

Goodbye recession, hello... recession

NZIER business survey plunges in Q4 2008

- **Business confidence fell sharply in Q4, with own-activity expectations easily surpassing the previous survey lows.**
- **Firms intend to delay investments and lay off more staff, which will add to the domestic downturn.**
- **The RBNZ has both the scope and the motivation to keep cutting interest rates aggressively.**

The December *Quarterly Survey of Business Opinion* was everything that we dreaded and more. With the New Zealand economy barely starting to recover from last year's domestically-driven recession, a severe global downturn and tougher access to credit are threatening to send it into a 'new' recession in the first half of 2009.

Business confidence, in seasonally adjusted terms, fell to its lowest levels since at least 1970. Expectations of general business conditions fell to a net -77%, while firms' expectations of their own performance plunged to -43% – easily beating the previous low of -21% set in 1982. The latter measure is a useful indicator of contemporaneous GDP, and at face value it suggests that the economy may have contracted sharply in Q4 2008. However, we caution that the survey doesn't directly capture the agricultural sector, which should see a pickup in output this season after the previous year's drought.

The details of the survey were universally weak, with many key activity indicators holding near, or surpassing, the lows seen in the 1991 recession. Businesses are clearly planning to ride out the slowdown by delaying investment and laying off staff – steps that may make sense at the firm level, but when done *en masse* will add further to the downturn in domestic demand.

The proportion of firms citing lack of sales as their main constraint to growth rose to 75%, the highest since Q2 1999. Encouragingly, in spite of fears generated by the global credit crunch that began over a year ago, access to finance still hasn't featured as a major constraint, with only 7% of firms citing this as a factor. On the other hand, overdue debtors rose sharply.

Key results – forward looking

	Q3 survey	Q4 survey
Business confidence, next 6 mths	-19	-64
Trading activity, sa, next 3 mths	-13	-43
Pricing intentions, next 3 mths	28	-3
Cost expectations, next 3 mths	52	27
Profitability, next 3 mths	-23	-46
Employment intentions, next 3 mths	-7	-32
Building investment intentions, next 12 mths	-20	-42
Plant investment intentions, next 12 mths	-16	-39

Key results – backward looking

	Q3 survey	Q4 survey
Trading activity, sa, past 3 mths	-32	-44
Pricing, past 3 mths	36	9
Costs, past 3 mths	59	42
Profitability, past 3 mths	-44	-49
Employment, past 3 mths	-11	-21
Difficulty finding skilled labour, past 3 mths	-5	20
Difficulty finding unskilled labour, past 3 mths	16	43
Capacity utilisation	0.9079	0.8878

Supply-side constraints eased a lot further in Q4. The drum-tight labour market that was the bane of both employers and the RBNZ in recent years has all but vanished. Ease of finding skilled labour moved into net positive territory for the first time since 1998, while ease of finding unskilled workers rose to its highest since 1991.

Capacity utilisation, which was at record highs just six months ago, fell sharply again to 88.8%. The fall was concentrated in the manufacturing sector, which suggests that meat processing was the main culprit again – the consequence of the high drought-induced slaughter last year is that livestock simply can't be found at the moment. The lack of livestock to kill is likely to worsen in the first half of this year.

Inflation pressures are fast coming off the boil, though firms are still facing a squeeze on their profit margins. A net 42% of firms reported higher costs in the last three months, and 27% expect

For further information, questions or comments contact Brendan O'Donovan, telephone (04) 470 8250, email bodonovan@westpac.co.nz

For all clients: Westpac Institutional Bank is a division of Westpac Banking Corporation ABN 33 007 457 141, incorporated in Australia ("Westpac"). The information contained in this report: does not constitute an offer, or a solicitation of an offer, to subscribe for or purchase any securities or other financial instrument; does not constitute an offer, inducement or solicitation to enter a legally binding contract; and is not to be construed as an indication or prediction of future results. The information is general and preliminary information only and while Westpac has made every effort to ensure that information is free from error, Westpac does not warrant the accuracy, adequacy or completeness of the Information. The Information may contain material provided directly by third parties and while such material is published with necessary permission, Westpac accepts no responsibility for the accuracy or completeness of any such material. In preparing the Information, Westpac has not taken into consideration the financial situation, investment objectives or particular needs of any particular investor and recommends that investors seek independent advice before acting on the Information. Certain types of transactions, including those involving futures, options and high yield securities give rise to substantial risk and are not suitable for all investors. Except where contrary to law, Westpac intends by this notice to exclude liability for the information. The information is subject to change without notice. Westpac expressly prohibits you from passing on this document to any third party. Westpac Banking Corporation is regulated for the conduct of investment business in the United Kingdom by the Financial Services Authority. © 2001

For Australian clients: WARNING – This document is provided to you solely for your own use and in your capacity as a wholesale client of Westpac.

further cost increases this quarter. However, while a net 28% of firms intended to raise their prices in the past three months, only 9% were able to do so. Pricing intentions for the next three months fell to -3%, the first negative print since 1998. Annual inflation will fall extremely quickly over coming quarters, in part due to a sharp fall in fuel prices.

We should note two quirks about this component of the survey. First, some of the negativity was in the services component, which includes the finance sector – i.e. lower ‘prices’ should be read as lower interest rates as the RBNZ cuts the cash rate further. Second, pricing intentions for merchants (which corresponds more closely with what enters the CPI) remained high at a net 28%. This may prove to be wishful thinking, but it is consistent with monthly business confidence surveys which suggest that retailers may be seeing more evidence of imported inflation, due to the weaker exchange rate, than other sectors.

Market implications

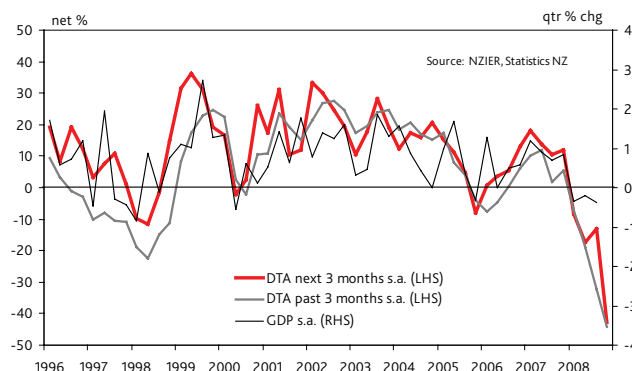
The New Zealand economy likely remained in recession through all of 2008, and is poorly placed to deal with the impending downturn among its major trading partners. On the plus side, the RBNZ have more room than just about any other central bank to deliver relief on interest rates, and they clearly intend to do so. We expect a cut of at least 50bp at the 29 January OCR review, and this survey massively skews the risks towards a much larger move.

Interest rate markets have understandably moved to price in an even lower OCR path after this survey, with a trough of around 3.25% expected by mid-year. The two-year swap rate has fallen by 13bps so far to a new record low of 4.07%, while NZD/USD is down more than a cent to 0.5660 since the release.

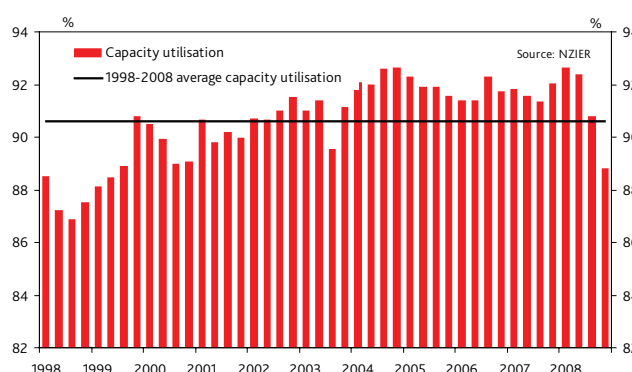
Brendan O’Donovan, Chief Economist, Ph: (64-4) 470 8250

Michael Gordon, Markets Economist, Ph: (64-4) 381 1412

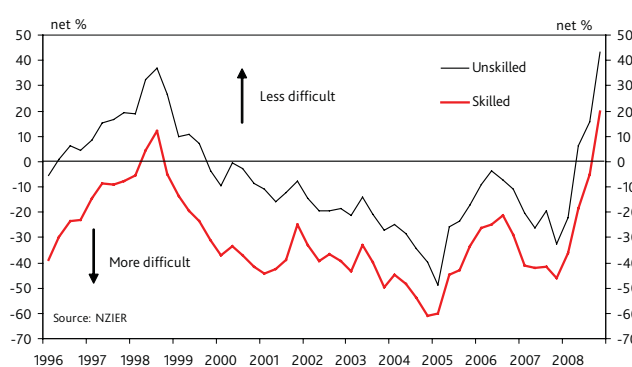
Domestic trading activity



Capacity utilisation



Firms’ difficulty of finding labour



Pricing intentions vs CPI

