In need of a caffeine hit

The bottom line

- QSBO business sentiment improved a little in the December quarter, consistent with the ANZ Business Outlook. Nonetheless, businesses are pessimistic, with the economic cycle looking tired.

- Experienced activity, which tends to be a good barometer of GDP growth, perked up a little in the quarter, but at face value is consistent with soft annual growth of 2-2½% in the short term.

- Today’s data are consistent with our view that the economy is not performing well enough to achieve a durable lift in inflation. We see the RBNZ cutting the OCR late this year to give the economy a pick-me-up.

Key points

Business sentiment improved in the December quarter, according to NZIER’s Quarterly Survey of Business Opinion. Headline views on the general business situation improved 10%pts, with a net 18% (sa) feeling pessimistic in Q4, consistent with the bounce in our ANZ Business Outlook Survey. Nonetheless, businesses remain downbeat, reflecting headwinds the economy is facing, with the cycle now looking tired. Firms are facing high labour costs, margin pressure, and credit constraints, while uncertainty about future demand is weighing, amidst lingering angst about political changes – and now, the global outlook.

Businesses continue to report activity levels consistent with lacklustre GDP growth, despite experienced domestic trading activity perking up a little in the quarter. A net 4% of firms reported an increase in their own activity, up from 0% last quarter. This is consistent with a small Q4 bounce-back from the weak Q3 GDP print (0.3% q/q), but at face value points to annual GDP growth of 2-2½%. It’s going to take more than that to keep energy levels high.

Firms generally expect some improvement in demand from here; looking forward, a net 17% of firms expect their own activity to pick up in Q1. The question is whether this eventuates. If it does, it would be consistent with more of an improvement in GDP growth later this year, consistent with our view that the economy isn’t about to go to sleep. But actual, rather than expected, activity tends to be a better gauge of outcomes, and a pick-up is not assured.

Firms are looking to hire and invest, but they are cautious. A net 7% are looking to increase their investment in plant and machinery (up 3%pts) and a net 13% are looking to expand their workforce, with 5% increasing employment in the quarter. However, a net 4% are looking to reduce investment in buildings, and architects report no growth in commercial work over the next 12 months.

The labour market is very tight and capacity utilisation remains elevated, though it eased in the quarter from 93.2% to 92.8%, driven by manufacturing. While continued resource pressure will support inflation to some degree, we suspect that resource pressures are past their peak, with the economic outlook looking less assured. As such, in our view it will be difficult to achieve inflation near target over the medium-term. Adding to that, in light of cost pressures firms would like to increase prices, but are struggling to do so. Pricing intentions remain elevated but dipped in the quarter from net 28% to 21%. A net 20% of firms report that they increased prices in Q4, down from 23%.
Cost pressures remain elevated, with experienced costs increasing for net 47% of firms (up 3%pts). Cost pressures are expected to intensify, though by less: a net 36% of firms are expecting cost pressures to increase further, down from net 41%. With the headline inflation pulse shaping to be pretty modest in Q4, the impetus from higher costs appears to be waning to some degree, though labour costs remain an important issue.

Reflecting higher costs and difficulties raising prices, experienced profitability remains weak, with a net 22% of firms reporting deterioration in the quarter (unchanged from Q3). Expected profitability deteriorated further and is likely weighing on sentiment. A net 15% expect further declines (compared with 7% last quarter).

Today’s data suggests that growth will remain modest in the short term and that growth above 3% is in the rear-view mirror for now. This supports our view that the economy is in need of a pick-me-up. Headwinds are making themselves felt, previous drivers of growth are dissipating, and international risks are at the fore. We don’t expect the economy to tank. But nonetheless, we don’t think growth’s going to be sufficient to achieve inflation sustainably near the 2% target midpoint. In our view, the RBNZ will eventually need to cut the OCR to give the economy a boost. And views appear to be shifting that way, with net 6% of firms now expecting an OCR cut over the next 12 months, compared with net 21% expecting interest rates to increase last quarter.

Right, it must be time for coffee.

**Figure 1: GDP vs QSBO expected domestic trading activity**

**Figure 2: CPI vs pricing intentions**

Source: NZIER, Statistics NZ
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