A CAUTIONARY TALE

THE BOTTOM LINE

- QSBO business confidence took a hit, which was expected, given the signal from our own Business Outlook survey. However, firms still reported reasonable levels of activity to end the year.
- But a little more caution is creeping in as firms deal with a more uncertain policy environment, capacity pressures and an intense margin squeeze.
- We are left with the impression of an economy which, while not performing poorly by any stretch, is set to face a few more headwinds over the first half of 2018.

KEY RESULTS

- Headline business confidence fell from 5 to -11 (sa) in Q4. That is directionally consistent with our own Business Outlook survey, but, as we expected given the survey’s smaller exposure to agriculture, not as weak. Weakness in sentiment was centred around manufacturing, retailing and services businesses. By region, sentiment was most downbeat in the main urban areas and dairy-intensive regions (in part reflecting drier conditions during the survey period).
- Importantly, and despite weaker headline confidence, firms’ experienced domestic trading conditions held up well. They did fall (a net 10% of firms reported an increase in their own activity, versus +13% in Q3), but that is still consistent with a reasonable pace of GDP growth.
- That said, there is a little more caution looking further forward, with a net 18% of firms expecting stronger trading conditions in Q1, down from 26% in the last survey. Manufacturers, retailers and services firms were all less optimistic. In addition, architects’ own office work points to a softening in commercial and government work. With the new Government reprioritising its spending there is uncertainty over the future of some infrastructure projects.
- One factor that may be weighing on future growth expectations is the fact that capacity pressures remain intense. Capacity utilisation popped back up to a historically high 92.8% (from 91.3%). The number of firms reporting capacity as a major limiting factor rose 3pts to 18. In addition, finding labour remains a major problem, with a net 49% and 31% of firms reporting skilled and unskilled labour respectively to be difficult to find. For the former, that is the highest reading since 2005.
- Not only this, but a margin squeeze continues, particularly in the construction sector. While both costs and prices were steady in the December quarter, they are both expected to intensify over the next quarter. Economy-wide, a net 38% of firms expect higher cost pressures in the next three months, the highest since 2011 (building industry: 46% vs. 36% last quarter).
- Firms do intend to pass on these cost increases. While average selling prices were steady over the past three months at +18%, more firms intend to increase prices over the next three (a net 31%, from 24%).
But with profit expectations also deteriorating, there appears to be a degree of resignation regarding how successful firms are likely to actually be in passing on cost increases. A net 6% of firms are pessimistic towards the outlook for profitability, the weakest since 2011.

Unsurprisingly, that is weighing on future investment and hiring intentions, with the latter falling from +19 to +12. The decline was centred on firms outside the manufacturing and building sectors – investment intentions for new buildings and plant & machinery rose, and remain above long-run averages. The easing in hiring intentions corroborates the story evident in job ads, which have levelled off in recent months. Both point to a moderation in employment growth in 2018.

Overall, we are left with the impression of an economy growing at a steady, albeit unspectacular, pace. The margin-squeeze story is also consistent with an economy grappling with late-cycle challenges, and the reduced pricing power many firms are facing at present.
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