

Charting a familiar course

NZIER business confidence rises in Q4

- **Businesses are at their most optimistic in years about general economic prospects.**
- **Activity indicators confirm the economy is experiencing a rapid recovery, and the labour market has turned.**
- **The jump in capacity utilisation will worry the Reserve Bank.**

The December *Quarterly Survey of Business Opinion* was further confirmation that New Zealand is in a recovery phase following recession. The various elements of the survey appear to be following the normal timeline for a recovery, with some improving earlier than others. Expectations of general business conditions over the next six months rose slightly from 22% to 23% (seasonally adjusted), the most optimistic businesses have been since September 1999 – which, not coincidentally, was the last time the economy was recovering from recession and a National government was in office.

Firms' expectations of their own trading activity over the next three months were unchanged at 13%, which is roughly average. The activity firms reported actually experiencing over the past three months improved markedly, from -20% to -9%. It is entirely normal during periods of recovery for trading activity experienced to lag a quarter or two behind expectations, so the gap between the two has no significance. Because it is more up-to-date, expected trading activity is the superior guide to what is going on in the economy. Today's data will not have us changing our Q4 2009 GDP forecast of 1.1%.

The surprising element in the survey was the 2.5 percentage point jump in capacity utilisation – something that will worry the Reserve Bank. The Bank was counting on spare capacity built up during recession to dampen inflationary pressures. But the Q3 inflation figures were surprisingly strong, suggesting the recession had only pruned non-tradables inflation rather than clear-felling it. Now today's capacity utilisation figures suggest non-tradables inflation could soon be building again! The only caveat is that capacity utilisation was very volatile over the course of 2009, and we could see a large fall next quarter.

Key results – forward looking

	Q3 survey	Q4 survey
Business confidence sa, next 6 mths	22	23
Trading activity, sa, next 3 mths	13	13
Pricing intentions, next 3 mths	13	24
Cost expectations, next 3 mths	16	21
Profitability, next 3 mths	-3	-2
Employment intentions, next 3 mths	0	1
Building investment intentions, next 12 mths	-16	-15
Plant investment intentions, next 12 mths	-8	-2

Key results – backward looking

	Q3 survey	Q4 survey
Trading activity, sa, past 3 mths	-20	-9
Pricing, past 3 mths	-5	4
Costs, past 3 mths	19	15
Profitability, past 3 mths	-39	-14
Employment, past 3 mths	-29	-18
Ease of finding skilled labour, past 3 mths	25	13
Ease of finding unskilled labour, past 3 mths	48	37
Capacity utilisation	88.42%	91.07%

The labour market appears to have well-and-truly turned, although it is still weak. A 1% majority of firms expects to expand staff numbers, suggesting business-as-usual employment growth (the average for the series is -2%). Similarly, firms reported less ease finding both skilled and unskilled labour. All this suggests employment growth resumed in Q4 and unemployment will rise only a little further.

Other details in the survey were neither strong nor weak, and were consistent with the recovery story. Investment intentions and profitability improved to around average levels. About a quarter of firms intend to raise prices over the next three months, further evidence that the price-depressing effect of recession is waning.

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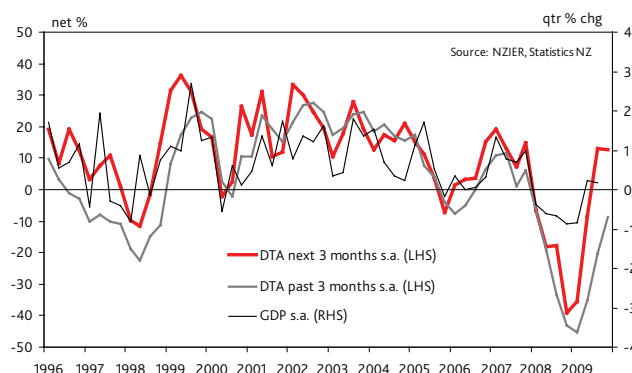
Market implications

The Reserve Bank says it expects to kick off its hiking cycle in the middle of 2010, but we think that will be brought forward to March, or at the latest April. There was nothing in this data to alter our view. In particular, the capacity and pricing pressures that are already showing up really do challenge the notion that the RBNZ can hold off for another five months. The breadth and depth of evidence showing the New Zealand economy is experiencing a robust recovery begs the question of why the Bank would want to wait.

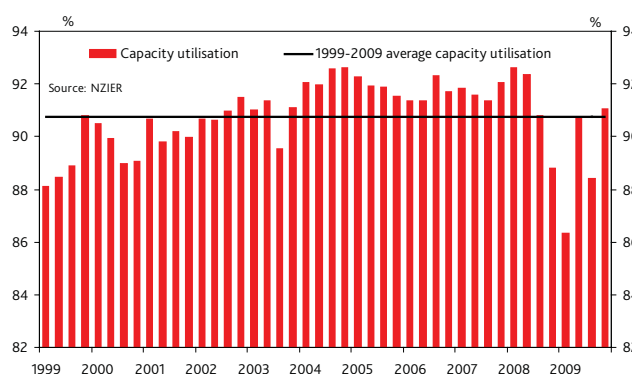
Markets are already fairly optimistic on New Zealand’s recovery, and are pricing in a March or April hike, so the data was no great surprise. Swap rates rose two basis points and the exchange rate was unchanged.

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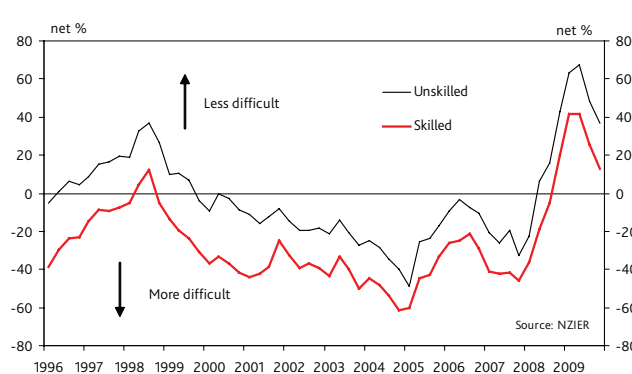
Domestic trading activity



Capacity utilisation



Firms’ difficulty of finding labour



Pricing intentions vs CPI

