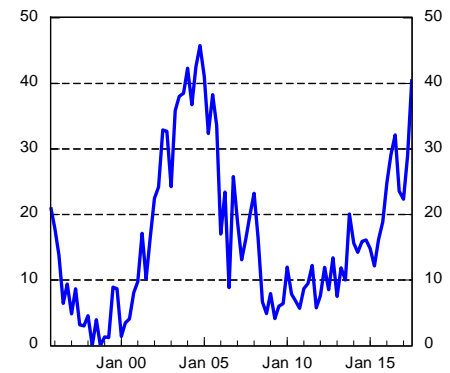
Measures of inflation pressures remained broadly steady. Pricing outcomes and expectations remained broadly unchanged and consistent with inflation lifting back to the mid-point of the RBNZ’s target band. Capacity utilisation remains elevated and cost pressures continue outpace price increases, suggesting ongoing margin compression.

INFLATION INDICATORS	Sep-17	Jun-17	Mar-17
Capacity Utilisation (%)	92.6	93.0	94.5
Costs (Past 3 Months, s.a.)	29.3	26.2	23.5
Costs (Next 3 Months, s.a.)	24.6	26.8	26.7
Selling Prices (Past 3 Months, s.a.)	18.1	18.5	14.8
Selling Prices (Next 3 Months, s.a.)	24.6	23.9	28.1

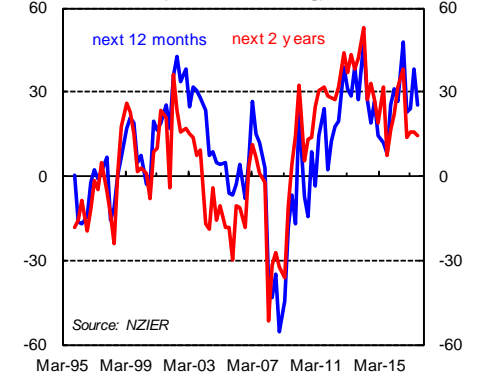
Some interesting insights for the RBNZ

There are no implications for the RBNZ or our view of when interest rate hikes will begin (early 2019). However, **the building sector insights will be of interest for the RBNZ.** To date, domestic inflation pressures outside of the construction sector have been fairly muted. If construction demand does slow over the coming year, any slowing of construction inflation could be yet another headwind for the RBNZ trying to hold inflation comfortably within the inflation target band. In saying that, **the RBNZ will likely take comfort from the general tone of the QSBO.** Most businesses remain optimistic on expectations for their own activity expansion. The labour market is **tightening**, which should soon deliver stronger wage inflation and contribute to lifting broader inflation pressures back to target. Furthermore, QSBO price measures are consistent with underlying inflation holding onto some of the recent lift in headline inflation.

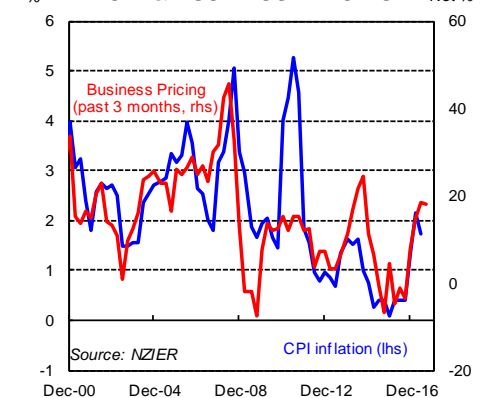
LABOUR AS A FACTOR LIMITING EXPANSION (BUILDERS)



ARCHITECTS OUTLOOK (work in housing)



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