31 May 2017

The Politics of a Buoyant Business Sector

- May's business survey another strong one
- With inflation firming up squarely
- All pre the Budget's announced stimulus
- But beware election nerves creeping in hence
- RBNZ FSR telling of low-rate context

If New Zealand's business sector is getting nervous about September's general election, there was little sign of it in today's ANZ business survey. Yes, net confidence – even with its 5 point increase in May, to +15 – is barely different to average, having been well above trend late last year. However, most every indicator regarding activity wriggled up, to a level further above trend. And the survey's inflation gauges were now pointing to inflation of 2%, at least.

Own-activity expectations were roughly unchanged at around +38. But when we seasonally adjust the series we judge a move to +37, from +34 (while for net confidence we get +12, compared to +5 in April). This gives a sense of underlying improvement, if anything.

Also bear in mind that this ANZ business survey result is pre the 25 May Budget. Granted, much of the Budget policy was "leaked" well in advance. Nonetheless, it confirmed a good dose of stimulus on official release day. And, yes, its centrepiece, the Family Income Package, is not scheduled until April 2018, and is obviously for the household sector rather than the business sector directly. Nonetheless, the business sector will no doubt see the benefits.

Yet there is also the broader issue of what government policy we will see, in fact, over the next few years. Whether or not the 2017 Budget policies are brought into effect depends on the outcome of September's election. As we approach this, it will pay to keep an eye on economic sentiment, whether business or consumer. For now, however, this is full of aplomb.

Exports in today's business survey rebounded to a strong level (+31), which coincided with further recovery in the agriculture sector's survey readings this month. Activity expectations of those in the residential construction sector shot back up to +45, from "just" +33 in April, while commercial's outlook remained robust at +37. This gives us confidence that the correction we saw in building consents late last year, and a potentially weak result for March quarter building activity, will prove statistical rather than the start of any down-trend.

Interestingly, construction sector respondents were now the laggards with respect to confidence (with a big fat zero), although were still well at the forefront when it came to activity and, especially, pricing. Indeed, the industry's pricing intentions, at +60, were the strongest on record. Then again, the Reserve Bank would seem to need strong inflation in the construction and housing markets, to help sustain the 2% rate of annual CPI inflation that it seems unconvinced will last.

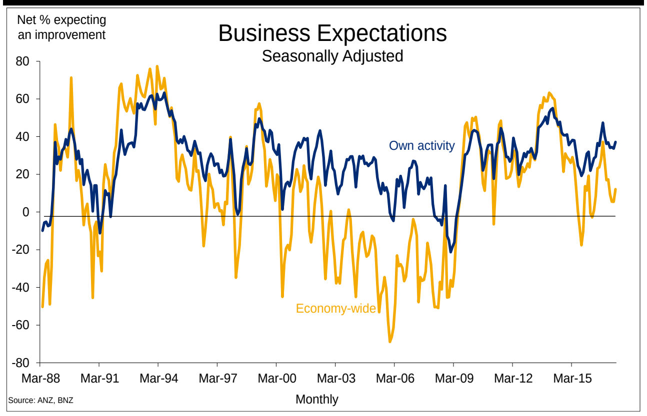
ANZ Bank Business Outlook

Net balance - next 12 months (All sectors)	May	April	Change	Average
General business outlook	**14.9**	**11.0**	3.9	10.9
Own business	**38.3**	**37.7**	0.6	27.4
Profits	**27.7**	**25.8**	1.9	9.8
Employment	**23.6**	**21.5**	2.1	8.2
Investment	**23.5**	**23.5**	0.0	13.9
Pricing intentions	**30.2**	**29.2**	1.0	20.9
Inflation expectations	**2.00**	**1.83**	0.17	2.64
Exports	**31.3**	**24.2**	7.1	30.5
(Own activity outlook)				
Retail	**21.8**	**28.9**	-7.1	25.3
Manufacturing	**37.5**	**31.4**	6.1	29.4
Agriculture	**33.3**	**34.8**	-1.5	22.8
Construction	**44.0**	**38.7**	5.3	18.8
Services	**44.3**	**43.4**	0.9	30.6

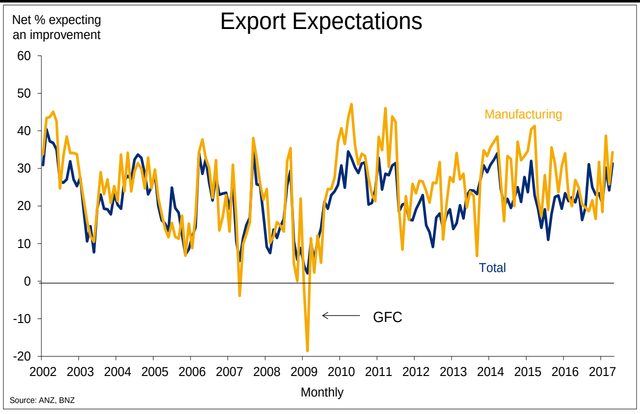
Yet respondents to today's ANZ survey appear more convinced that inflation will keep running around the mid-point of the 1.0 to 3.0% target band. To wit, general inflation expectations lifted to the magical 2.00% level, having paused at 1.8% last month. Last year they got down to 1.4%, as the early crash in global commodity prices was crimping headline CPI inflation.

Own pricing intentions, meanwhile, continue to suggest annual CPI inflation will move clearly above 2% this year. They edged up to +30, from +29 in April. Their average across industries, excluding agriculture, hit +35. Construction was playing a role in this, but was not the

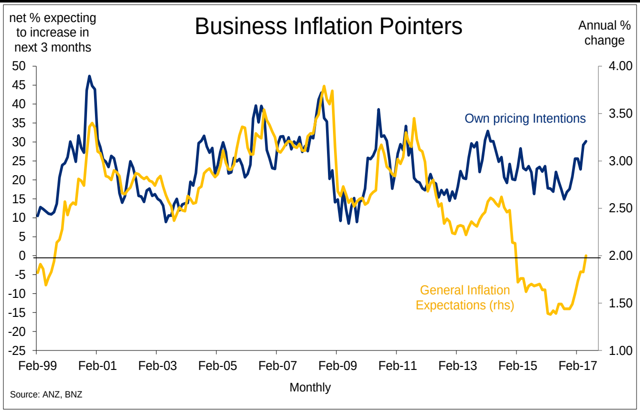
Robust



Solid, Like the Global Economy



Heading Above 2%?



only inflation pulse in town. A net 30% of service firms intended raising selling prices. It was a similar story for retailers, with 31%. These are at odds with the Reserve Bank forecasts that annual CPI inflation will moderate to 1.1% in the year to March 2018.

But, as we've argued all along, central banks need to consider more than just the annual rate of CPI inflation when setting their policy rates. Ultimately, it needs to have regard to the medium-term health of the economy, and financial system. This morning's RBNZ Financial Stability Report was a timely reminder in this regard. It surely highlighted the way interest rate policy (and signaling thereof) can have a strong bearing on such things as asset prices, debt accumulation and thus, ultimately, financial stability.

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