

NEW ZEALAND ECONOMICS DATA REVIEW

NZIER QSBO – December 2011 quarter

17 January 2012

CONTRIBUTORS

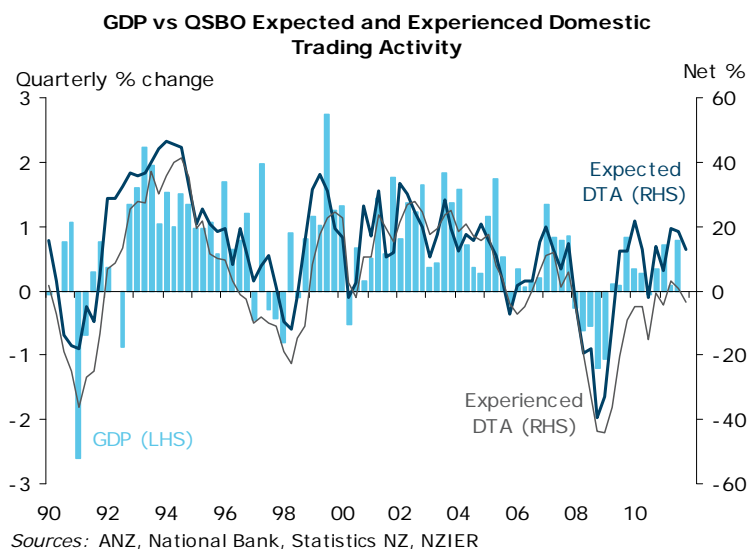
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QSBO SUGGESTS A SLOWING IN GROWTH MOMENTUM

KEY POINTS

- General business confidence and own activity fell further in the Q4 Quarterly Survey of Business Opinion. The general tenor is that some of the resilience that has characterised the earlier surveys has been lost, with the recovery appearing to lose momentum.
- The QSBO illustrated regional differences, with domestic trading activity rising in Canterbury, but falling elsewhere. The QSBO also revealed some sector differences, with services sector activity improving, construction sector sentiment weakening, retail sales easing (but remaining in positive territory), and non-primary manufacturing sector sentiment subdued.
- Labour market indicators showed signs of resilience, while investment intentions eased. Skill shortages remain acute in pockets of the economy, which is likely to weigh on supply side performance.
- Pricing pressures eased, but have not dissipated altogether, with a net 10 percent of respondents increasing prices (+18 in Q3), and a net 17 percent expecting to increase prices (previously +22). The net balance experiencing higher average costs remained high (at +30), and with profitability falling there is limited scope to absorb cost increases without lifting prices.
- Of some concern for the RBNZ, capacity measures did not ease as many had been expecting, although this was largely due to Canterbury. Both capacity utilisation and capacity as a limiting factor measures lifted. We expect this to translate into a firming in domestically generated inflation towards the end of the year, provided that the economy strengthens. Barring global meltdown, the next move in the OCR is up, but the RBNZ have considerable time on their side.

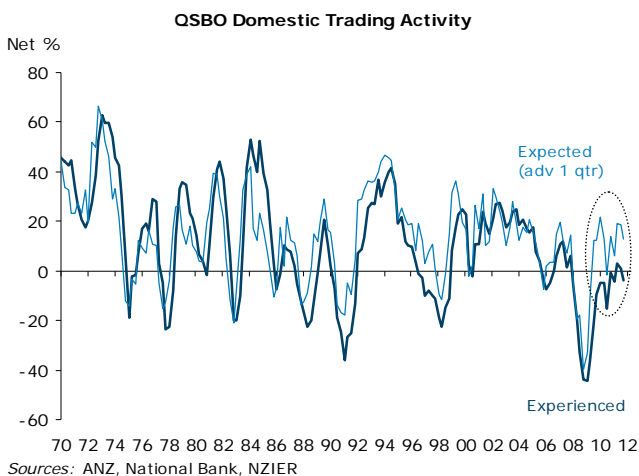


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DATA WRAP

	Headline business confidence		Domestic trading activity s.a.		CUBO	Avg selling price – next 3 mths
	actual	s.a.	past	expected	actual	actual
Q1 2010	22	36	-5	22	0.9054	27
Q2 2010	18	22	-5	13	0.9076	40
Q3 2010	6	-8	-15	-2	0.9039	30
Q4 2010	8	5	-1	14	0.8900	22
Q1 2011	-27	-12	-4	6	0.8938	14
Q2 2011	27	30	3	19	0.8873	31
Q3 2011	25	10	1	18	0.8963	22
Q4 2011	0	-3	-4	13	0.9015	17

Following earlier declines in the National Bank Business Outlook, the ongoing negative spate of global headlines, and with the post-Rugby World Cup glow becoming more of a distant memory, **today's fall in general business confidence was not surprising**. Experienced domestic trading activity in Q4 eased to -4 from +1 in the Q3 survey, which is suggestive of a below-trend Q4 GDP print, a disappointing result considering the potential Rugby World Cup boost. Expected domestic trading activity (which NZIER suggest is a less reliable growth indicator) fell further (to +13 s.a. from +18 in the Q3 survey), which suggests the loss of economic momentum at the start of this year. While these net balances are higher than for experienced domestic trading activity, NZIER note that the recovery to date has consistently undershot firms' optimistic expectations. We tend to agree, but note there is a structural element (i.e. ongoing deleveraging) that is tempering the cyclical recovery.



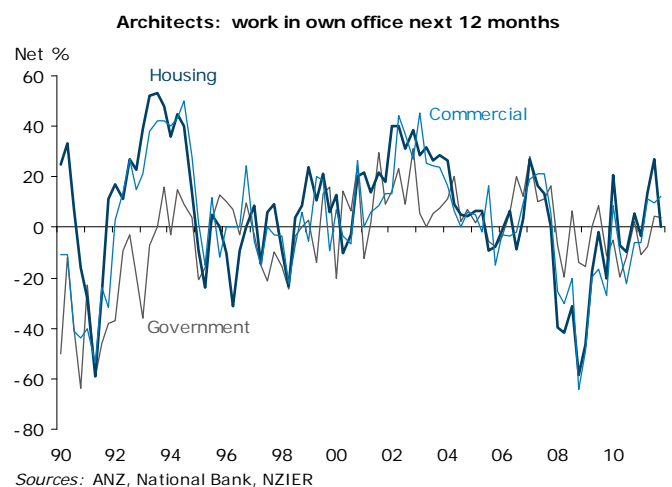
The QSBO highlighted regional divergences.

Experienced domestic trading activity in Canterbury surged to +18 (+9 previously), although NZIER

caution that the optimism might be overstated as non-respondents to the survey are likely to be facing more challenging conditions. By contrast, domestic trading activity in the rest of the country fell to -7 from 0, the lowest reading since September 2010. Investment intentions were stable for building and eased a touch for plant and machinery. Investment intentions outside of Canterbury remain well above those in the rest of the country. Encouragingly, employment intentions moved back into positive territory, with hiring intentions improving. Again, more of the positivity is in Canterbury, with the rest of the country less upbeat.

The QSBO release highlighted sector divergences.

Building sector activity slowed, and inventories have risen. Considering the ongoing delays caused by frequent aftershocks, the fickle global scene, and ongoing insurance issues, this is not a bolt out of the blue, but it suggests a smaller contribution to growth from construction sector activity over 2012. And indeed, expected work by Architects over the next 12 and 24 months eased back sharply, particularly for residential activity, where planned residential work over the next 12 months slumped to 0 from +27 in Q3. Construction sector activity is at cyclical lows and is unlikely to contract further, but the increasing pessimism of the construction sector suggests the pending rebound is likely to be pushed back by more than previously assumed. With OCR moves linked to the stepping up of earthquake reconstruction, a slower construction recovery is likely to see the OCR remain on hold for longer.

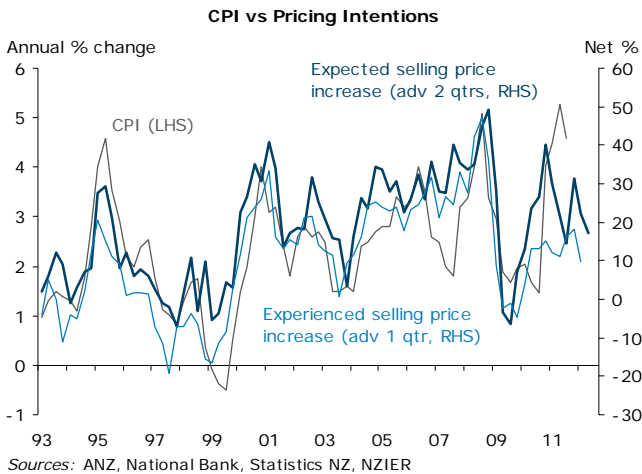


Activity in the services sector continued to improve gradually, with respondents reporting higher activity volumes and rising employment. Merchants' expectations eased from near-record highs, possibly

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due to optimistic expectations of a RWC windfall not having been met. Manufacturing sales remained downbeat, but exports were resilient. The build-up of inventories was mostly from dairy processing, which should be able to be unwound without weighing on activity further ahead. The build-up in construction and retail inventories is another matter.

Of some concern for the RBNZ, capacity measures actually tightened. Surveyed capacity utilisation rose in Q4, with the increase reflecting tightening capacity in Canterbury. Capacity as a limiting factor rose to +9 from +7, largely as a result of pressures on Canterbury capacity. Capacity pressures are becoming more acute in the labour market, where conditions are improving for workers and skill shortages remain acute.



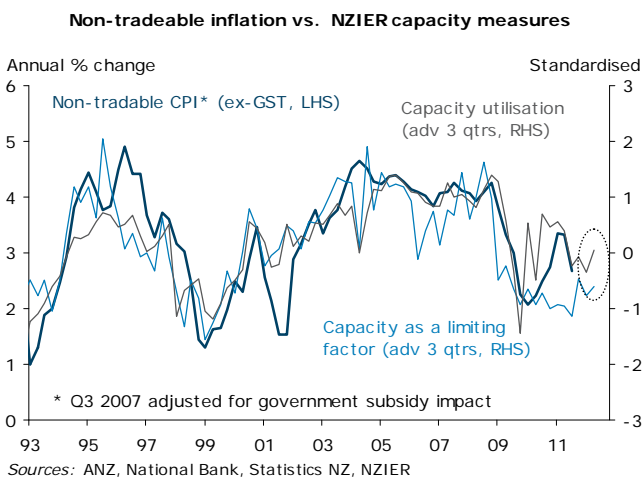
With activity metrics falling, it was not surprising that pricing gauges eased, with a net 10 percent of firms increasing prices (previously +18). Expected selling prices eased a touch, with a net 17 percent of respondents intending to increase prices (previously +22). Average experienced costs remained high, with a net 30 percent of firms reporting higher average costs, the same as the Q3 survey. As a result, profitability remains under pressure, with a net 17 percent of firms experiencing lower profitability over the last 3 months (previously -14). The soft demand environment continues to keep price increases restrained, but there are limits to how long this can last, given the pressure on margins.

THE UPSHOT

Today's QSBO release suggests the economy has lost some of its resilience, but capacity and pricing metrics are not yet consistent with a lower OCR. The negative reading for experienced domestic trading activity suggests a soft quarter for Q4 GDP is in prospect, particularly considering the possibility that a rapid unwinding of inventories may also push activity lower. While we would not rule out a negative Q4 GDP result, the spirit of our assessment is that weakness in GDP is likely to become more apparent in the first half of 2012.

We expect confidence measures to remain reasonably downbeat over the first half of the year, but then to recover as the global economy stabilises, and construction sector activity and investment strengthens in response to increased demand. However, this could be pushed back further by ongoing earthquake reconstruction delays or if the global scene deteriorates further.

There is little in today's survey to encourage an OCR move in either direction, and we expect the OCR to remain on hold for most of 2012. At 2½ percent and with pressures on capacity remaining present the OCR will eventually need to move higher, barring global meltdown. However, the RBNZ can afford to be patient.



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	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Average
Business Confidence – actual	18	6	8	-27	27	25	0	-7
– s.a.	22	-8	5	-12	30	10	-3	-8
Experienced domestic trading activity – actual	-7	-16	4	-6	2	0	1	11
– s.a.	-5	-15	-1	-4	3	1	-4	11
Expected domestic trading activity – actual	11	9	11	-2	18	30	10	15
– s.a.	13	-2	14	6	19	18	13	14
Capacity Utilisation (CUBO)	0.9076	0.9039	0.8899	0.8938	0.8873	0.8963	0.9015	0.8891
Average selling price – past 3 months	13	15	12	11	16	18	10	27
Average selling price – next 3 months	40	30	22	14	31	22	17	33
Costs – past 3 months	24	29	26	39	37	30	30	46
Costs – next 3 months	36	38	32	44	40	28	21	45
Profitability – past	-16	-30	-21	-28	-23	-14	-17	-18
Profitability – expected	-6	-14	-5	-22	-1	10	0	-7
Difficulty finding labour – skilled	-2	-4	-7	-10	-15	-20	-19	-16
Difficulty finding labour – unskilled	23	19	19	15	11	8	8	16
Investment intentions – Buildings	-8	-10	-8	-7	-4	-6	-6	-14
Investment intentions – Plant & Machinery	0	0	0	0	9	6	0	-2
Employment intentions – past 3 months	-7	-12	-3	2	-6	-4	1	-6
Employment intentions – next 3 months	1	5	4	0	7	4	7	-1
Capacity as a limiting factor	5	5	5	7	6	7	9	8

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