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Economics

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QSBO continues to point to economic recovery

The QSBO for Q1 shows a further improvement in most business activity indicators over the past three months, largely echoing the improvement in the NBNZ business survey over approximately the same period. In our view, the QSBO points to an economy that is on course to grow about 3-4% yoy this year – a decent performance but, as widely expected by economic forecasters, more muted that during past recoveries. Notably, both employment and capex intentions are modestly stronger than historic averages suggesting that hiring and investment spending is on the cusp of recovery. Somewhat surprisingly given the perceptions of widespread slack in the economy, the proportion of firms expecting to raise prices over the next 3 months is well above the historic average seen during the low-inflation era, as is surveyed capacity utilization.

On balance, in our view this survey, together with the continued improvement evident in trading partner economies, leaves the RBNZ on track to begin raising the OCR at the June MPS meeting. However, unless domestic activity and inflation data accelerate notably over the next two months, the first move seems more likely to be a 25bp hike than the 50bp hike we had earlier thought probable.

The key details within the latest survey were as follows:

- After adjusting for seasonal effects, a net 36% of firms expect the general business situation to improve over the next 6 months, up 13pp since Q4 and the most optimistic reading since 1999 (see Figure 1).
- After adjusting for seasonal effects a net 20% of firms expect trading activity to strengthen over the next 3 months, the most optimistic reading since Q4 2004 and over time consistent with GDP growth accelerating to around 4% yoy (see Figure 3).
- After adjusting for seasonal effects, a net 7% of firms reported weaker trading activity in the Q1, a 2pp decline since Q4. It is worth noting that this series has tended to understate the level of growth (recall that GDP grew 0.8% qoq in Q4) and that it is usual for reported activity to lag quarter earlier expectations (over the past two decades, respondents have typically been 8pts too optimistic in their forecasts). That said, we do think that GDP growth in Q1 was probably modestly weaker than in Q4.
- Surveyed capacity utilization in the manufacturing and building sectors fell 0.6pts to 90.5% in Q1, partly reversing a surprising 2.7pt rise in Q4. The level of surveyed capacity use remains higher than historic averages.
- A net 1% of manufacturers reported that their inventory levels were 'too high' in Q1, the lowest reading since 1979. This suggests that near-term production will continue to be boosted by inventory restocking, whilst production will also be quick to respond to any increase in demand.

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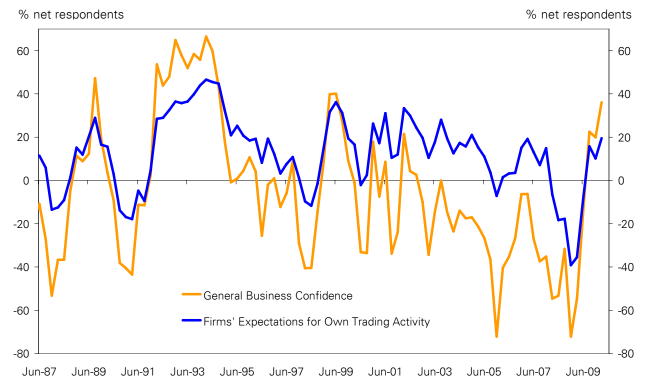
Figure 1: General business confidence and firms' activity expectations improved in Q1 after pausing in Q4



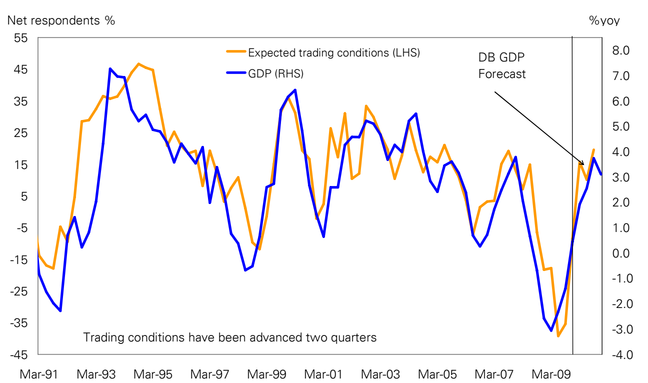
Source: Deutsche Bank,, NZIER

Figure 2: Summary Table

(net respondents %)	Q4	Q1	L-t average
Confidence (Headline)	31	22	-8
Confidence (s.a.)	23	36	-8
Activity (s.a. past 3 mths)	-10	-5	12
Activity (s.a. next 3 mths)	10	20	15
Skill Shortages (Easy Skilled)	13	9	-16
Invest P&M (next 3 mths)	-2	9	-2
Invest Bldings (next 3 mths)	-15	-5	-14
Profitability (next 3 mths)	-2	-2	-7
Employment Intentions	1	2	-2
Pricing Intentions	24	27	16
Cost Expectations	21	25	21
Capacity Util. (%,level)	0.907	0.905	0.8959

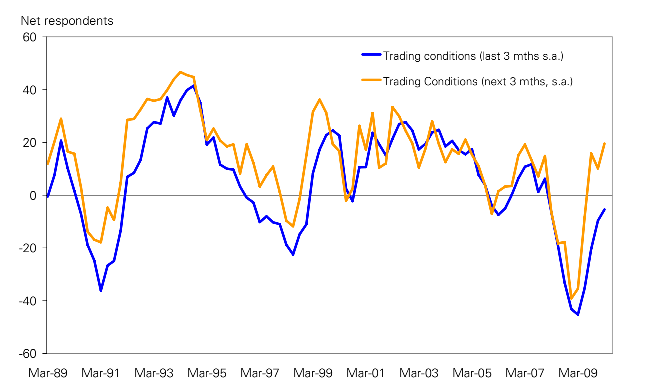
Source: Deutsche Bank, NBNZ

Figure 3: Expected trading conditions consistent with an economy growing at up to a 4% annual pace



Source: Deutsche Bank, NZIER, SNZ

Figure 4: Expected trading conditions and experienced trading conditions

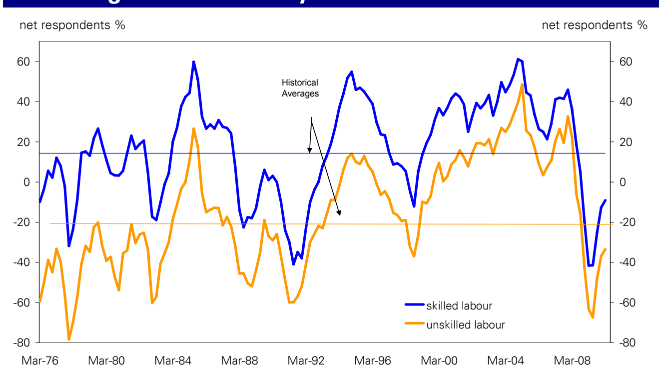


Source: Deutsche Bank, NZIER

- A net 15% of firms said that they reduced employment over the past 3 months, compared with 18% over the prior 3-month period. A net 2% of firms expect to increase employment over the next 3 months, up 1pp from last quarter. This reading is modestly stronger than the average reading for this survey (which, somewhat counter-intuitively, is modestly negative, in contrast to other hiring surveys).
- A net 15% of firms said that they reduced overtime over the past 3 months, a 9pt improvement since Q4. A net 11% of firms expect to reduce overtime over the next 3 months. The latter reading is actually more positive than the average reading for this indicator.
- A net 9% firms recorded reduced difficulty in finding skilled labour in Q1 (compared with a net 13% experiencing reduced difficulty in Q4). A net 6% of firms said a shortage of labour was the biggest constraint on growth, up a little from the last survey. A net 74% of firms cited insufficient sales as the biggest constraint to growth, with just 7% citing financial constraints.
- A net 19% of firms said that they experienced decreased profitability in Q1 (compared with the 15% who had experienced decreased profitability in Q4). A net 2% of firms expect decreased profitability over the next 3 months.

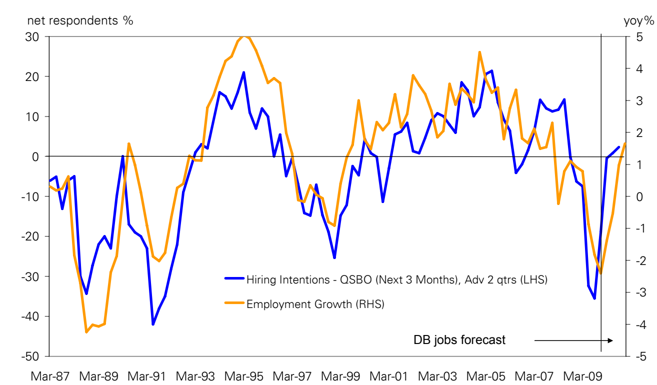
- The building, merchant and manufacturing sectors all reported an increase in debtors in Q1. The large increase occurred within the building industry in what appears to be a regular seasonal pattern.
- A net 9% of firms said that they plant to increase plant and machinery investment over the next 12 months, an improvement on the 2% of firms that had expected to cut investment in Q4. This is the best reading since Q4 2006 and above the historic average for this series. Firms intentions to investment in buildings remained negative, albeit much less so than three months previously (-5% versus -15%).
- Direct measures of inflation pressure continue to firm despite the widespread perception that there is significant slack in the economy. A net 20% of firms reported cost increases over the past three months (compared with 15% in Q4) and a net 25% reported an expectation of cost increases over the next three months (compared with 21% in Q4). The latter is slightly above the average level recorded in the low inflation era. Meanwhile a net 13% of firms reported that they raised prices in Q4 (up from the 4% that had had raised prices in Q4). And a net 27% of firms indicated that they expect to raising prices over the coming 3 months, a 3pt rise since the last survey, almost back to the levels seen in Q3 2008 and 13pts higher than the average reading during the low inflation era.
- Finally, given the focus on housing, we noted that in contrast to recent weakness seen in existing home sales, architects' assessment of the outlook for housing was notably more upbeat than three months ago. In Q1, a net 20% of architects expect an increase in housing work over the next 12 months (previously 20% expected a reduction) whilst a net 30% expect an improvement in work over the next 12-24 months (previously 11%). Architects' assessment of the commercial sector also improved notably with a net 9% expecting work to rise over the next 12 months (previously 27% had expected a reduction) and a net 35% expect an improvement over the next 12-24 months).

Figure 5: Skilled and unskilled labour is gradually becoming a little less easy to find



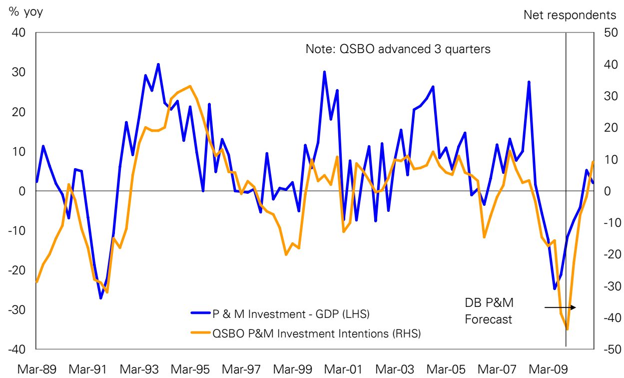
Source: Deutsche Bank, NZIER

Figure 6: Hiring intentions suggest that employment is on the cusp of a modest recovery



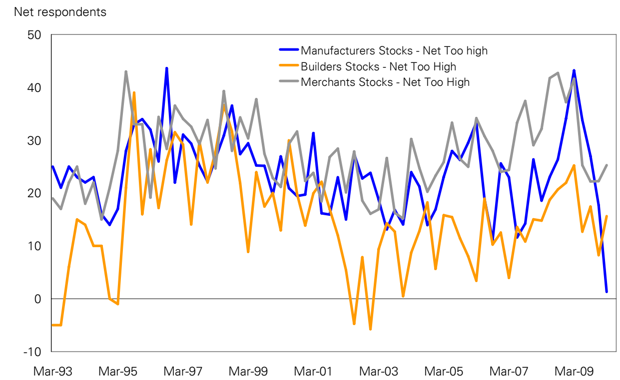
Source: Deutsche Bank, NZIER, SNZ

Figure 7: Capex intentions are improving, suggesting an investment recovery is beginning to get underway



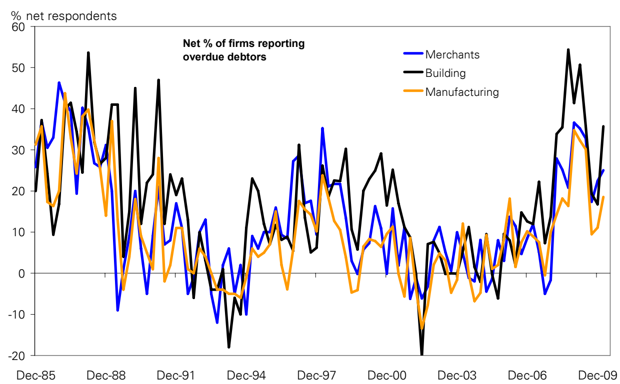
Source: Deutsche Bank, SNZ, NZIER

Figure 8: Fewer manufacturing firms are reporting that their inventory levels are too high



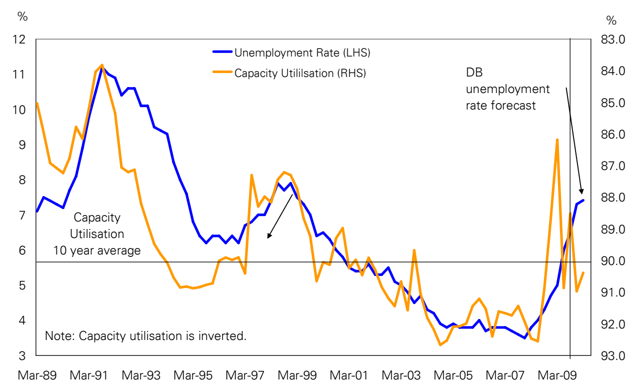
Source: Deutsche Bank, NZIER

Figure 9: Overdue debtors pick up in Q1, especially in the building sector (most of which looks seasonal)



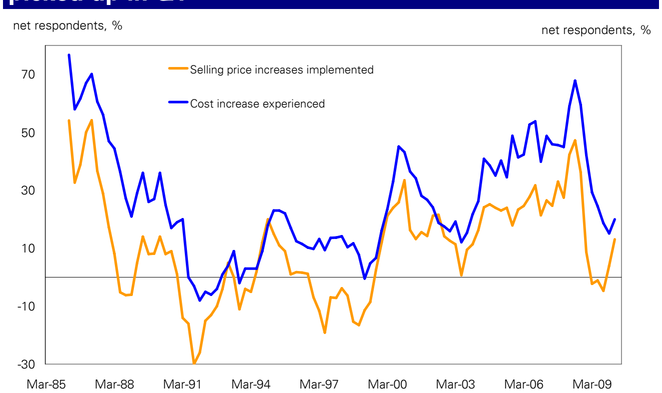
Source: Deutsche Bank, NZIER

Figure 10: Despite the latest Capu reading, we think the economy is operating with spare productive capacity



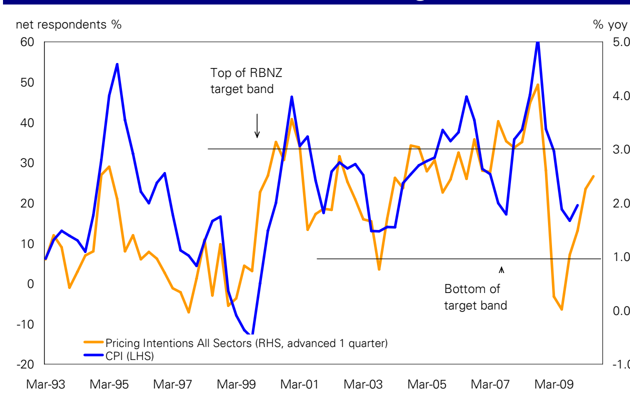
Source: Deutsche Bank, NZIER, SNZ

Figure 11:Cost and selling price pressures seem to have picked up in Q1



Source: Deutsche Bank, NZIER

Figure 12: Selling price expectation suggest that measured CPI inflation is headed higher



Source: Deutsche Bank, NZIER, SNZ

Appendix 1

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