Economic Update

NZIER Q3 Quarterly Survey of Business Opinion

4 October 2011

Domestic activity ambles on

- **Headline business confidence falters in the face of increased uncertainty in global markets.**
- **But own activity indicators point to continued recovery in underlying activity in NZ economy.**
- **Construction cost inflation from the rebuilding in Christchurch will be a key development to watch.**

The NZIER Quarterly Survey of Business Opinion showed a drop in headline business confidence over Q3, reflecting the effects of the heightened uncertainty in global markets. However, businesses' own activity indicators held up reasonably well, with businesses' experienced activity suggesting underlying growth will remain around 0.5% over Q3. This is in line with the recent results seen in monthly business surveys. We expect Q3 GDP growth of 1%, aided by the start of the Rugby World Cup.

It appears the recovery in activity in Canterbury from the declines seen in the wake of the earthquakes is underpinning economic activity. In particular, there are signs of emerging capacity pressures in the building sector in the region as rebuilding activity picks up pace.

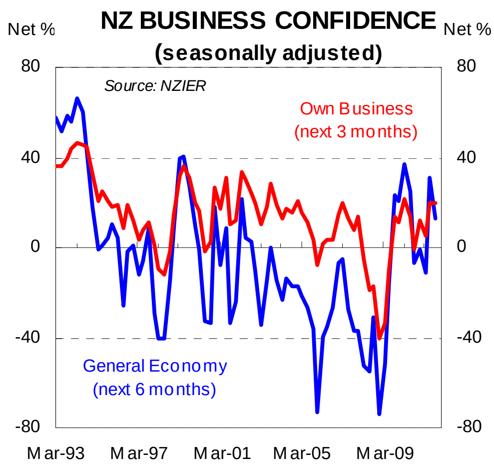
While today's result indicates a continued recovery in underlying activity in the NZ economy, the global financial market volatility continues to dominate the RBNZ's outlook for now. We continue to expect the RBNZ will hold off raising the OCR until March 2012.

Businesses remain optimistic about own trading conditions ahead.

Overview

The NZIER survey asks a cross-section of questions pertaining to activity, profitability and pricing.

While businesses' perceptions of the general business environment have declined, businesses remain optimistic about their own trading conditions ahead. Both measures remain above their long-term averages.



Key growth indicators hold up above long-term averages.

GROWTH INDICATORS	Sep-11	Jun-11	Mar-11	10yr average
Business Confidence (seasonally adjusted)	12.6	30.9	-11.4	-15.8
Own Activity (expected, s.a.)	19.8	19.8	5.4	9.8
Investment Intentions (building)	-6.3	-3.8	-6.6	-9.3
Investment Intentions (plant)	5.8	9.2	-0.2	-0.4
Profitability (past 3 Months)	-14.4	-23.2	-28.1	-16.1
Profitability (next 3 Months)	10.2	-0.9	-22.2	-6.5

LABOUR MARKET INDICATORS	Sep-11	Jun-11	Mar-11	10yr average
Number Employed (Past 3 Months)	-4.3	-5.8	2.5	-0.9
Number Employed (Next 3 Months)	3.6	7.1	0.5	4.1
Labour Shortages (Skilled)	19.7	15.0	9.9	26.1
Labour Shortages (Unskilled)	-7.8	-10.6	-15.2	4.4
Factor Constraints (Labour)	5.9	5.4	4.3	13.2

INFLATION INDICATORS	Sep-11	Jun-11	Mar-11	10yr average
Capacity Utilisation (%)	89.6	88.7	89.4	90.8
Cost Prices (Past 3 Months)	29.7	37.0	38.5	34.6
Cost Prices (Next 3 Months)	28.3	40.1	44.5	34.2
Selling Prices (Past 3 Months)	18.2	16.1	11.2	18.8
Selling Prices (Next 3 Months)	22.4	31.3	14.5	25.2

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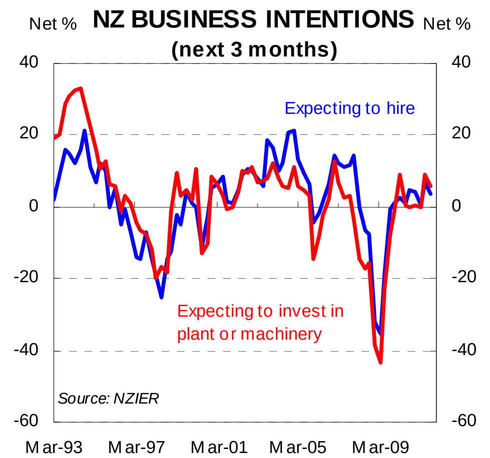
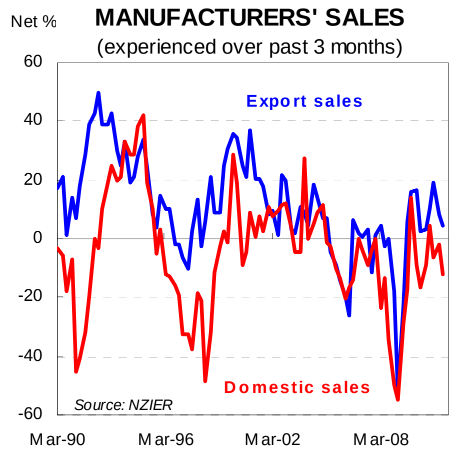
Recovery in Canterbury provides boost to NZ economic activity.

Looking at the regional breakdown, activity indicators in Canterbury were stronger than the rest of NZ, reflecting the continued recovery in activity in the region from the declines seen in the wake of the earthquakes. In particular, it appears rebuilding activity is leading to capacity pressures in the building sector in the region.



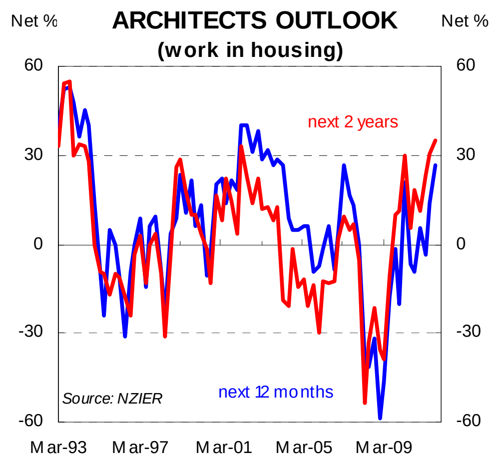
Investment and hiring intentions indicate businesses still looking to expand.

Nationwide, while there has been some easing in investment and hiring intentions, the results indicate businesses still intend to put in place expansion plans. Business intentions for hiring and investment in plant and machinery are still positive and above their long-term averages. This suggests businesses remain confident about an improvement in demand ahead, and points to a continued recovery in employment and business investment over the coming year.



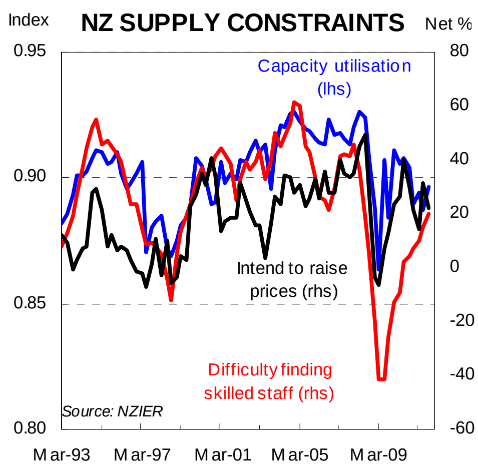
Manufacturing recovery shows signs of slowing.

The survey points to a slowing in manufacturing activity, following some strong results earlier this year. Over the past year, there has been some divergence between domestic and export demand, with export orders holding up against a backdrop of weak domestic demand. This is likely to have reflected the low NZD/AUD and robust growth in the Australian economy, given Australia is a key customer of our manufacturing exports. However, export demand looks to have slowed more recently, and there has been further deterioration in domestic demand.



Architects' outlook improves.

Architects' outlook can often provide useful insight into construction activity over the coming years. Along with the improvement in activity reported in the building sector, there was a broad-based improvement in architects' outlook for both residential and commercial work. This rebound is likely to reflect the substantial amount of rebuilding work that will be required in Christchurch. The latest building consents data have shown an improvement in issuance for both residential and private non-residential consents. This suggests an underlying improvement in construction demand is taking place, which we expect to continue over the coming year.



Inflation indicators suggests breathing space for the RBNZ for now.

Inflation indicators within the survey were mixed, with capacity utilisation continuing to edge higher. This was particularly the case in the building sector. Meanwhile, there was also a tick-up in businesses highlighting capacity as a constraint. This has gained favour with the RBNZ in recent months as a measure of capacity pressures in the NZ economy. Businesses also report emerging skills shortages in light of the improvement in employment demand. However, there was a decline in both cost expectations and pricing intentions. Overall, these results suggest some breathing space on the inflation front for the RBNZ for now, although construction cost inflation will be a key development to keep an eye on.

Implications

Own activity indicators point to continued recovery in underlying activity in NZ economy.

The decline in headline business confidence is understandable in light of the escalation in uncertainty in global markets. The fact that own activity indicators have held up reasonably well is encouraging, and points to a continued recovery in the NZ economy. Much of this reflects the boost from post-earthquake rebuilding in Canterbury, although retailers also anticipate a jump in sales possibly as a result of the Rugby World Cup.

Construction cost inflation will be key development to watch.

While the mixed inflation indicators suggest there is some breathing space for the RBNZ on the inflation front for now, the rise in capacity pressures in the building sector highlight that construction cost inflation will be a key development to watch. We expect rebuilding activity from mid-2012 will underpin an increase in inflation pressures in the NZ economy.

Global uncertainty continues to dominate RBNZ outlook for now.

Today's results add to the recent raft of encouraging domestic data. However, the heightened global financial market volatility dominates the RBNZ's outlook at the moment. We continue to expect that the RBNZ will wait until March 2012 to lift the OCR by 50bp and for the OCR to peak at 4% by end-2012.

Background to the data

The NZIER's Quarterly Survey of Business Opinion (QSBO) is New Zealand's longest running and most comprehensive business confidence survey. The survey samples manufacturers, builders, architects, wholesalers and retailers, and service sector firms regarding both their recent experience and their expectations for the next three to six months. The questions are focussed on general business conditions; output, sales and orders; costs, prices and profits; levels of investment; staffing levels; the difficulty finding skilled and unskilled labour; and constraints on production. The survey is a useful barometer of the current state of the economy. It is also useful in forecasting economic activity in the short-term by providing information on future plans, and the likely direction and composition of economic growth in coming quarters.

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