

NEW ZEALAND ECONOMICS DATA REVIEW

NZIER QSBO – June 2011 quarter

5 July 2011

CONTRIBUTORS

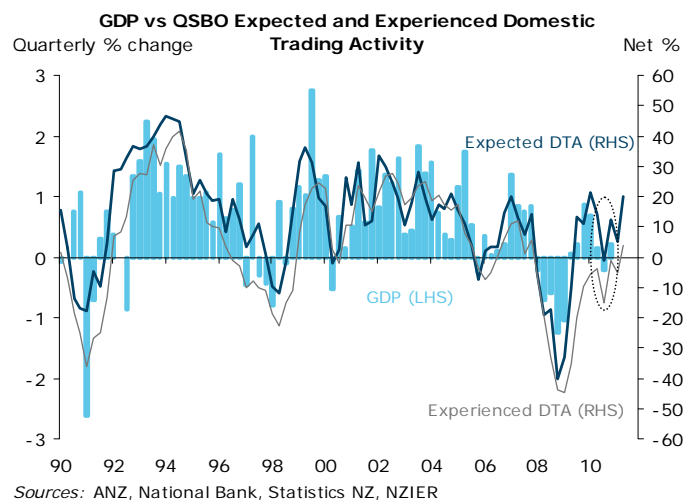
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ON THE MEND

KEY POINTS

- We were expecting a bounce after the earthquake-induced nadir, and the QSBO did not disappoint. Both headline business confidence and experienced domestic trading activity picked up sharply.
- The recovery in experienced domestic trading activity is consistent with the 0.4 percent RBNZ pick for Q2 GDP. Expected domestic trading activity firmed, consistent with further strengthening in activity from Q3.
- Within the QSBO survey there was something of a mixed bag across sectors. Building/construction and manufacturers are generally outperforming retailing and services (particularly financial).
- Domestic trading activity bounced the most in Canterbury but remained weaker than the rest of the economy.
- QSBO readings for employment were up, with much of this driven by Canterbury. Firms reported more difficulty in finding labour. Investment intentions held up quite well but remain low for this point of the cycle.
- Of some relief for the RBNZ, capacity measures did not firm as many (including us) had been expecting. However, lower capacity pressures in Canterbury seem unlikely to be a long-term story. The nationwide CUBO measure of capacity utilisation stands near its historical average, but we expect this to pick up as the reconstruction effort kicks into a higher gear.
- Pricing intentions firmed, with a net 31 percent expecting to increase prices (previously +14). This is now close to its long-run historical average. The net balance experiencing higher average costs rose, and experienced profitability remains below historical averages, indicating still-squeezed margins.



DATA REVIEW

DATA WRAP

	Headline business confidence		Domestic trading activity s.a.		CUBO	Avg selling price – next
	actual	s.a.	past	exp.	actual	actual
Q1 2010	22	37	-6	21	0.9054	27
Q2 2010	18	25	-4	14	0.9076	40
Q3 2010	6	-7	-15	-1	0.9039	30
Q4 2010	8	-1	-1	12	0.8900	22
Q1 2011	-27	-11	-5	5	0.8938	14
Q1 2012	27	31	4	20	0.8873	31

The improvement in general business confidence to its highest level since last March had been flagged by the National Bank Business Outlook (NBBO). The largest bounce was in Canterbury, though the region still lags the rest of the country.

Activity gauges (past and expected domestic trading activity) firmed, suggesting the pace of activity is strengthening. These gauges are consistent with a small positive rate of GDP growth in Q2, with growth set to move above trend in Q3. This growth will hardly set the world on fire (particularly considering the level of GDP is still considerably below late 2007 levels), but it is a start, and will erode spare capacity.

Today's QSBO presented some strong regional themes, although the more pronounced improvement in Canterbury narrowed the gap with the rest of NZ. Gains in headline business confidence and domestic trading activity were larger in the Canterbury region, with experienced trading activity in the region improving from -19 to -3. With the pending construction boom the Canterbury region is set to outperform the rest of New Zealand, but this growth is replacing destroyed capital – hardly the “feel good” growth variety. There are other regional disparities at play too, with the upper North Island confidence of +29 trouncing the lower North Island's +15.

The firming in business confidence was not just a Canterbury story, however. Experienced domestic trading activity firmed from -3 to +3 outside of Canterbury too, suggesting the economic recovery is not just a “one-trick pony”. However, the reality is that more resources will need to shift towards the Canterbury economy and into the construction sector. Canterbury building investment intentions were unchanged at high levels, while Canterbury builders' and manufacturers' experienced activity soared. This will be an ongoing dynamic that is set to create some regional and

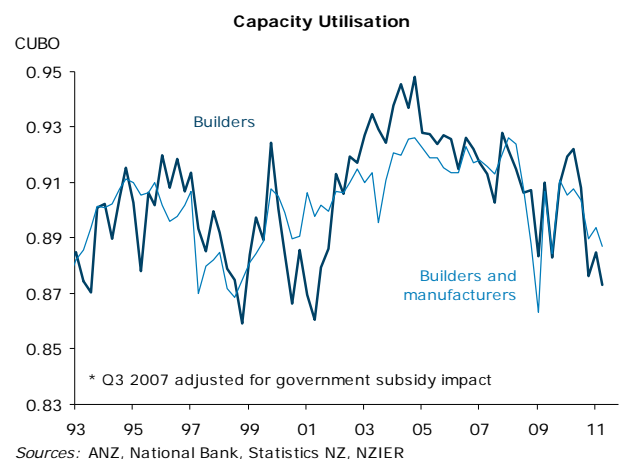
sector tensions within the economy. Work in architects' own offices also moved higher, illustrating the multi-year boost aspect of the earthquake reconstruction.

The QSBO highlighted sector divergences.

Sentiment for retailers nationwide recovered (and most encouragingly, overdue debtors plunged). Manufacturers' fortunes are being sustained by domestic sales, but global ructions and the weaker Australian economy are starting to weigh. The building sector is of course gearing up for years of going all-out. But financial services firms' volumes are the lowest since the series began.

Employment gauges recovered, with a net 7 percent of respondents planning to increase employment levels (previously -4). Canterbury employment intentions turned around sharply (from -22 to +22), with the rest of NZ also improving. By sector, construction firms intend to increase staff levels (with intentions increasing from -2 to +9), and manufacturers too (+14 vs. +4). Retailers have been shedding jobs but do not expect to continue doing so (employment intentions -2 vs. -11 in Q1), while labour indicators deteriorated for the services sector.

Investment intentions firmed, with building investment increasing from -7 to -4 (not a flash-sounding number, but the long-run average is -15!), and plant and machinery investment intentions increasing from 0 to +9. Both plant and building investment intentions are at post-recession highs.

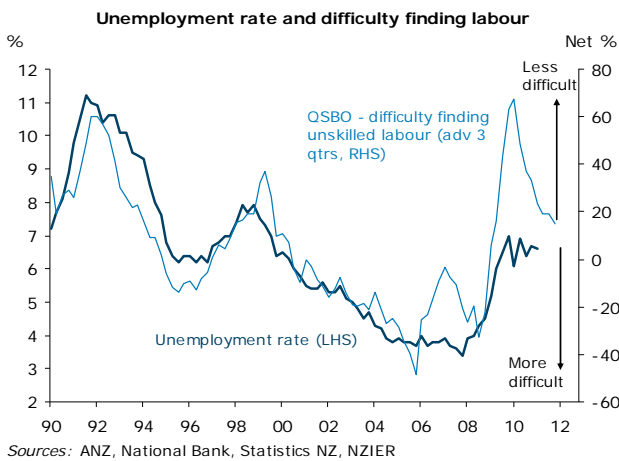


Capacity measures remained contained, which will please the RBNZ. The RBNZ noted in their June *MPS* that “indicators of excess capacity are mixed, with some suggesting that there is less slack in the economy than might be expected given this weak activity picture.” Surveyed QSBO

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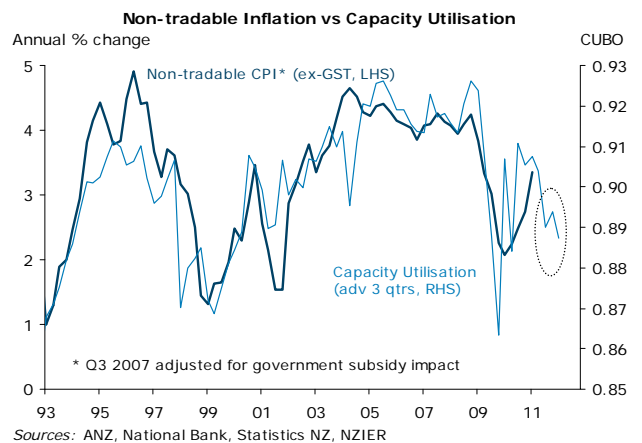
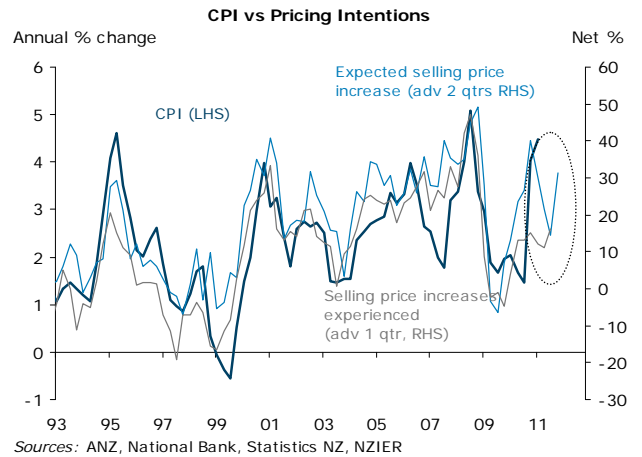
capacity utilisation actually eased in Q2, across builders and manufacturers. Capacity as a limiting factor eased marginally from +7 to +6, due entirely to an easing in Canterbury (remaining unchanged elsewhere). Given the large boost to construction in Canterbury, and strong employment intentions in this sector, one can only surmise that it is a manufacturing sector story. And since Canterbury manufacturers' reported activity was strong, it seems likely the result reflects reduced earthquake disruption. All-up, today's QSBO release buys a little more time on the capacity front, but given the scale of the task in Christchurch, a major bottleneck is clearly coming.

One area where capacity pressure is already becoming more marked is in the labour market. Measures of both skilled and unskilled labour shortages continued to become more acute (a net 15 percent of firms are finding it difficult to find skilled labour). These statistics are consistent with recent jobs ads and benefit numbers that suggest the demand for labour is strengthening. Labour market pressure is likely to intensify over the next year or two given the reconstruction requirements and increased demand for labour as the economy strengthens.



Pricing gauges firmed, with a net 16 percent of firms increasing their prices in the last 3 months (vs. +11 in Q1). Expected selling prices also rose, with a net 31 percent of respondents intending to increase prices, versus +14 last quarter. Average costs eased but remained at high levels, with a net 37 percent of firms reporting higher average costs in the previous 3 months. Profitability remains under pressure, with a net 23 percent of firms

experiencing lower profitability over the last 3 months. The soft demand environment continues to keep price increases restrained, but there are limits to how long this can last.



We expect confidence measures to remain consistent with above-trend growth rates for the remainder of the year. The Canterbury reconstruction is truly a daunting task. But the Government is moving quickly and progress is being made. And it is not just an earthquake reconstruction story behind the improved economic outlook. Although the QSBO does not directly survey the outperforming rural sector, there will have been some impact on surveyed manufacturers. Financial conditions are providing considerable support, and the Rugby World Cup is set to provide additional impetus for growth later this year. With the economy still below pre-recession levels, there remains a springboard from which activity will rebound in the second half of this year.

DATA REVIEW

	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Average
Business Confidence – actual	31	22	18	6	8	-27	27	-8
– s.a.	21	37	25	-7	-1	-11	31	-8
Experienced domestic trading activity – actual	-5	-7	-7	-16	4	-6	2	11
– s.a.	-10	-6	-4	-15	-1	-5	4	11
Expected domestic trading activity – actual	11	15	11	9	11	-2	18	14
– s.a.	11	21	14	-1	12	5	20	14
Capacity Utilisation (CUBO)	0.9107	0.9054	0.9076	0.9039	0.8899	0.8938	0.8873	0.8890
Average selling price – past 3 months	4	13	13	15	12	11	16	27
Average selling price – next 3 months	24	27	40	30	22	14	31	33
Costs – past 3 months	15	20	24	29	26	39	37	46
Costs – next 3 months	21	25	36	38	32	44	40	45
Profitability – past	-14	-19	-16	-30	-21	-28	-23	-18
Profitability – expected	-2	-2	-6	-14	-5	-22	-1	-7
Difficulty finding labour – skilled	13	9	-2	-4	-7	-10	-15	-16
Difficulty finding labour – unskilled	37	33	23	19	19	15	11	16
Investment intentions – Buildings	-15	-5	-8	-10	-8	-7	-4	-15
Investment intentions – Plant & Machinery	-2	9	0	0	0	0	9	-2
Employment intentions – past 3 months	-18	-15	-7	-12	-3	2	-6	-6
Employment intentions – next 3 months	1	2	1	5	4	0	7	-1
Capacity as a limiting factor	6	5	5	5	5	7	6	8

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