

High hopes

NZIER business confidence rises in Q3

- **Businesses are at their most optimistic in years about near-term prospects, though they have continued to do it tough over recent months.**
- **Activity indicators are consistent with an economy in the early stages of recovery, and inflation pressures remain subdued.**
- **Improving data in NZ means that interest rates will eventually need to be higher, but the RBNZ could resist the pressure to tighten for longer than the market anticipates.**

The September *Quarterly Survey of Business Opinion* showed that business sentiment has improved markedly since the depths of the recession earlier this year. Expectations of general conditions for the next six months soared to their highest in ten years, while own-activity expectations rose to slightly above their long-term average.

The details of the survey, while encouraging, were less emphatic than the headline measures suggest. For one, the gap between own-activity expectations and recent performance was easily at its widest in the history of the survey. Firms reported that conditions remained tough in the September quarter – little better than in June by many measures. Secondly, the sharp rise in expectations for the key indicators largely reflects a return to long-run averages, having come from record or near-record lows. This is consistent with an economy in the early stages of recovery, rather than one that is roaring ahead.

In terms of the key activity indicators, investment intentions have risen on balance, but remain below average. Employment is expected to be flat over the next three months; for those who are hiring, the ease of finding both skilled and unskilled workers has slipped but remains at historically high levels. Profits are expected to stabilise in the next quarter, bringing this measure broadly in line with its long-term average – though it has been consistently negative for the past five years or so.

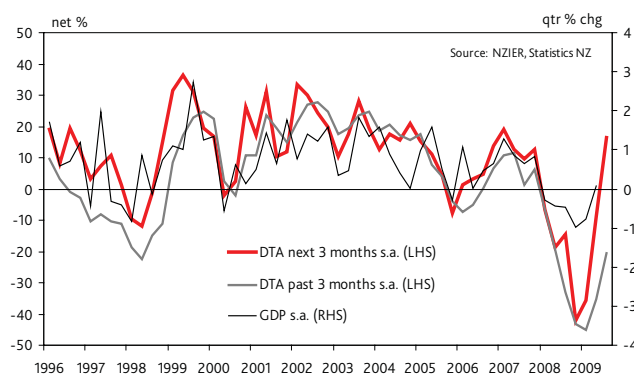
Key results – forward looking

	Q2 survey	Q3 survey
Business confidence, next 6 mths	-25	36
Trading activity, sa, next 3 mths	-9	17
Pricing intentions, next 3 mths	7	13
Cost expectations, next 3 mths	17	16
Profitability, next 3 mths	-24	-3
Employment intentions, next 3 mths	-19	0
Building investment intentions, next 12 mths	-29	-16
Plant investment intentions, next 12 mths	-23	-8

Key results – backward looking

	Q2 survey	Q3 survey
Trading activity, sa, past 3 mths	-35	-20
Pricing, past 3 mths	-1	-5
Costs, past 3 mths	25	19
Profitability, past 3 mths	-44	-39
Employment, past 3 mths	-31	-29
Ease of finding skilled labour, past 3 mths	42	25
Ease of finding unskilled labour, past 3 mths	67	48
Capacity utilisation	90.70%	88.42%

Domestic trading activity



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Indicators of inflation pressure remain modest. Pricing intentions rose in September, with a net 13% of firms expecting to raise their prices in the next quarter. This is a fairly low proportion compared to recent history – though it is consistent with annual inflation edging back into the upper half of the RBNZ’s 1-3% target band over the next year.

Capacity utilisation fell from 90.7% to 88.4% in September, a relatively large fall for what has previously been a slow-moving series. We see this as a correction of the abnormally sharp gain in the June quarter, the biggest quarterly increase on record (this may have been due to an unusually low response rate for the question). Capacity utilisation is still at the second-lowest level seen during this cycle, and is some way below its long-run average.

Market implications

Expectations of domestic trading activity are a useful indicator for same-quarter GDP, and the latest reading is consistent with growth in Q3 in excess of 1%. However, the relationship has been strained recently, with expectations severely overstating the extent of decline throughout the recession. We put this down to the fact that the QSBO excludes some sectors that have been a driving force in recent growth performance – with agriculture being the most glaring omission. For the same reasons we think Q3 GDP growth will be more modest than the survey implies. Having said that, we feel the risks for the second half of the year in general are to the upside – the easiest gains are to be made in the early stages of recovery.

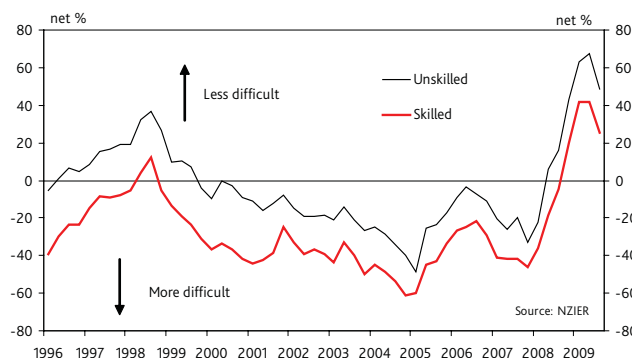
Overall the QSBO was in line with our expectations, with the rebound in sentiment having been signposted by monthly business confidence surveys. Activity is on the rise again, but the weak capacity utilisation and labour market indicators suggest that there is a significant amount of slack in the economy to be mopped up before inflation becomes an issue again.

Nonetheless, a cash rate of 2.50% is extremely low, and the well-known lags in the operation of monetary policy mean that the RBNZ will need to start normalising policy well before inflation re-emerges. The recent run of stronger data will make it tough for the RBNZ to maintain its stance of leaving rates “at or below the current level through until the latter part of 2010” – but they may well resist the pressure to raise rates for longer than the market anticipates. We expect tightening to begin around the middle of 2010.

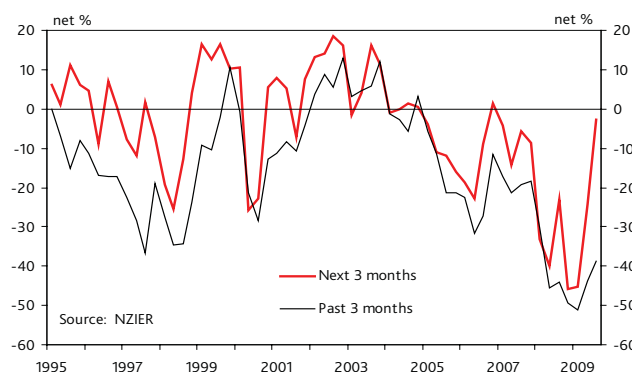
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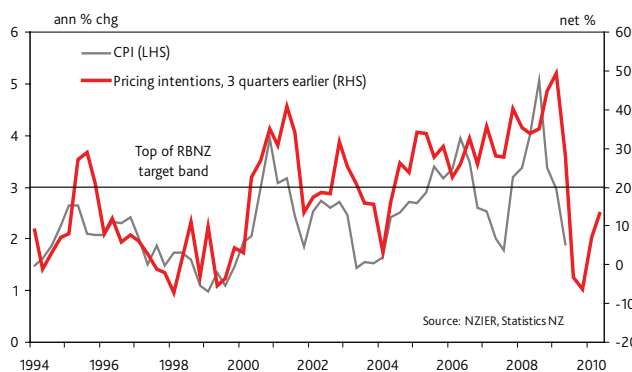
Firms’ difficulty of finding labour



Profitability



Pricing intentions vs CPI



Capacity utilisation

