

4 April 2017

## Inflation Not All Meat and Vege

- QSBO intimates CPI inflation headed over 2.0%
- Labour market conditions tighten further
- Capacity utilisation hits record high
- Indicators suggest heightened investment activity  
Upward pressure grows on our GDP forecasts

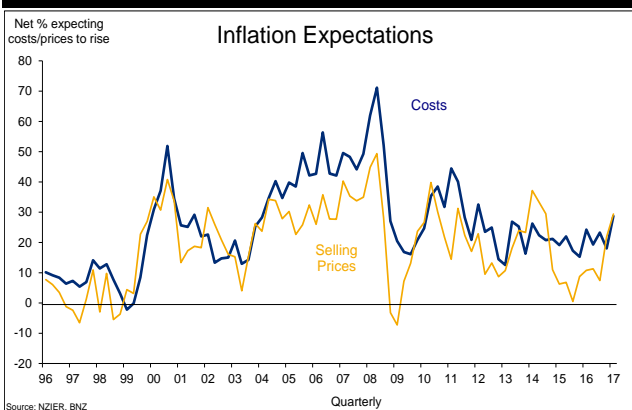
Inflationary pressures continue to mount. That's the main theme in today's NZIER Quarterly Survey of Business Opinion (QSBO). Pricing intentions remain lofty, labour shortages are becoming more severe and capacity utilisation has hit a record. Some commentators reckon rising CPI inflation is all about oil and fresh fruit and veges. The QSBO would tend to suggest that there's a little more to it.

Having said that, one of the truly wondrous aspects of the current expansion is that traditional leading indicators have failed to deliver. The question thus remains, will the "normal" pricing response simply occur with a lag or are there some genuine secular changes at play? We think it's a bit of both but that the cyclical drivers will still be strong enough to push CPI inflation up to the midpoint of its target band and, more importantly, keep it there.

Perhaps the strongest indication that this is likely is the ongoing strength in future selling price expectations. In the March quarter, a net 29% of respondents said that they expected selling prices to rise. That's the highest reading since September 2014 and very much consistent with annual CPI inflation of well over the important 2.0% mark.

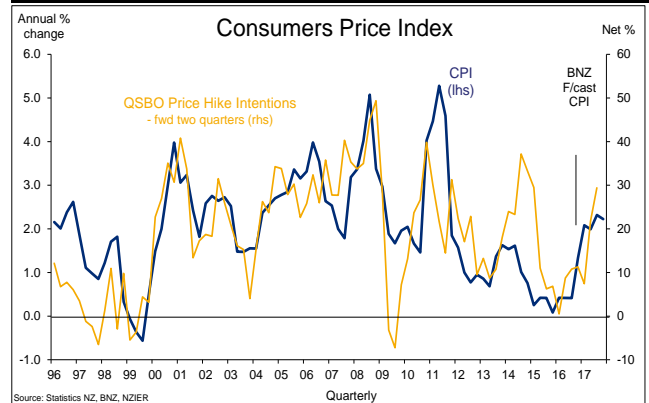
These expectations could reverse rapidly if input cost pressures were to fall but there is no expectation of this at the moment. Moreover, any reduction in input cost pressures by way of reduced labour costs looks highly

### Input Costs Rising

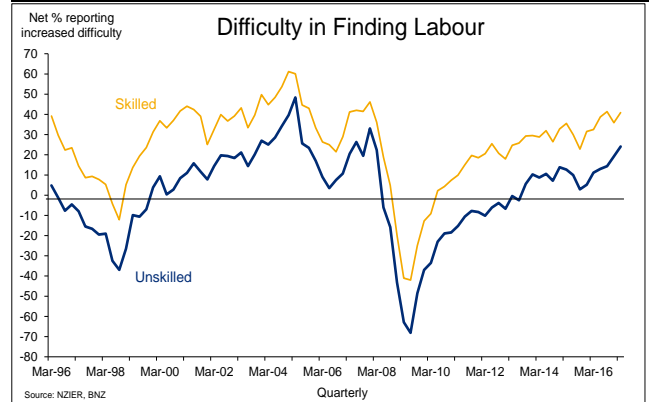


### Inflationary Pressures Rising

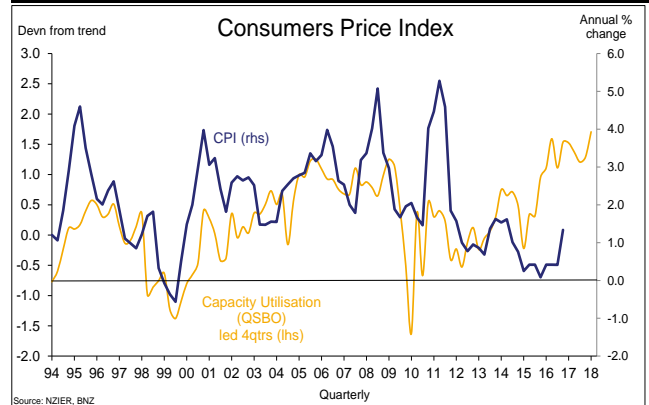
#### Pricing Intentions Elevated



#### Labour Market Tightens Further



#### Capacity Utilisation Soars



unlikely. 15% of businesses report that labour is the most significant impediment to increased sales. This reading is well above its long term average of 10%. Furthermore, reported difficulty in finding labour continues to trend higher. The level of difficulty in finding skilled labour is its most intense since late 2007 and, interestingly, the reported difficulty in finding unskilled labour is not only similarly placed but displaying a sharp upward trend.

It is thus perhaps somewhat surprising that the intention to take on more staff has dipped but one might conclude that it's simply too difficult to find anyone so businesses are starting to look at alternative ways to expand output such as increased capital expenditure.

Certainly investment intentions remain very high. When you combine this with strong profitability, high capacity utilisation, low interest rates, a relatively strong NZD, labour market constraints and, so far at least, minimal financing constraints, it is surprising that investment activity in New Zealand is not much higher than it is. Perhaps the general background of uncertainty is playing a part.

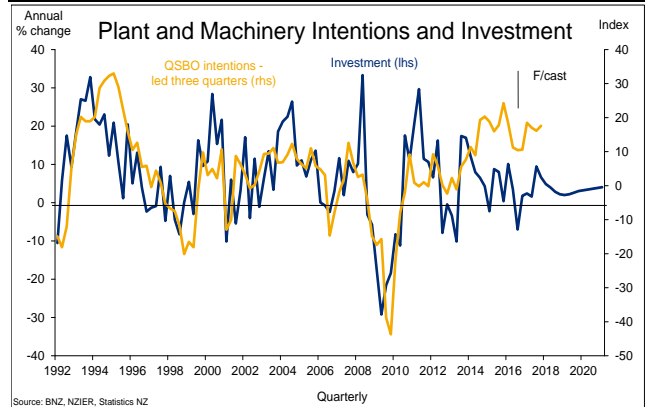
Nonetheless, what the investment intentions indicators do tell us is that we may be underestimating the pace of GDP growth ahead. Indeed, NZIER's trading conditions series says the same. It supports our view that the Q4 GDP outturn was an anomaly but goes further to suggest that the likely bounce-back in economic activity will be greater than we have forecast. It is yet another indicator that suggests an economy-wide growth rate closer to 3.5% than the 2.5% track we are projecting.

In summary then, the QSBO is further evidence that New Zealand's long period of stable expansion has significant room to run longer. But the sting in the tail is that growing inflation pressures are looking increasingly likely to morph into actual inflation and higher interest rates. We continue to stress that the inflationary adjustment should be relatively benign but warn that those in denial of its possible occurrence inevitably risk something of a shock.

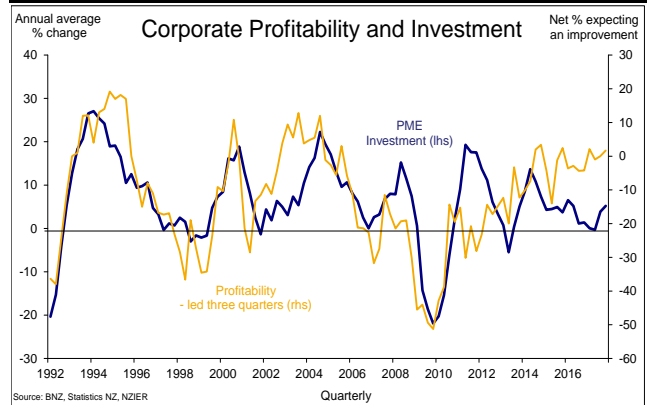
stephen\_toplis@bnz.co.nz

## We May Be Underestimating Growth

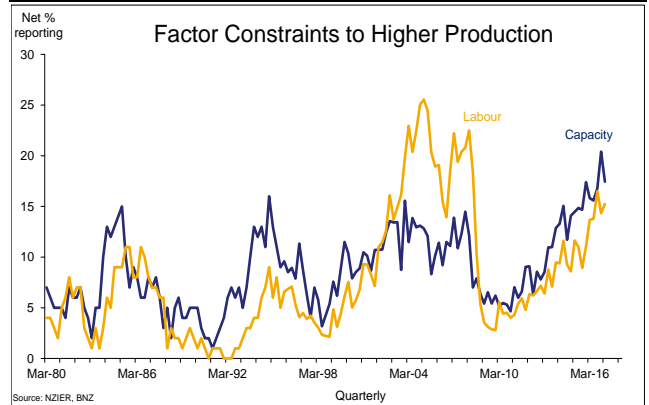
### Investment Intentions Lofty



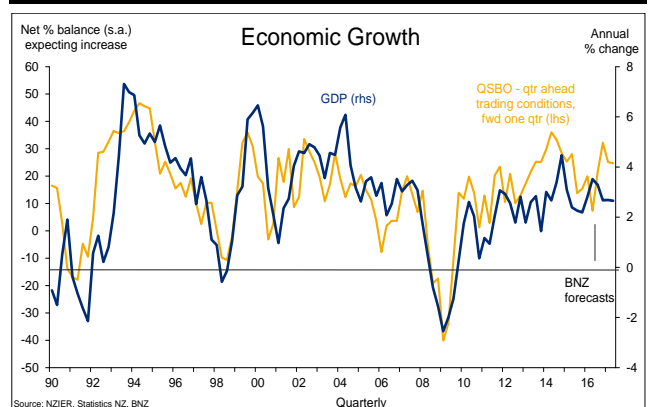
### Profits Solid



### Capacity Constraints Demand Investment



### Business Buoyant



## Contact Details

### BNZ Research

**Stephen Toplis**

Head of Research  
+(64 4) 474 6905

**Craig Ebert**

Senior Economist  
+(64 4) 474 6799

**Doug Steel**

Senior Economist  
+(64 4) 474 6923

**Kymerly Martin**

Senior Market Strategist  
+(64 4) 924 7654

**Jason Wong**

Currency Strategist  
+(64 4) 924 7652

### Main Offices

**Wellington**

60 Waterloo Quay  
Private Bag 39806  
Wellington Mail Centre  
Lower Hutt 5045  
New Zealand  
Phone: +(64 4) 473 3791  
FI: 0800 283 269

**Auckland**

80 Queen Street  
Private Bag 92208  
Auckland 1142  
New Zealand  
Phone: +(64 9) 976 5762  
Toll Free: 0800 081 167

**Christchurch**

111 Cashel Street  
Christchurch 8011  
New Zealand  
Phone: +(64 3) 353 2219  
Toll Free: 0800 854 854

### National Australia Bank

**Peter Jolly**

Global Head of Research  
+(61 2) 9237 1406

**Alan Oster**

Group Chief Economist  
+(61 3) 8634 2927

**Ray Attrill**

Global Co-Head of FX Strategy  
+(61 2) 9237 1848

**Skye Masters**

Head of Interest Rate Strategy  
+(61 2) 9295 1196

**Wellington**

Foreign Exchange +800 642 222  
Fixed Income/Derivatives +800 283 269

**Sydney**

Foreign Exchange +(61 2) 9295 1100  
Fixed Income/Derivatives +(61 2) 9295 1166

**London**

Foreign Exchange +(44 20) 7796 3091  
Fixed Income/Derivatives +(44 20) 7796 4761

**New York**

Foreign Exchange +1 212 916 9631  
Fixed Income/Derivatives +1 212 916 9677

**Hong Kong**

Foreign Exchange +(85 2) 2526 5891  
Fixed Income/Derivatives +(85 2) 2526 5891

**ANALYST DISCLAIMER:** The person or persons named as the author(s) of this report hereby certify that the views expressed in the research report accurately reflect their personal views about the subject securities and issuers and other subject matters discussed. No part of their compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in the research report. Research analysts responsible for this report receive compensation based upon, among other factors, the overall profitability of the Markets Division of National Australia Bank Limited, a member of the National Australia Bank Group ("NAB"). The views of the author(s) do not necessarily reflect the views of NAB and are subject to change without notice. NAB may receive fees for banking services provided to an issuer of securities mentioned in this report. NAB, its affiliates and their respective officers, and employees, including persons involved in the preparation or issuance of this report (subject to the policies of NAB), may also from time to time maintain a long or short position in, or purchase or sell a position in, hold or act as advisors, brokers or commercial bankers in relation to the securities (or related securities and financial instruments), of companies mentioned in this report. NAB or its affiliates may engage in these transactions in a manner that is inconsistent with or contrary to any recommendations made in this report.

**NEW ZEALAND DISCLAIMER:** This publication has been provided for general information only. Although every effort has been made to ensure this publication is accurate the contents should not be relied upon or used as a basis for entering into any products described in this publication. Bank of New Zealand strongly recommends readers seek independent legal/financial advice prior to acting in relation to any of the matters discussed in this publication. Neither Bank of New Zealand nor any person involved in this publication accepts any liability for any loss or damage whatsoever may directly or indirectly result from any advice, opinion, information, representation or omission, whether negligent or otherwise, contained in this publication.

**US DISCLAIMER:** If this document is distributed in the United States, such distribution is by nabSecurities, LLC. This document is not intended as an offer or solicitation for the purchase or sale of any securities, financial instrument or product or to provide financial services. It is not the intention of nabSecurities to create legal relations on the basis of information provided herein.

**National Australia Bank Limited is not a registered bank in New Zealand.**