

Easing Talk Premature As Confidence Slumps

- **Rising cost and capacity constraints**
- **So reduced profitability slams business expectations**
- **But not yet inflation**
- **Easing talk premature**
- **Dismiss business surveys at your peril**

Business nervousness about the prospects for the New Zealand economy continues to grow. This is hardly surprising given the numerous headwinds currently facing the economy. Amongst other things these include: capacity constraints (especially in the labour market); rising input costs (wages, rents and fuel amongst them); heightened regulatory uncertainty; the prospect of a more difficult external trading environment; increasing on-line competition (for retailers) and the increasingly worrying impact on the broader economy (beef and dairy in particular) of Mycoplasma Bovis.

Consequently, a number of the indicators in today's ANZ Survey have slipped to levels not seen since the global financial crisis. Indicators such as: business confidence; the own-activity measure; expected profits; and the pace of increase in capacity utilisation are all at near ten year lows.

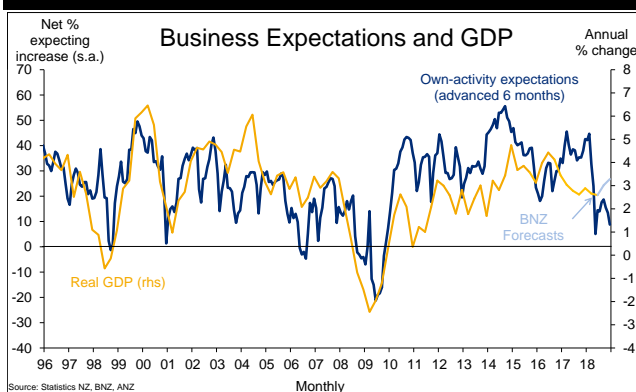
Unsurprisingly, this has got a number of folk talking about the prospect of near-term rate cuts in New Zealand, particularly with annual CPI inflation lying just above the bottom of the RBNZ's target range. Unsurprisingly it may be, but we still think that such talk is premature.

ANZ Bank Business Outlook				
Net balance - next 12 months				
(All sectors)	June	May	Change	Average
General business outlook	-39.0	-27.2	-11.8	9.9
Own business	9.4	13.6	-4.2	27.5
Profits	-13.2	-8.5	-4.7	10.0
Employment	1.2	6.9	-5.7	8.6
Investment	3.6	3.2	0.4	14.0
Pricing intentions	26.9	26.3	0.6	21.2
Inflation expectations	2.29	2.13	0.16	2.6
Exports	12.2	13.2	-1.0	30.2
(Own activity outlook)				
Retail	5.7	3.6	2.1	25.0
Manufacturing	15.6	17.7	-2.1	29.3
Agriculture	10.0	14.0	-4.0	23.0
Construction	13.0	3.8	9.2	19.6
Services	8.4	15.5	-7.1	30.6

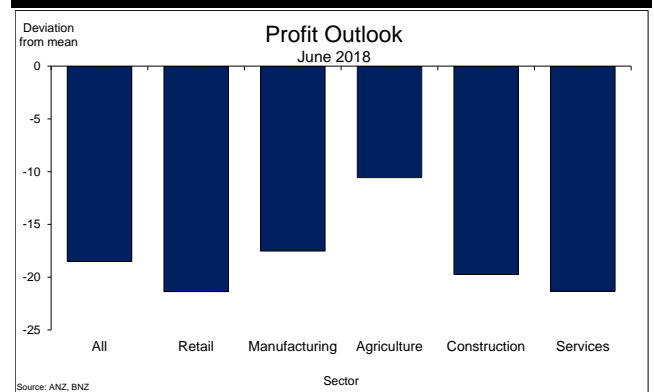
The first, and main, point to note is that annual CPI inflation is set to rise. Indeed, we believe CPI inflation will be back at its mid-point within six months. Moreover, it's likely to stay there for some time. One could argue that this will not necessitate a rate increase but, equally, it argues aggressively against a rate cut – particularly if the unemployment rate stays below the NAIUR, as is forecast.

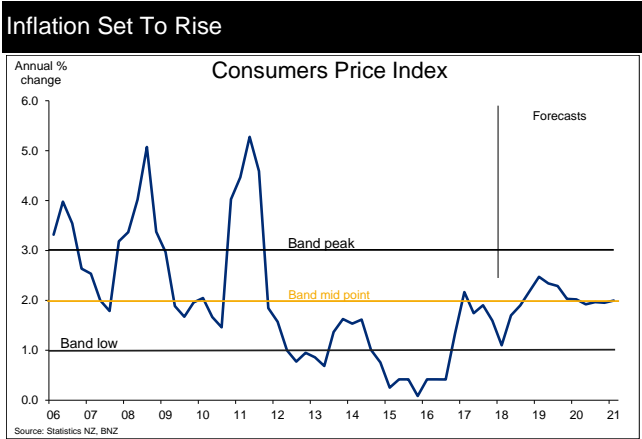
Interestingly, today's survey supports the view of inflation headed higher. Inflation expectations lifted to 2.29% from 2.13% and are clearly trending upward. A net 26.9% of respondents also intend raising selling prices. This too is consistent with inflation headed back to its target mid-point.

Business Hopes Slump

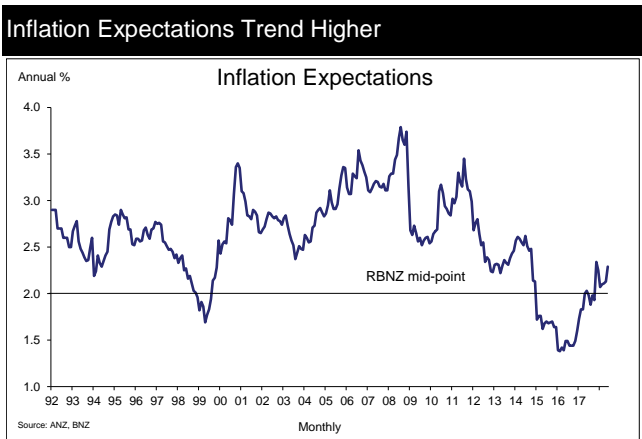


Profits Squeezed





Secondly, we believe the dip in own-activity expectations is overstating the likely fall in economic growth. At face value businesses expectations for their own growth are consistent with GDP growth slumping to an annual 1.5% within six months. This simply can't happen. In fact we think growth is more likely to accelerate than decelerate from here. And while businesses are very aware of the negatives that are out there, they probably haven't thought enough about the positive momentum that will stem from the upcoming fiscal stimulus.



Accordingly, we don't see sufficient reason in the survey to change our view that the RBNZ will end up raising interest rates in the middle of next year. Our formal published view is for a May hike but we are ambivalent between May and August.

That said, while we are cautious of not over-reacting to the weakness in business confidence, we do believe there are very strong warning signals contained in this and other surveys. Regulatory change was clearly highlighted by survey respondents as something that was adversely impacting activity. And it doesn't matter whether uncertainty about a new government is justified or not, what we do know is that uncertainty causes deferred investment and that means lower actual and potential economic growth. We are also concerned that hiring intentions have dipped so aggressively. Is this a sign of rising wage costs, a paucity of labour or simply a decision that sales growth is limited? Whatever the truth, if employment growth slumps, as intimated by this survey, then economic activity will be adversely affected too.

As noted above, we are not changing our view of the world based on this survey but, for the record, we are strong believers in the value of the information that such surveys provide. This survey, our own BNZ-Business New Zealand PMI and PSI, and NZIER's Quarterly Survey of Business Opinion are all key to our understanding of the current and prospective state of the economy. With this in mind, further deterioration in business hopes or, in fact, simply the failure of confidence bouncing, would likely lead to an eventual downgrade in our economic forecasts. Whether it does the same for our inflation view is very much open to conjecture.

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