Westpac InstitutionalBank

Down in the dumps

NZIER business confidence up in Q1 2009 but details weaker

- **Business confidence improved in seasonally adjusted terms from the record lows of Q4 2008, but the details of the survey remain extremely weak.**
- **Firms are continuing to batten down the hatches, making a second-half recovery this year increasingly unlikely.**
- **We continue to expect a 50bp cut in the OCR at the 30 April review.**

The March *Quarterly Survey of Business Opinion* was, on balance, even weaker than the horrendous read of December 2008. The New Zealand economy, still wearing the bruises from the domestically-driven recession of 2008, has fallen into a deeper globally-driven downturn in the first half of this year.

General business conditions rose to a net -58% in seasonally-adjusted terms, an improvement on the record low of -77% in Q4 last year. Firms' own-activity expectations also picked up to a net -38%, though they remain at extremely depressed levels – prior to the current recession, the record low on this measure was -21%, recorded in 1982.

On balance, the details of the survey were even weaker than in December. Firm's investment and employment intentions fell to new lows, and profit expectations remained extremely low. Capacity utilisation fell sharply again to 86.3% – this measure has fallen from a record high to a 17-year low in the space of three quarters. Some of the weakness in manufacturing capacity reflects a lack of supply in meat processing, as a high drought-induced slaughter last season has led to a shortage of livestock this season. However, builders are reporting a growing amount of slack as well.

The vast majority of firms (77%) cited a lack of sales as the main constraint on expanding output. And this weakness in demand is now being felt intensely in international markets – a record 54% of manufacturers reported a fall in export orders in the last quarter. The collapse in global trade in recent months has been felt more keenly in high-end manufacturing, but even as a producer of 'necessities' such as food, New Zealand is still clearly exposed.

Key results – forward looking

	Q4 survey	Q1 survey
Business confidence, next 6 mths	-64	-65
Trading activity, sa, next 3 mths	-43	-38
Pricing intentions, next 3 mths	-3	-6
Cost expectations, next 3 mths	27	21
Profitability, next 3 mths	-46	-45
Employment intentions, next 3 mths	-32	-36
Building investment intentions, next 12 mths	-42	-46
Plant investment intentions, next 12 mths	-39	-44

Key results – backward looking

	Q4 survey	Q1 survey
Trading activity, sa, past 3 mths	-43	-47
Pricing, past 3 mths	9	-2
Costs, past 3 mths	42	29
Profitability, past 3 mths	-49	-51
Employment, past 3 mths	-21	-34
Difficulty finding skilled labour, past 3 mths	20	42
Difficulty finding unskilled labour, past 3 mths	43	63
Capacity utilisation	0.8878	0.8633

Labour market conditions have taken a dramatic turn in the last year. The ease of finding labour, both skilled and unskilled, is now the highest in more than 30 years. A net 36% of firms intend to shed staff over the next three months, the highest ratio since September 1991. And a net 31% reported a fall in labour turnover, suggesting that workers are becoming more appreciative of the jobs that they have.

Price pressures remain very subdued. Fewer firms reported an increase in average costs, and in every sector except retail, firms on balance expect to lower their prices in the coming quarter.

The own-activity measure of the *QSBO* is a useful indicator for contemporaneous GDP. Today's survey suggests some downside risk to our forecast of a 1% contraction in Q1 GDP – in fact, eyeballing the relationship between the two would suggest a quarterly fall of more like 3%. However, the survey doesn't

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capture agriculture or government activity, which have been the two relatively bright spots in the economy lately.

Market implications

Financial markets have not surprisingly moved to price in a greater chance of RBNZ easing – the two-year swap rate is down 10 basis points, while NZD/USD has fallen by around 70 points to 0.5810. The *QSBO* offers little hope that business activity will stabilise in the second half of this year, as the RBNZ forecast in the March *Monetary Policy Statement*. To add insult to injury, the recent rise in interest rates and the NZD have left overall financial conditions much tighter than the RBNZ was counting on.

To us, this survey seals the economic case for a 50bp cut at the 30 April OCR review. The biggest unknown is how much weight the RBNZ will place on the perceived need to "retain competitiveness in the international capital markets", which in short means maintaining a margin over Australian interest rates. New Zealand's cash rate is already 25bp below Australia's (though longer-term market rates are substantially higher). That means this afternoon's RBA rate decision will be crucial for the RBNZ later this month.

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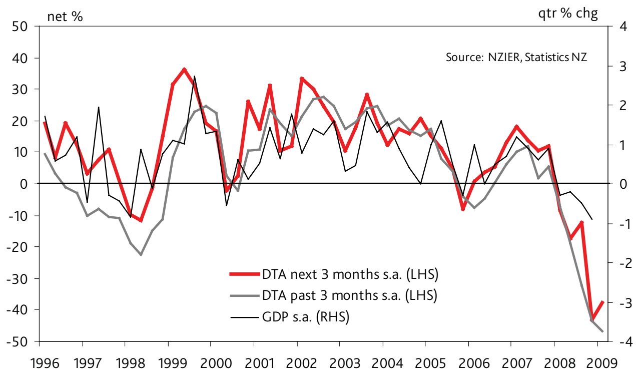
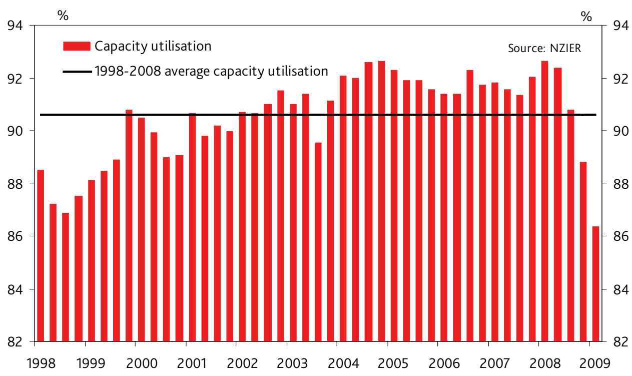
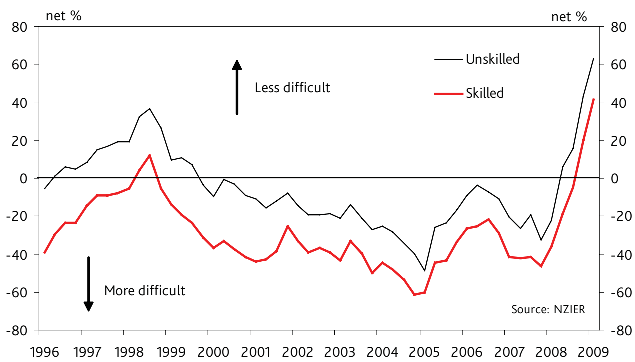
Domestic trading activity



Capacity utilisation



Firms' difficulty of finding labour



Pricing intentions vs CPI