ANZ Research

Quarterly Survey of Business Opinion – 2021 Q2

6 July 2021

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Data summary

	Latest
Headline business confidence (actual)	7
Headline business confidence (sa)	10
Domestic trading activity (sa, past)	26
Domestic trading activity (sa, expected)	28
CUBO (actual)	94.9%
Avg selling price – next 3 months	52

Tighter and tighter

The bottom line

Business sentiment increased (sa) in the June quarter, and is well-above pre-COVID levels (and the historical average). More importantly for economic activity over the next few quarters, firms' reported and expected trading activity rose strongly, investment intentions continued to increase, and employment intentions were up too. Of particular note for the RBNZ is the sharp surge in gauges of capacity pressure. Pricing intentions were up versus Q1, consistent with our ANZ Business Outlook. The CUBO measure rose, and the labour market is tightening, with difficulty finding labour well-up, and a larger share of firms reporting that labour shortages are the main constraint holding them back. All up, these results reinforce our expectation that rate hikes are on the horizon – we've pencilled in February 2022, but risks are pointing towards sooner rather than later. The economy is booming, and while there's still some softness in the tourism industry due to the border closure, the sheer strength in demand elsewhere is swamping this effect.

Key points

Data from the Quarterly Survey of Business Opinion (QSBO) shows that the economic recovery is well underway, and the strength in demand is generating significant inflationary pressures.

- **Businesses sentiment at post-2017 high:** Seasonally adjusted business sentiment improved in Q2, with 10% of businesses feeling optimistic about the economic outlook (up from net 1% in Q1, and well up from -60% a year ago). That's a slightly stronger signal than we got from the ANZ Business Outlook over Q2. Business confidence improved across the board, with manufacturers up 5 points to -2%, builders up to 14% vs -8% previously (above average), merchants up from -38% to -11%, and services up to 9% from -9% previously. Except for merchants, all sectors now have an above-average level of confidence in the economic outlook.
- **Experienced domestic trading activity rose,** with a net 24% of firms reporting higher activity over the quarter, from 2% previously (sa). This measure usually provides a good steer on annual growth in GDP, but Q2 2021's GDP will be very noisy since it's calculated off Q2 2020, when GDP fell due to lockdown (in fact, our forecast for a 0.4% q/q rise in GDP in Q2 is consistent with a 15.3% y/y increase in GDP). But, we can say that the strong increase in domestic trading activity over Q2 does point to ongoing momentum over mid-2021, consistent with our near-term GDP forecasts.
- **Investment intentions on the up,** with plant and machinery investment intentions for buildings up 5 points to 12%, and plant and machinery up 5 points to 20%. The recovery in investment has been one of the most encouraging signals in the data recently, particularly in Q1's GDP data. Business investment is a key ingredient to sustaining economic momentum (something that was lacking in many countries after the GFC), so the strong investment signals in today's data are good news for the economic recovery.

- **Capacity constraints continue to build:** The headline CUBO measure ticked up to 94.9% (93.3% previously), well above average. And, the labour market shows signs of intense stretch, with firms' reported difficulty finding labour up sharply for both skilled (69%) and unskilled labour (57%) – record highs for both. Labour as a limiting factor rose sharply to 25% from 18% previously, while orders fell to 33% from 36%. Less firms are concerned about demand, and more are concerned about finding workers – that speaks to rising capacity pressures coming from the labour market, and strong wage pressure in the coming year. These pressures don't look to ease any time soon, with a net 22% of firms expecting to increase headcount in the next three months, and 15% reporting an increase in the past three months.
- **Firms are passing on cost increases:** Cost pressures continue to be a major headache for firms, with a net 54% of businesses reporting higher costs in the past 3 months, and 50% expecting higher costs over Q3. Supply chain disruptions are causing delays and cost overruns across many different parts of the economy, and these disruptions aren't even close to being over. A tight labour market is adding further pressure. What we've seen recently though is firms seem more willing to pass on higher costs to customers, with pricing intentions rising sharply to 39% (up 31pts on Q1). That's consistent with our expectation that we'll see inflation spike to 3% y/y over this year.
- **Profitability recovering well:** the QSBO showed that for the first time since 2016, more firms reported increased profitability, with a net 1% reporting higher profits, versus -21% previously. Of particular note was the rise in construction sector profitability to 30% from -6% previously (although the sector is looking incredibly constrained, with stocks very low). This rise in profitability is a great sign – it means that firms are able to pass on higher costs to consumers, and that the current growth we're seeing is more sustainable than before. It's not all good news though, with manufacturing profitability still below average.

Overall, today's QSBO outturn adds further evidence towards our assessment that the economy is in a very strong cyclical position. The economy has come roaring back to life since lockdown, and the strength of domestic demand has been enough to more than make up for the absence of international tourism over the past year.

Indicators from the QBSO show that capacity pressures in the economy have only continued to increase, as strong demand runs into supply constraints. The labour market is giving off very strong signals, and we think it's well on the way to maximum sustainable employment. And, firms are finally starting to pass on higher costs to consumers (something that they struggled to do pre-COVID), which has helped see a recovery in profitability. These developments are important for the monetary policy outlook – it's easy to look at supply disruptions and say that these are persistent, but not permanent, sources of inflation pressure. But with the labour market tightening and firms starting to pass on cost increases to consumers (a significant behavioural change), that speaks to a more sustained source of underlying inflationary pressure that will require a tightening in monetary policy, and sooner rather than later.

[Charts over page]

Figure 1. GDP and QSBO domestic trading activity

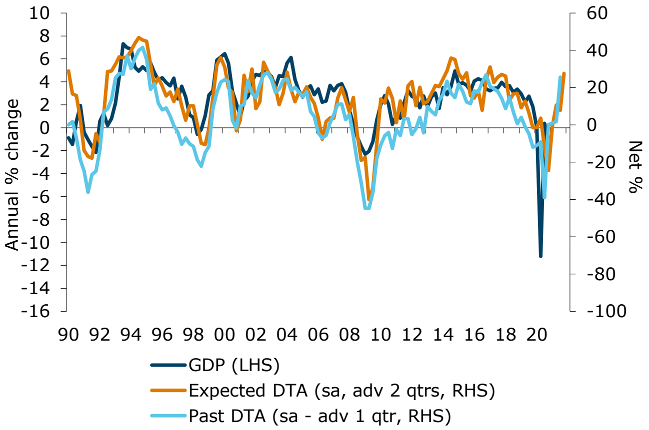


Figure 2. Employment vs QSBO employment intentions

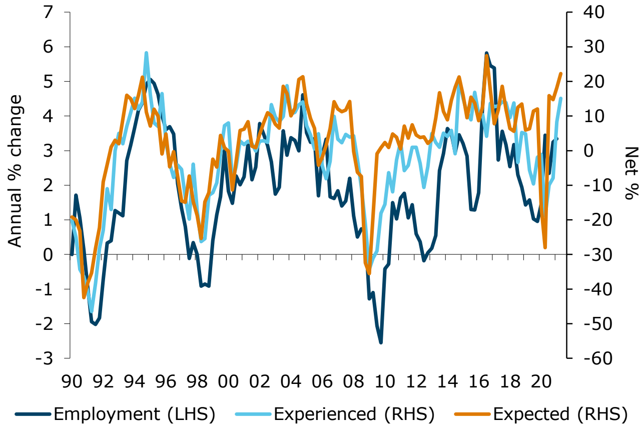


Figure 3. QSBO capacity indicators

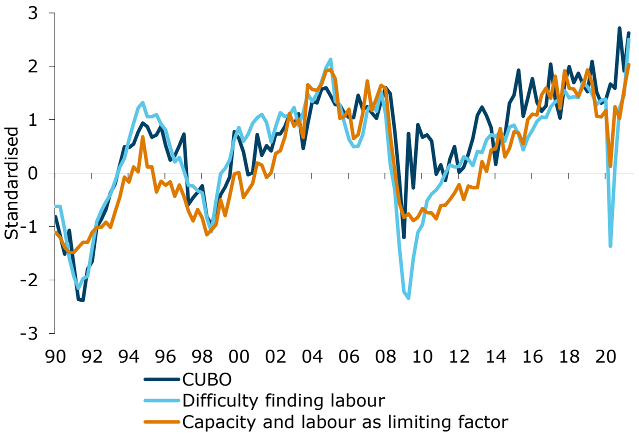
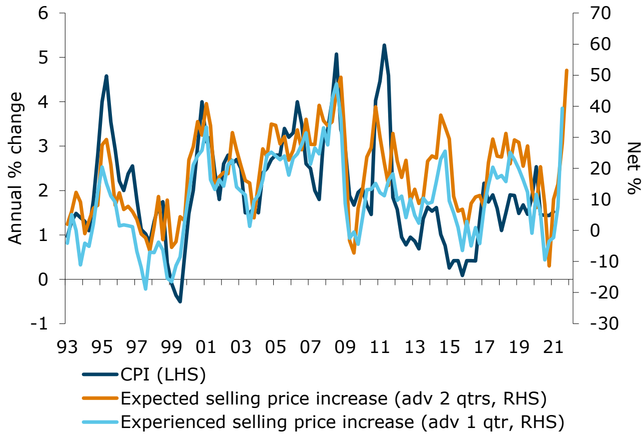


Figure 4. Inflation and pricing indicators



Source: NZIER, Statistics NZ, ANZ Research

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