16 January 2018

QSBO Holds Up Rather Well, Considering

- **Net business confidence turns negative**
- **But Q4 QSBO otherwise holds up admirably**
- **Are we too reserved on near-term GDP/CPI?**
- **Capacity constraints biting harder than ever**
- **Rising costs nibble at profits**

Sure, this morning's Quarterly Survey of Business Opinion (QSBO) registered a further fall in net confidence, into negative territory. However, the further we delved into this NZIER report the more resilient it appeared. While firms are publicly expressing unease about the new government, they are privately getting on with business. Indeed, their most pressing issue at the moment would seem to be a lack of resources – both capital and labour – which is starting to impinge on profitability.

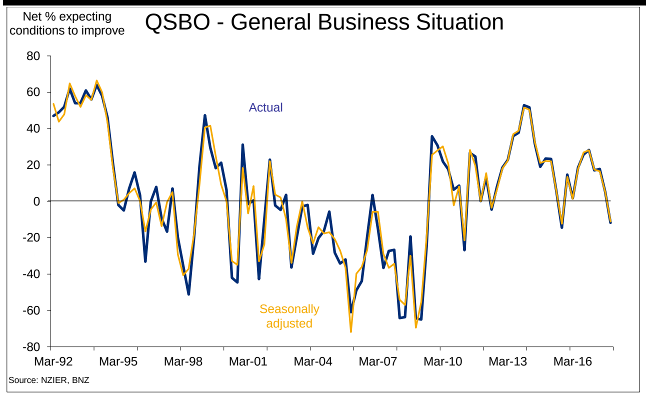
To be blunt, today's QSBO was not as weak as we figured on. Of course, we were primed to warn against reading too much negativity into today's survey, given the likely influence of political uncertainty. In the event there wasn't quite the negativity to have to discount. It mostly boiled down to the net confidence measure, which dropped to -12, from the +5 it had already moderated to in September. But even this didn't fall nearly as far as the monthly ANZ survey had suggested it might.

True, own-activity reports regarding the past three months slowed a bit further, in seasonally adjusted terms. However, at +10, they were simply back to about average, having been very much on the strong side 12-18 months ago. Own-activity expectations for the coming three months also slowed, but at +18 (from +26 in September's QSBO) were still a margin above their long-term norm.

At one level, these results make us comfortable in having cautious expectations around GDP growth for Q4 2017 (0.5%) and Q1 2018 (0.5%). At another level they make us wonder if we might just be a little too conservatively pitched on these.

We mention this also as retail trade growth looks to have rebounded strongly in the December quarter, after almost stalling in the September quarter. We got this impression from this morning's electronic card transactions for December. While they increased just 0.2%, this followed a seasonally adjusted 1.4% jump in November and a 0.7% lift in October. For the December quarter as a whole we

Political Indigestion

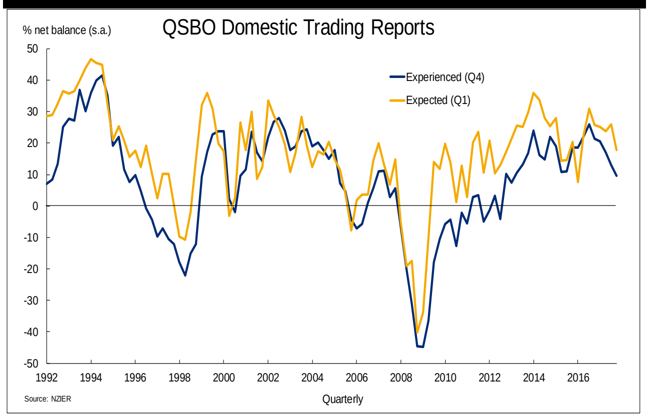


judge a big gain in value terms, compared to the September quarter, and a strong gain in retail trade in volume terms. This would obviously be good for Q4 GDP growth computations.

Yet merchants in today's QSBO reported slow sales for the last three months, and it was the weakest industry regarding own-activity expectations for the coming three months.

If there is a question over how GDP growth is going to look over the six months to March 2018, there seems little doubt that capacity constraints are as pressing as ever. The NZIER capacity utilisation measure, CUBO, rebounded to 92.8% in the December quarter, after moderating to 91.3% in the prior quarter. As such, it's even further above normal.

Hanging in There



National Australia Bank

Consistent with this, QSBO respondents reported increased difficulty in finding staff – whether skilled or unskilled. Indeed, each series is now the most biting they have been in at least 10 years. With this we can probably expect the unemployment rate to keep trending lower for the foreseeable future. This is reinforced by the fact that hiring reports have remained well above normal. And while hiring intentions in the QSBO eased a bit this quarter, at +12 they were also comfortably north of their long-term average.

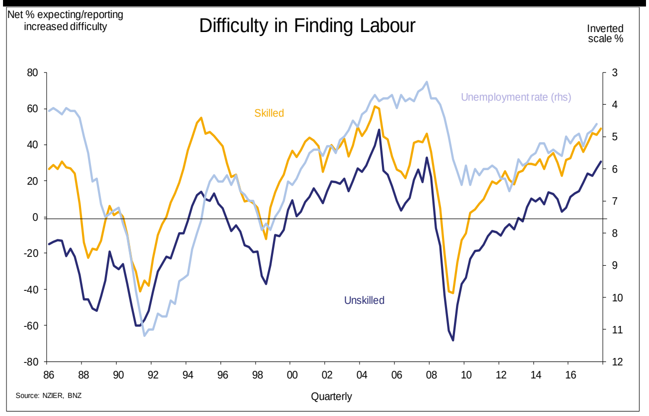
Still, we might need to keep an eye on business investment as a potential source of slowdown. This can often be most sensitive to policy uncertainty. To be sure, the QSBO gauges on investment eased in today's edition. However, they remained well above normal – whether for plant and machinery, or buildings.

The latter was given form by the fact that the building section of this latest NZIER business survey was perhaps the most resilient of the lot. It certainly had the least negative confidence about the general economic outlook, while its new forward orders were perking up. This leaves us comfortable that construction activity will keep providing a backbone to GDP growth for a while yet, having swung back in support in Q3 of last year (after weakening over the first half of 2017).

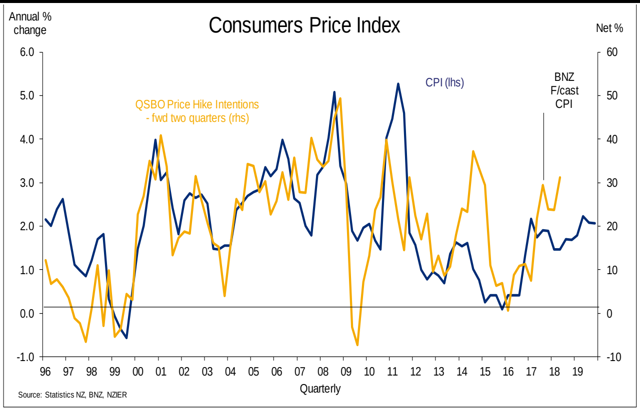
Today's QSBO was also a confirmation, of sorts, of the very positive messages that have come from the monthly Performance of Manufacturing Index (PMI) over recent months. We'll get December's PMI on Friday.

If we might be too conservative on GDP growth underfoot, we could venture the same thing regarding CPI inflation. As a technical matter, we expect annual CPI inflation to remain at 1.9% in Q4 2017, slow to 1.5% in Q1 and Q2 of 2018, but then pick up to just above 2.0% in 2019. The direct pricing and cost variables in the latest QSBO suggest increasing pressure, rather than any let up.

Difficulties Intensifying



Through the Valley

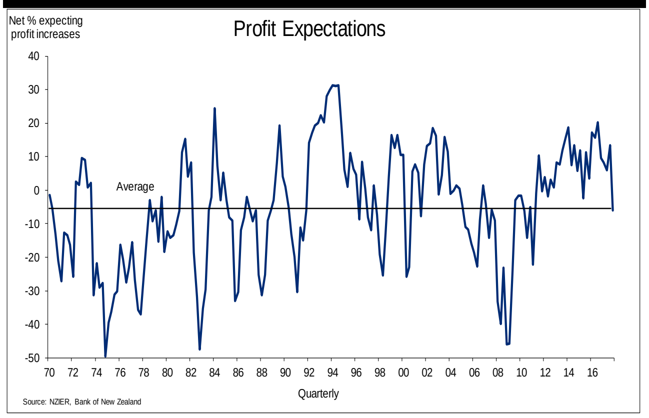


In particular, pricing intentions for the coming three months lifted to +31.2, from 23.7 in last quarter's survey. This coincides with a shunt higher in respondents' outlook for costs, to +37.9 – the strongest in more than six years.

This is, on balance, knocking profit expectations off their recent pedestal, although is far from the point of signalling weak profitability. More of a process of cost pressure for firms to keep on top of.

Broadly speaking, this morning's QSBO was not nearly as weak as it might have been, given protestations about the new centre-left government, and its seemingly business-unfriendly policies. Sure, sentiment about the overall economy has turned negative. But when firms look to their own businesses they are talking of reasonably good expansion, for now and the near future. The more immediate issue is one of ongoing capacity constraints.

Knock, Knock



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