Businesses Glum – Tony Alexander - July 2018

The main new set of economic data made available to us last week came in the form of the NZIER's long-running Quarterly Survey of Business Opinion. As we all expected, the headline business confidence number declined during the June quarter to a net 20% pessimistic from 11% pessimism in the March quarter and 18% optimism a year ago.

A net 7% of businesses also reported that their trading activity rose during the June quarter which was down from 15% last quarter and 17% a year ago. A net 13% expect higher activity from 16% last quarter and 24% a year ago. The average reading for this important indicator is a net 17% positive. So trading expectations are below average but frankly not as much as could be the case given the downward bias.

As noted in our analysis of the ANZ's monthly release, there is a downward bias to business sentiment when Labour are in power as businesses worry about new regulations, the lack of business sector familiarity of the MPs, the eventual loss of fiscal bowel control, infighting by ideology-driven people, and this time around the fragile nature of the coalition and secret deals not yet revealed to the public. Arrogance and incompetence basically.

This means we have to be careful not to over-extrapolate these results into a dystopic economic outlook. It is best to acknowledge then move on from the headline sentiment reading and look at the underlying indicators. Doing that we get the following.

The labour market is very tight. A net 45% of businesses say it is hard to get skilled labour. The result last quarter was 44% and a year ago 47%. A net 30% say it is hard to get unskilled labour. A quarter ago this was 29% and a year ago 23%.

This tightness could explain why the employment intentions reading is low. Only a net 6% say they plan hiring more people from 6% last quarter and 12% a year ago. This 6% is right on the long-term average therefore in no way suggests a weakening labour market. That is important for things like continued demand for retail goods and services, domestic and outward travel, and housing demand from householders.

Businesses are continuing to indicate that their profits are under extreme pressure – from difficulties managing margins. A net 36% said their costs went up in the June quarter from 31% last quarter and 26% a year ago. The average is 25%.

But only a net 29% plan raising their selling prices from 21% last quarter and 24% a year ago. The average is 21%. So price rise expectations are above average. Are prices actually rising?

A net 25% said they did raise their prices during the June quarter. This is well above the 11% average and suggests that there are some inflationary pressures bubbling underneath which will make our central bank wary of cutting interest rates in the coming year even if the global growth outlook continues to deteriorate.

Nonetheless, despite the price rise pressures, a net 12% of businesses say they expect their margins to compress which is above the 7% average.

Margin management pressures mean even though we see a good outlook for the economy many businesses are going to struggle.
One area of concern is a large fall in investment intentions to only a net 2% positive from 17% last quarter, 20% a year ago, and an average of 8%. Business caution does appear to be causing some rethinking of earlier investment plans. This is concerning because if businesses are to manage rising costs and labour shortages, prepare for change and boost capacity, they need to raise capital spending. We shall wait and see if this hit to investment intentions continues however before concluding that high pessimism is leading businesses to go back into their shells.