Economic Note

Quarterly Survey of Business Opinion

2 October 2018

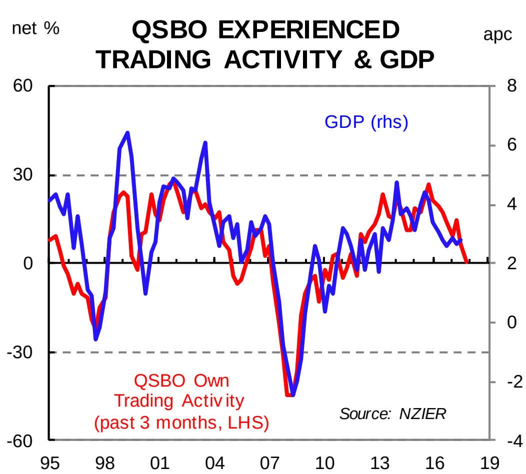
Risks to the outlook now close to becoming reality

- NZIER QSBO survey details were softer than we expected and point to a deceleration in GDP growth over H2 2018.
- However, forward-looking indicators remained relatively upbeat. As such we will look to see how key data evolve over the coming months.
- If the growth and employment figures released over the rest of the year are consistent with soggy business confidence, we see it becoming increasingly likely that the RBNZ will pull the trigger and possibly cut the Official Cash Rate (OCR) early next year.

KEY INDICATORS	Sep-18	Jun-18	Mar-18
Business Confidence (seasonally adjusted)	*-27.7*	-21.1	-10.9
Own Activity (expected, s.a.)	*9.9*	12.4	15.6
Number Employed (Past 3 Months, s.a.)	*0.0*	13.4	9.1
Investment Intentions (plant)	*3.8*	1.2	16.6
Selling Prices (Past 3 Months, s.a.)	*23.1*	23.3	16.4

Summary & implications

The **NZIER Quarterly Survey of Business Opinion has confirmed that economic growth likely decelerated heading into the start of the second-half of 2018**. While some of the forward-looking confidence measures remain upbeat compared to the monthly ANZ survey, it was the **backward-looking responses that were very weak**. Reported trading activity over Q3 and reported employment growth were at the very low end of our expectations. **At face value, this survey suggests annual growth could potentially slow from its Q2 2.8% annual pace to just 2.4% by the end of the year**, and that growth may struggle to reach 3% over 2019. Furthermore, it suggests that the labour market may have lost considerable momentum over Q3. Business confidence figures are concerning, but are not 'hard data'. If the growth and employment figures released over the rest of the year are consistent with soggy business confidence, we see it **becoming increasingly likely that the RBNZ will pull the trigger and possibly cut the Official Cash Rate (OCR) early next year**.



Detail points to decelerating GDP growth

Key details within the NZIER Quarterly Survey of Business Opinion were at the very low end of our expectations and point to a deceleration in

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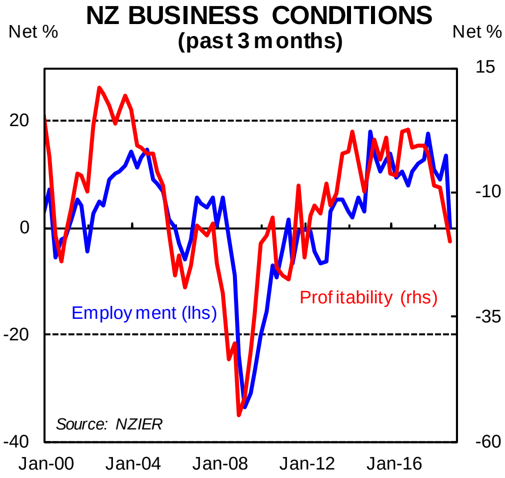
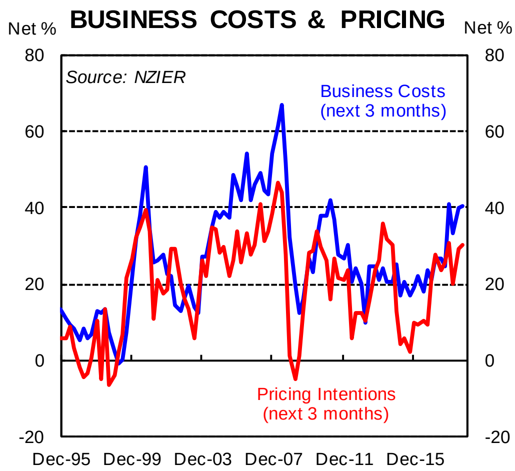
GDP growth heading into the second half of 2018. Over the first half of the year, the QSBO survey responses remained relatively upbeat compared the more pessimistic ANZ survey, with certain measures within the QSBO correctly predicting that the underlying trend in growth would hold up relatively well over H1 2018. However, **reported levels of activity within the Q3 report were much weaker than hoped.** In particular, firms' views of their trading activity experienced over the past three months fell to net 0.4% - which is consistent with underlying quarterly GDP growth of around 0.4-0.5%. **If we assume this level of activity continues over Q4, then it would point to annual GDP growth slowing from 2.8% in Q2 to just 2.4% by the end of the year, and that growth may struggle to reach 3% over 2019.**



Employment also weak

It was not just trading activity which was weak, with **reported employment also falling sharply** and well below the previous quarter's signalled expectations. At the end of Q2, employment intentions had slowed but suggested still-positive rates of employment growth. Over Q3, net 0% of firms reported an increase in employment over the past three months. **This suggests that the labour market could have lost considerable momentum over Q3.**



Cost pressures chewing into profits

Firms' reported profitability deteriorated further in Q3. Rising business costs are driving firms' pricing intentions higher. **The key is whether firms are able to pass on higher prices** - lifting inflation pressures. If not, then the firms must cut costs or wear lower profits, which would lead to lower employment and/or investment. **Upcoming employment, activity and inflation data will be crucial in deciphering which path businesses will head down**. If demand proves to be too soft for firms to pass on higher costs, it would suggest that the RBNZ needs to put its foot on the gas and provide a bit more support to the economy.

RBNZ's downside scenarios becoming closer to reality

The Q3 QSBO survey was not all pessimistic, with **forward-looking measures** of firms' own trading activity, employment and investment intentions **holding up quite well and more consistent with our current economic forecasts** (which assume annual growth will hold up rather than decelerate). However, experienced trading activity for Q3 underperformed businesses' Q3 trading expectations from the Q2 QSBO – which makes drawing a firm conclusion on the implications for Q4 growth from the latest trading expectations slightly more difficult. As such, we will look at how the "hard data" evolves over the coming months. **If the data confirm a deceleration in economic activity in line with some of the QSBO's soggy results, the RBNZ will be confronted with an economic reality more consistent with its downside scenario view and an OCR cut is likely to be delivered early next year.**

GROWTH INDICATORS	Sep-18	Jun-18	Mar-18
Business Confidence (seasonally adjusted)	*-27.7*	-21.1	-10.9
Own Activity (expected, s.a.)	*9.9*	12.4	15.6
Investment Intentions (building)	*-5.3*	-4.5	0.9
Investment Intentions (plant)	*3.8*	1.2	16.6
Profitability (past 3 Months)	*-20.0*	-15.6	-8.9
Profitability (next 3 Months)	*-10.0*	-9.9	-1.3

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