

### Confidence lifts but inflation measures remain weak

- Business confidence surged higher in Q3 as domestic trading conditions improved.
- Business employment intentions continue to lift as labour shortages start to increase.
- Direct measures of inflation remain weak and we continue to expect a 25bp OCR cut in November.

The NZIER Q3 Quarterly Survey of Business Opinion showed a **strong increase in business confidence**, a clear sign that underlying economic momentum will increase over H2 2016. However, beyond the lift in confidence, some of the results remain mixed and, importantly for the RBNZ, **direct inflation measures remain weak**. On one hand, the labour market is clearly tightening. On the other, firms remain unable to pass on cost increases and profitability growth remains low – which could impact employment and investment plans going forward.

There are **no implications to our OCR view, we continue to expect a 25bp rate cut in November** and still see a risk of another cut next year.

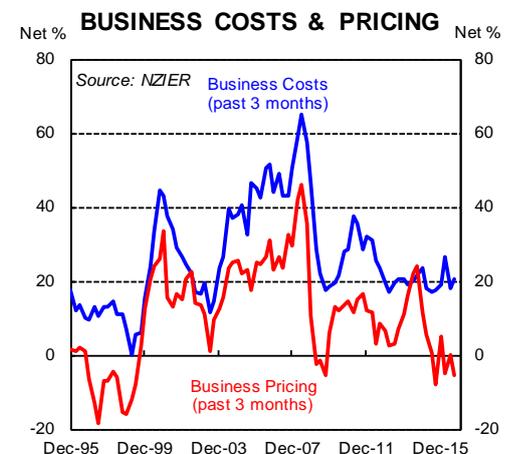
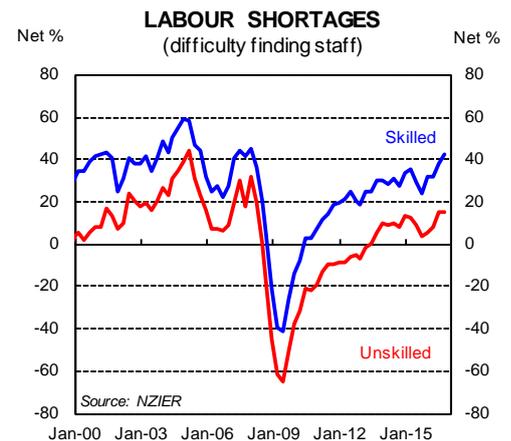
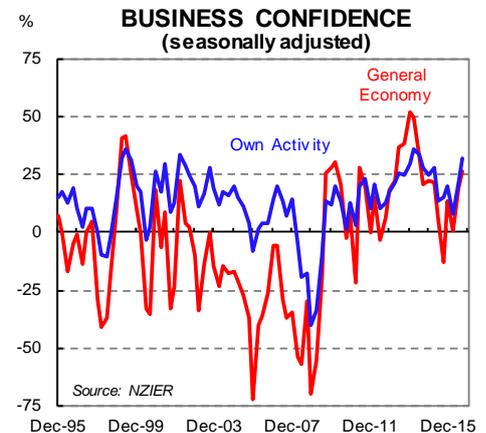
KEY INDICATORS	Sep-16	Jun-16	Mar-16
Business Confidence (seasonally adjusted)	26.5	19.5	0.6
Own Activity (expected, s.a.)	32.0	21.7	7.8
Number Employed (Past 3 Months, s.a.)	8.3	10.9	9.2
Investment Intentions (plant)	17.6	17.1	10.7
Selling Prices (Past 3 Months, s.a.)	-5.5	0.2	-4.9

**Business confidence continued to lift strongly over the September quarter**, as foreshadowed by the monthly ANZ confidence survey. Furthermore, firms reported a strong lift in domestic trading activity over the past quarter. This **suggests further improvement in the underlying growth rate of the NZ economy**.

The lift in confidence has also filtered through to **employment demand**, with **employment intentions lifting strongly**. In saying that, the reported increase in employment over the past quarter was a bit disappointing given the level of employment intentions in the previous quarter. It's possible that growing labour shortages may be starting to impact the ability of firms to recruit. Alternatively, strong competitive pressures and the inability to increase prices (see below) may add to some reluctance to commit to new hires. The different explanations have different implications for inflation, which suggests the RBNZ should interpret these results cautiously.

Nonetheless, **labour shortages increased over Q3** indicating the labour market is now the tightest it has been since prior to the Global Financial Crisis. The RBNZ will be particularly encouraged by this development. **A tighter labour market will result in stronger wage growth and, in time, lead to stronger broad-based domestic inflation pressures**. The RBNZ can become increasingly confident of inflation returning within target once it starts to see evidence of broader wage and domestic inflation pressures lifting.

However, in the meantime, **direct inflation measures remain weak**. A net 5% of firms (seasonally-adjusted) reported cutting prices in Q3. This is despite firms reporting an expectation to increase prices back in March and June, as well as reporting cost increases. **This may reflect ongoing competitive pressures. Profitability improvements also remain low** (although positive).



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