10 April 2018

QSBO Gets a Grip

- **QSBO still lacking confidence**
- **But otherwise OK re the near-term economy**
- **Capacity-constraint message remains the clearest**
- **Suggesting near-term CPI dip transitory**
- **Investment intentions robust, employment slower**
- **But no real surprises in the QSBO for us**

This morning's NZIER Quarterly Survey of Business Opinion (QSBO) was broadly unchanged from last quarter (when it was knocked post the election). Sure, this meant that confidence was still negative but also that its indicators on economic activity remained OK – albeit dented since the recent change of government.

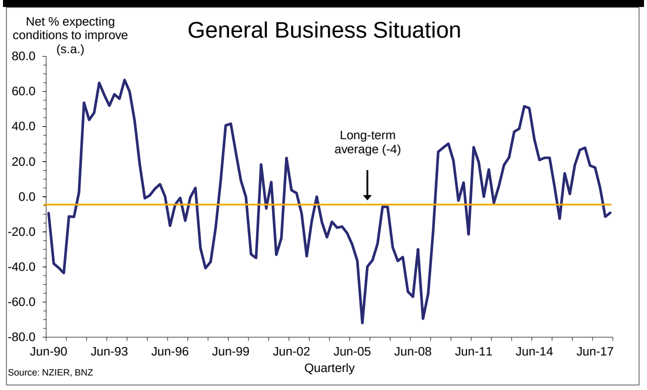
In terms of net confidence in the general economic outlook, this came in at -11, from -12 in Q4, +5 in Q3 and +18 back in Q2 last year. So still negative, but stabilised.

As for trading reports, these wriggled up to +15, from +10 in Q4, seasonally adjusted, while trading expectations for the coming three months were +16, compared to +17. These outcomes were at or slightly above average. As such, they pose little threat to our estimation that GDP expanded 0.6% in Q1 and will advance a further 0.8% in Q2.

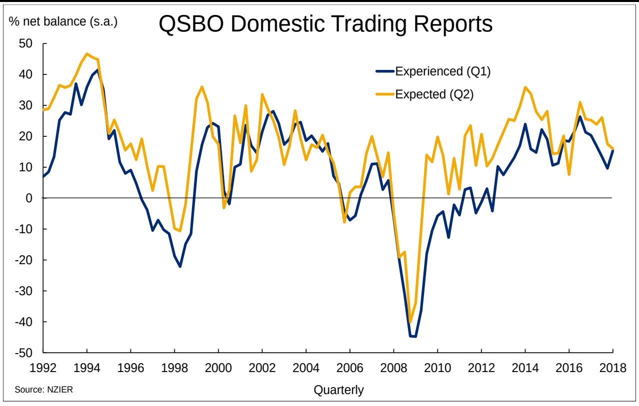
If there is to be disappointment on the economic growth front it will likely stem from the business sector suffering too many slings and arrows, rather than via households or the public sector directly. But so far at least there is little sign of a sharp pullback in business activity.

In fact, an important bellwether in this regard – intentions to invest in plant and machinery – strengthened a bit in this quarter's QSBO, to be riding more surely above normal.

Hesitant Rather Than Horrible



Holding Up



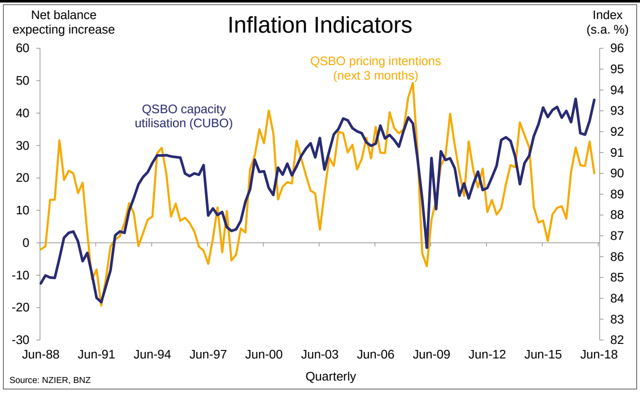
Granted, the QSBO employment indicators continued to lose gas. Hiring reports pertaining to the last three months eased to +9, from +14 the previous quarter, while expectations for the coming three months slowed to +6, from +12. However, they were each still on the right side of their averages (of -4 and zero respectively).

So we thought the NZIER made a bit much of the idea that businesses are starting to substitute capital in place of labour. It might be something to watch for, given the tilt of the new government's policies. However, today's QSBO provided no evidence that this was in fact occurring already.

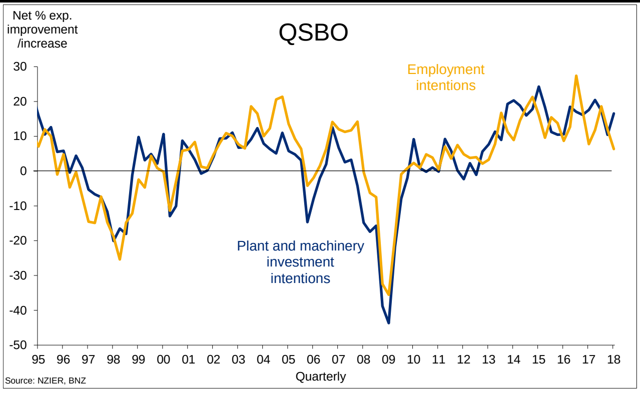
We also thought the NZIER commentary about "weak" profitability was a little overdone. We read the indicators on such as having moderated to about normal over recent quarters, after being especially strong. But, like for employment, it is a petering trend worth keeping tabs on. This is especially as cost inflation remains relatively strong, according to today's QSBO.

Yet pricing intentions slipped to +21, from the +31 they spiked to last quarter. Nonetheless, at +21, they are consistent with CPI inflation running central to the Reserve Bank's (recently reaffirmed) 1.0 to 3.0% target band. This is important, given the likelihood of annual CPI inflation itself "slumping" to 0.9% when the March quarter outturn is published (19 April). It's different, say, to 2015/16, when QSBO pricing reports and intentions were looking soft (along with inflation expectations around the time).

Core Pressure



Unders and Overs



The more fundamental reason to expect any dip in near-term CPI inflation to be temporary is the capacity constraint bedevilling the economy. This arguably remained the clearest message from this latest QSBO. And the NZIER survey has a wealth of gauges in this regard, which other business surveys do not.

To take one example, the capacity utilisation measure, CUBO, went up even further in Q1 2018, to a near record high of 93.5%. We know that some analysts downplay the worth of this indicator these days. But to ignore its latest extremes is irresponsible in our view. It's tantamount to telling the construction sector, in particular, that it's not stretched to the maximum.

And who can downplay the CUBO measure when the QSBO labour constraint variables are also running very near extremes? Sure, difficulty in finding labour came off a fraction during Q1, but it was still extremely high in a cyclical sense (consistent with the unemployment continuing to trend lower). It's akin to the worst we witnessed over the 2003-07 cycle (as are some of the anecdotes we're starting to hear).

The missing link, of course, remains any strength in pay-rate inflation. But we think it's just a matter of time before this shows up (egged on by the range of labour market policy initiatives, not least the strong and sustained increase in the legislated minimum wage).

In summary, today's QSBO was very close to what we expected. While there was potential for it to look a bit better, because it doesn't cover farmers (who are currently gloomy in their general outlook), it also seemed prone to the negative global rhetoric around trade, along with the recent market volatility. As it turned out, business sentiment found a floor, while its activity expectations were reasonable enough to suggest maintained pressure on resources.

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