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THE BOTTOM LINE

- QSBO business sentiment deteriorated in the September quarter to the lowest level since March 2009. Experienced activity also took a step down.
- Firms cite government policy, labour costs, consumer confidence and labour shortages as the key challenges leading to downbeat confidence.
- Pessimism is flowing through into firm decisions, although investment and hiring intentions are generally still positive.
- Today’s data are consistent with a softening in annual GDP growth – challenging the RBNZ’s outlook for acceleration in the second half of the year. We continue to believe the next OCR move is more likely to be a cut.

KEY RESULTS

- Business sentiment deteriorated in the September quarter to the lowest level since March 2009, according to NZIER’s Quarterly Survey of Business Opinion. Headline views on the general business situation deteriorated 7%pts, with a net 28% (sa) feeling pessimistic in Q3.
- Headline business confidence points to lingering pessimism amongst businesses, consistent with our ANZ Business Outlook Survey. The pessimism is no doubt partly political – businesses cite government policy as their #1 concern. But that’s only part of the story. Businesses also identify challenges related to high labour costs, consumer confidence (related to demand), availability of labour and margin pressure as other top concerns contributing to downbeat business confidence.
- Looking beneath the headline confidence numbers, firms’ expectations and intentions – which tend to be better barometers of activity – are pointing to a more challenging environment for growth after Q2’s strong GDP print. Experienced activity has taken a step down. A net 0% of firms reported an increase in their own activity – down 7%pts from Q2. Experienced trading activity was last at this level in September 2012 – and is consistent with annual GDP growth softening from here, to around a 2% annual pace. Manufacturers and services industries are most downbeat. Looking forward, a net 10% of firms expect their own activity to pick up in Q3, down from 12% in the previous survey.
- Pessimism is affecting investment and hiring decisions, although these are generally a little more positive. Businesses are looking to scale back investment in buildings; a net 5% of businesses plan to reduce investment in buildings (down 1%pt). Investment in plant and machinery remains slightly positive. A net 4% of businesses are looking to increase investment (up 2%pts), consistent with our expectation for modest growth in investment. However, capacity utilisation remains elevated at 93.2%, pointing to continued resource pressures.
- Firms reported hiring is consistent with continued employment growth, concuring with the broad signal from ANZ Job Ads. A net 3% reduced employment over the past quarter, versus a net 14% who reported having increased it in Q2. But firms intend to increase hiring going forward, with a net 13% of firms expecting to increase headcount. It remains difficult to find labour, with these metrics unchanged.
• Profitability has deteriorated again. A net 23% of firms experienced deteriorating profitability in the quarter (compared with 16% in Q2). But a net 7% expect further declines (an improvement of 5%pts). Cost pressures are contributing to reduced profitability. Experienced costs increased for a net 44% of firms (up 8%pts). This is expected to continue, with a net 41% of firms expecting cost pressures to increase further (unchanged from last quarter).

• Firms expect to pass these cost increases on – but we expect they will do so cautiously, and indeed these intentions moderated a touch in the quarter. A net 23% of firms are expecting to increase prices (down 2%pts) and a net 28% increased their prices over the past quarter (down 1%pt). It is likely that increases in input costs (such as higher fuel prices) will leave firms little choice but to up prices to some degree. However, this is likely to have only a transitory effect on inflation. Firms’ perceived pricing power will be limited by the fact that activity expectations are downbeat.

• Today’s data are consistent with a softening in GDP growth, which casts considerable doubt on the RBNZ’s August MPS expectation that annual GDP growth will accelerate from here. Today’s data will add to concerns about the current degree of economic momentum, providing a timely reminder that OCR cuts remain a distinct possibility. The RBNZ stands at the ready to support the economy should they deem it necessary to get inflation sustainably back to the midpoint in an acceptable timeframe. Accordingly, today’s data have the potential to move the RBNZ’s rhetoric further into dovish territory.

• We continue to believe that on balance the next OCR move is more likely to be a cut than a hike, though more “hard” evidence of a slowdown would be required to shift us from our flat track. Uncertainty persists regarding the degree to which firms will follow through on their downbeat intentions.

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

<table>
<thead>
<tr>
<th>GDP (LHS)</th>
<th>Expected DTA (sa, adv 2 qtrs, RHS)</th>
<th>Past DTA (sa - adv 1 qtr, RHS)</th>
</tr>
</thead>
</table>

Source: ANZ, NZIER, Statistics NZ

**Figure 2: CPI vs pricing intentions**

<table>
<thead>
<tr>
<th>CPI (LHS)</th>
<th>Expected selling price increase (adv 2 qtrs, RHS)</th>
<th>Experienced selling price increase (adv 1 qtr, RHS)</th>
</tr>
</thead>
</table>

Source: ANZ, NZIER, Statistics NZ
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