3 October 2017

QSBO Demonstrates Political Correctness

- **QSBO hardly rattled by the (prospective) election**
- **With steadfast commitment to employ and invest**
- **Fissures in building and services look transitory**
- **Inflation indicators firm but not lifting**
- **Responses to next government of most interest**

The news in this morning's NZIER Quarterly Survey of Business Opinion (QSBO) was that it held its shape rather well, when it might have gone a bit wobbly, if only because of its proximity to the general election. Sure, its net confidence subsided, but not all that much. More to the point, the QSBO's indicators on activity, employment, investment, profitability, capacity constraint, and pricing/costs, remained firm.

This is not to suggest that public policy doesn't matter. It surely does, certainly for the longer haul. And so the make-up of the next government might yet cause a stir in subsequent business outlook surveys. It's something we'll follow keenly. But the message we took from today's QSBO was that economic momentum remains resolute for the meantime, notwithstanding potential vicissitudes of government policy.

How much of the fall in net confidence – to +5, from +18 in June (or +7, from +17 in seasonally adjusted form) – reflected the election? While all responses would have been completed before it, it was interesting that not all of them wavered in the same manner. Indeed, net confidence amongst manufacturers and merchants was largely unchanged, at +12 and +14 respectively. The falls were (thus) isolated to builders and the services sector, wherein confidence in the general outlook subsided to +3 and +2, respectively, having been +18 and +20 three months ago.

QSBO - Summary of key results

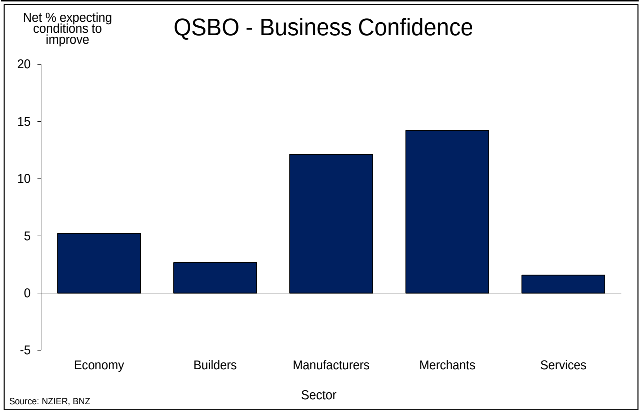
Net % of respondents	Jun-17	Sep-17	Expected 3m ahead
General Business Situation (next 6m)	+18	+5	
- s/adj	+18	+7	
Trading Conditions (s.a.)	+18	+13	+27
Capacity Utilisation	92.1%	91.3%	
Plant & Mach invest (next 12m)	+20	+17	
Building investment (next 12m)	+3	+18	
Employment	+13	+14	+19
Profitability	-1	-6	+13
Selling Prices	+20	+17	+24
Costs	+26	+30	+24

There were added cracks appearing in the building sector component of the QSBO, in the form of slower expansion in output and pricing. While this is something to note, our judgement is that it's only temporary. Building intentions across all QSBO sectors surged to its equal highest in many decades, for instance. And just one look at the architects' responses to the NZIER survey showed that the pipeline for construction work remains full to overflowing (aided most recently by a jump in government work). We also note that building consents have rebooted over recent months, after a lull earlier in the year.

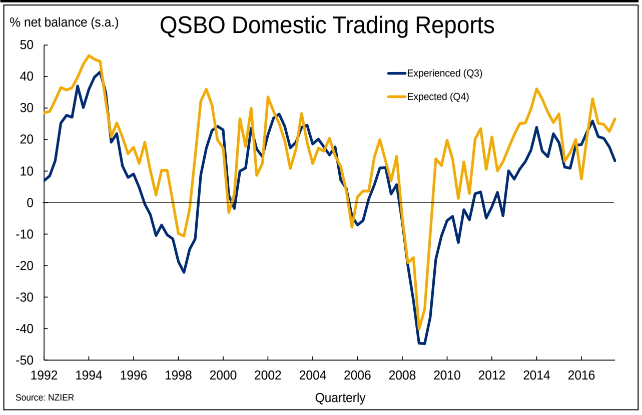
As for the drop in confidence in QSBO services, we are also inclined to not read too much into this at this stage. It's certainly at odds with the messages of robustness that were coming through the Performance of Services Index over the last few months (with an average reading of 57.2).

The robustness amongst merchants in the latest NZIER survey is encouraging. It is further grist to the mill that the big wheels keep on turning for retailers. In particular, that the contraction we're likely to see in September quarter

A Little Varied



Hop Skip and Jump



real retail trade will, indeed, be just a "natural" correction from an outsized sports-fuelled gain in Q2, rather than the start of a genuine slowing.

Generally speaking, today's QSBO remained upbeat about the rate of expansion in the economy. To be sure, trading reports suggested we shouldn't get excited about the extent to which Q3 GDP expanded. We are not anyway, in picking a real gain of 0.7%. But our pick of a 0.6% increase in Q4 GDP might prove too slow, if the QSBO expectations around trading for the coming three months are anything to go by. At +27 (seasonally adjusted), from +23 previously, this series was further above its long-term norm.

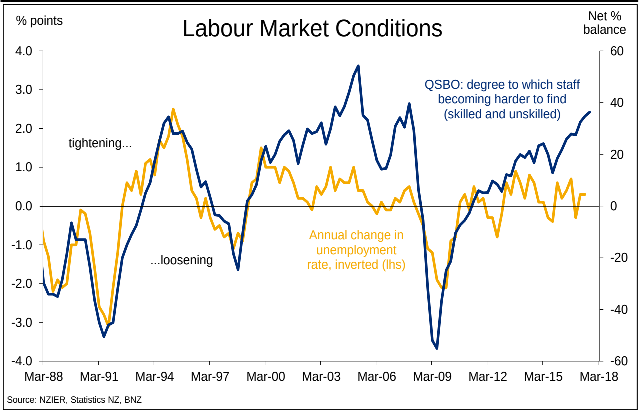
But arguably the best sign of robustness amongst QSBO respondents was their commitment to hiring and investing, even with a close-run election in the immediate offing. Indeed, employment intentions nudged up to +19, from +12 in June and +8 in March. As noted above, intentions to build surged to high levels. And intentions to invest in plant and machinery stayed relatively strong – at +17, from +20.

With all of this, it wasn't a surprise to see the NZIER survey's capacity-constraint variables still running on the tight side, albeit not quite as tight as before. Its capacity utilization measure, CUBO, eased a bit further during the last few months. But at 91.3% (or 91.9% on our seasonally adjusted estimate) it was still well above its long-term norm.

The proportion of firms citing labour as the main constraint to expansion moderated to 16, from 21. But 21 was the highest post GFC. And the reported difficulty in finding skilled staff was hardly abated (with an index of +46, from +47) while for unskilled staff it intensified (to +27, from +23). Taken together, these measures still point to a falling trend in New Zealand's unemployment rate. While this seems no guarantee of a pick-up in wage inflation, it certainty establishes the potential for it.

Of course, the QSBO has nothing to say, directly, about wage and salary movements. However, it does have some direct gauges on pricing and costs. These, for the most

Still Tightening



part, were still middling (neither strong nor weak) – with +17 in terms of the last three months selling prices, and the next three months still riding at +24. These readings are consistent with annual CPI inflation remaining around the 2% mark; thus feeding our expectation that it will run higher over Q3 and Q4 than the August Monetary Policy Statement forecast.

The QSBO costs indices, meanwhile, were a little stronger at +30 regarding last three months although a bit slower in their three-month outlook, at +24, from +28 in the previous survey. While this cost pressure seems to be putting a floor under selling price direction, it's not yet at the stage of pushing for higher inflation downstream. This is backed up by the fact that reports and expectations around profits remained stout in today's QSBO, implying little in the way of a margin squeeze at this point.

All things considered, there was nothing in today's QSBO that should have changed anyone's views all that much, if at all. Then again, the risk was that respondents might have thrown a bit of a wobbly, if only because of the impending election. So the fact the NZIER survey held its shape, with even its confidence measure holding above average, should probably add to its still-encouraging undertones.

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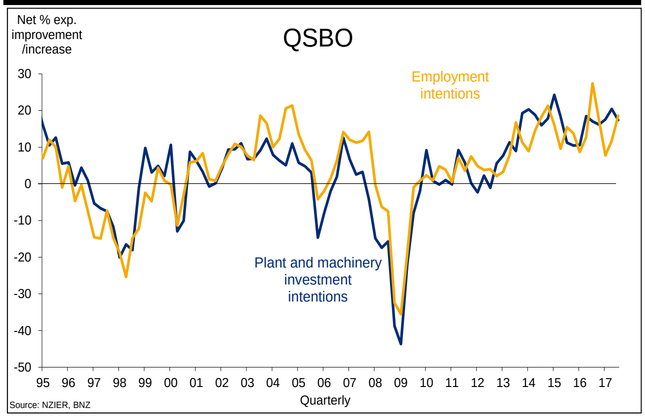
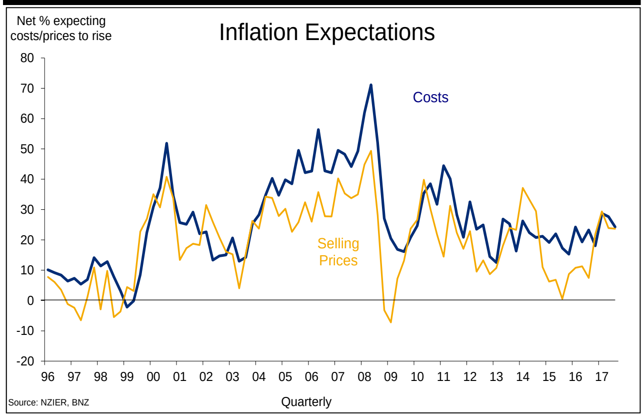
Steadfast



Firm Rather Than Fiery



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