

Economic Review

New Zealand

7 July 2009

NZIER Quarterly Survey of Business Opinion – June 2009 quarter

Key points

- > **Business confidence recovers off last quarter's extreme lows.**
- > **But key gauges are still pointing to further contractions in economic activity, just not as large.**
- > **Businesses are still doing it tough with falling profits. This portends of continued belt-tightening in order to improve productivity growth, and the labour market remains key to watch.**
- > **Nonetheless, improvement – albeit off lows – is encouraging.**
- > **Overall, the survey points to an economy that remains weak, and is consistent with the RBNZ's latest economic projections.**
- > **We see nothing in today's survey to alter our expectation that we are set for an extended period of low rates, and a long and protracted recovery when it eventually comes.**

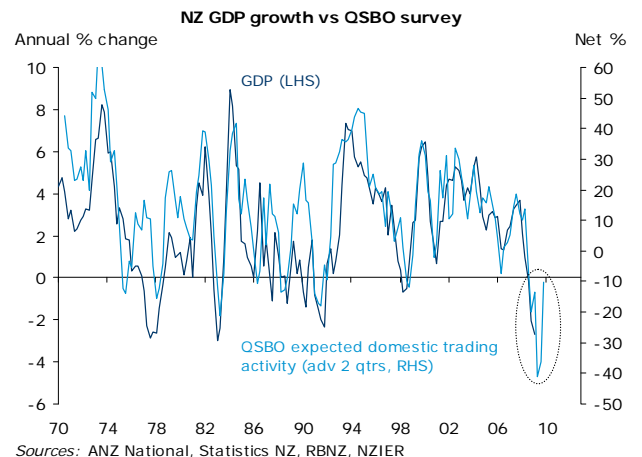
Assessment

Business confidence improved across all regions and sectors, according to the Q2 Quarterly Survey of Business Opinion (QSBO) run by the NZIER. Following the record low readings of the previous quarter, which coincided with the low point in global economic activity, a rebound was always on the cards. The question was what would be the extent of any recovery in sentiment. In this regard, the improvement seen in today's QSBO broadly mirrors that seen in the recent National Bank *Business Outlook* survey in terms of depicting recovering confidence, activity expectations, employment and investment intentions.

Such improvement should be taken in a positive light. However, the improvement is all off extremes and needs to be interpreted as such. All the key variables remain in negative territory, and well below historical averages (refer to the table at the end). The biggest recovery in confidence occurred in the building industry, followed by merchants. To us, this reflects a classic FIFO (first in first out) pattern, given those two sectors were impacted earlier and harder so far. The acceleration in net migration no doubt will also be playing a part. The services sector, which had fared relatively better during the downturn, recorded the lowest confidence and expected domestic trading activity reading of all the sectors. This suggests they will be going through a LILO (last in last out) phase.

Back to a "normal" recession. If there is one key message from today's QSBO, it is that we are back to facing a "normal" recession as opposed to something far more damaging. The improvement in the expected domestic trading activity to -10 from -36 previously suggests the -1 percent

contraction in GDP seen over Q4 2008 and Q1 2009 will be the worst for this cycle. More modest contractions are in store for Q2 and Q3. At the rate that the recent dataflow has been improving, we could well see the official end to this recession in Q4.



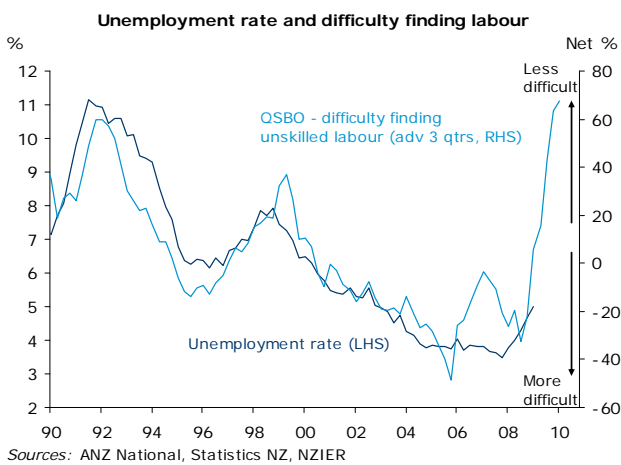
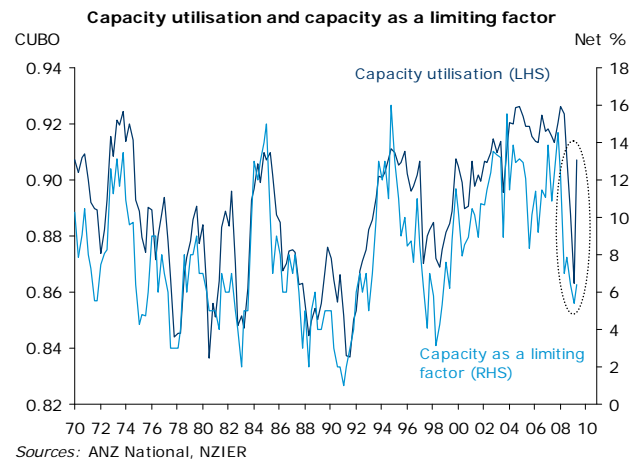
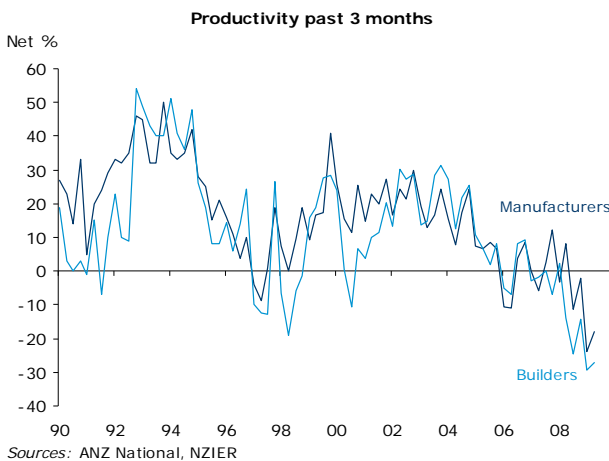
	Headline business confidence		Domestic trading activity – next 3 mths		CUBO	Avg selling price – next 3 mths
	actual	s.a.	actual	s.a.		
Q2 2007	-37	-28	9	12	0.9156	35
Q3 2007	-27	-33	15	10	0.9134	34
Q4 2007	-26	-39	14	14	0.9204	35
Q1 2008	-64	-55	-10	-7	0.9262	45
Q2 2008	-64	-54	-23	-20	0.9237	49
Q3 2008	-19	-25	-8	-14	0.9079	28
Q4 2008	-64	-77	-41	-41	0.8878	-3
Q1 2009	-65	-55	-39	-36	0.8633	-6
Q2 2009	-25	-16	-13	-10	0.9070	7

The details suggest caution over the recovery path. Businesses are still doing it tough. Profit expectations remain negative (though less so), a

lack of sales remain the key factor constraining output, and alarming, firms continue to report poor productivity performance in the last quarter. This is despite many already taking steps to restructure via lowering staffing levels. Strong productivity is essential in driving a sustained recovery, and this looks to be sorely missing at present. Firms expect future productivity performance to improve, but this has been their expectation in the last few quarters, which is yet to eventuate. With more firms still expecting to cut investment, this does not bode well for future productivity performance. Weak profits also flags further job cuts and cost control.

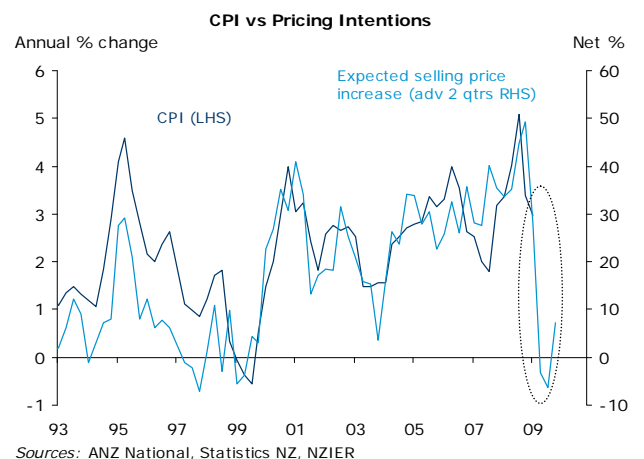
quarter, while it is slightly easier to find unskilled labour (for those firms that are looking).

If there is an anomaly in today's QSBO, it is the surprisingly large rebound in the capacity utilisation (CUBO) measure. After plummeting to 0.8633 in the previous quarter, the CUBO measure recorded the largest quarterly increase in the series' history to 0.9070, slightly above the decade average. NZIER noted that *"The increase in capacity utilisation suggests that firms have made adjustments to lower activity, by trimming staff numbers and capital inputs. They are running leaner operations."* We wonder whether this is really the case, or just volatility caused by the way respondents answer the question. We note that the CUBO has historically tracked the "capacity as a limiting factor" response very closely, and this measure still suggests ample spare capacity. We will await the CUBO readings in the coming quarters to get a more accurate picture.

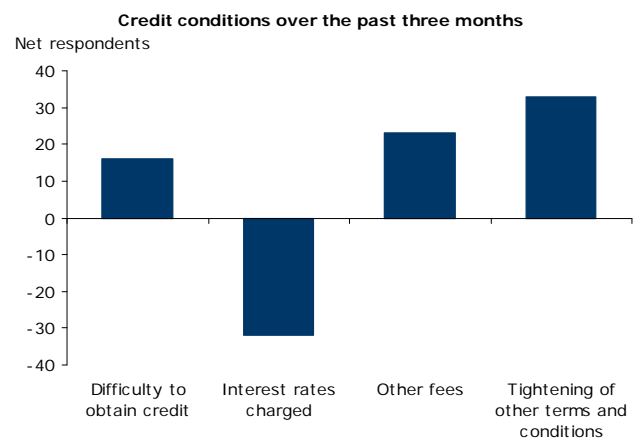


On the pricing intentions front, more firms are expecting to raise prices. However, this is not going to cause too much alarm at the RBNZ. Current levels are still consistent with headline inflation heading below the target band. And builders' expected selling price, a reasonable gauge of future construction cost inflation, remains subdued.

The labour market is one area looking the most vulnerable. Despite employment intentions improving from -36 to -19, there is still considerable slack in the labour market. Employment growth looks set to contract further, or stay flat at best (a view we would consider to be very optimistic). Given that some 40,000 to 50,000 jobs need to be created each year just to absorb the new entrants into the labour market and therefore keep the unemployment rate unchanged, the employment intentions reading point to further rises in the unemployment rate over the next few quarters. Firms report that the ease of finding skilled labour is unchanged from the previous



A new question on credit conditions show a net 16 percent finding difficulty in obtaining credit, a similar level to the National Bank *Business Outlook* result. While a net 32 percent have seen interest rates decline, a net 23 percent have had other fees increased, and a net 33 percent have had a tightening of other terms and conditions (e.g. covenants and collateral). While credit conditions on the whole have tightened, a net 33 percent of respondents said it had no impact on their business. This reinforces our view that unlike in other economies where there are fundamental structural issues with their financial institutions, NZ's financial system remains sound and it is the traditional credit related risk associated with the economic cycle that businesses on the whole are faced with.



Sources: ANZ National, NZIER

Implications

Overall, we see little in today's QSBO to alter our core economic views. The economy remains weak, but the pace of contraction is modifying. A fair bit of the improvement in key measures should be read as corrections off "extremes". The survey is also entirely consistent with the RBNZ's view of the economy, as reflected in their June *Monetary Policy Statement*. The recovery in confidence does mean that near-term easings are off the table, though an easing bias will likely remain. But we are still set for an extended period of low rates, and a long and protracted recovery - when it comes.

	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Decade Average
Business Confidence - actual	-64	-64	-19	-64	-65	-25	-19
- s.a.	-55	-54	-25	-77	-55	-16	-18
Experienced domestic trading activity – actual	-7	-22	-34	-39	-45	-38	5
- s.a.	-6	-20	-32	-43	-45	-36	5
Expected domestic trading activity – actual	-10	-23	-8	-41	-39	-13	10
- s.a.	-7	-20	-14	-41	-36	-10	10
Capacity Utilisation (CUBO)	0.9262	0.9237	0.9079	0.8878	0.8633	0.9070	0.9052
Average selling price – past 3 months	42	47	36	9	-2	-1	16
Average selling price – next 3 months	45	49	28	-3	-6	7	22
Costs – past 3 months	59	68	59	42	29	25	31
Costs – next 3 months	62	71	52	27	21	17	30
Profitability - past	-30	-45	-44	-49	-51	-44	-15
Profitability - expected	-33	-40	-23	-46	-45	-24	-6
Difficulty finding labour – skilled	-36	-19	-5	20	42	42	-29
Difficulty finding labour – unskilled	-22	6	16	43	63	67	-6
Investment intentions – Buildings	-18	-18	-20	-42	-46	-29	-11
Investment intentions – Plant & Machinery	-15	-17	-16	-39	-44	-23	-2
Employment intentions – past 3 months	4	-3	-11	-21	-34	-31	-1
Employment intentions – next 3 months	0	-6	-7	-32	-36	-19	2

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- Expelled from or has been prohibited from being a member of a professional body; or
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- Derivative products including interest rate and currency forward rate contracts and options; and
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ANZ (part of ANZ National Bank Limited), Level 7, 1 Victoria Street, Wellington 6011, New Zealand Phone 64-4-802 2000 Fax 64-4-496 8639 <http://www.anz.co.nz> e-mail ecnmcs@anz.com

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