

31 July 2018



## Still Not Happy

- **Businesses still very unhappy**
- **On policy uncertainty and rising costs**
- **Profit pressure influencing employment and investment decisions**
- **And intentions to lift prices**
- **What's a central bank to do?**

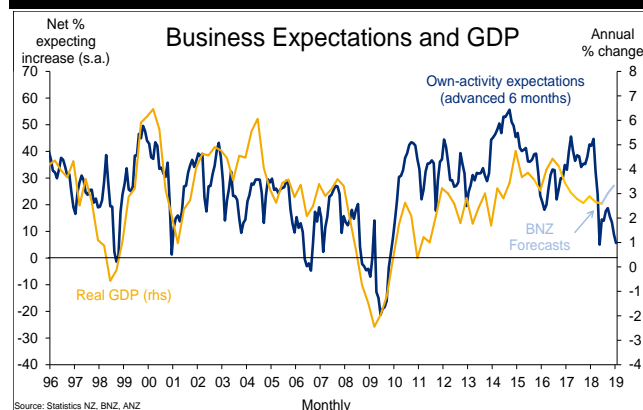
Corporate New Zealand is in a funk. Whether it is uncertainty around government policy, concern around global trade tensions, or ongoing angst regarding the disease Mycoplasma bovis, businesses are not happy. Indeed, they are very unhappy according to this afternoon's ANZ business survey.

Business confidence fell to a net -44.9 in July, even weaker than the -39.0 it slumped to in June. Sure the monthly drop is essentially seasonal, but that misses the point. It is a long way south of long term average levels of around +10. In fact, business confidence is at levels that were last seen around the time of the Global Financial Crisis ten years ago. While business confidence can be fickle, flung around but all manner of things, it is not a good look.

Two major themes we have long been discussing have become more entrenched. Namely, growth indicators continue to ebb while inflation pressure builds. It is difficult to disentangle the two given general signs of capacity pressures within the economy. Is it cost pressures from the likes of a lift in the minimum wage and higher oil prices that is slowing growth or is slowing growth going to dampen future inflation? How these dynamics play out over the medium term will be important for what the RBNZ ultimately does with interest rates. In the near term no change is likely.

Put another way, it is not immediately clear that the slowdown in activity indicators is necessarily associated with a major slowing in demand, although demand may well be in part. What we know for sure is that business margin pressure has intensified. Firms' profit expectations have fallen further, to -16.8, despite a lift in firms' intentions to lift selling prices. This strongly suggests costs are rising and certainly backs up an abundance of anecdotes that we have been hearing from our own discussions with business that costs are becoming problematic. Firms are responding to rising costs by

### Growth Downside Potential

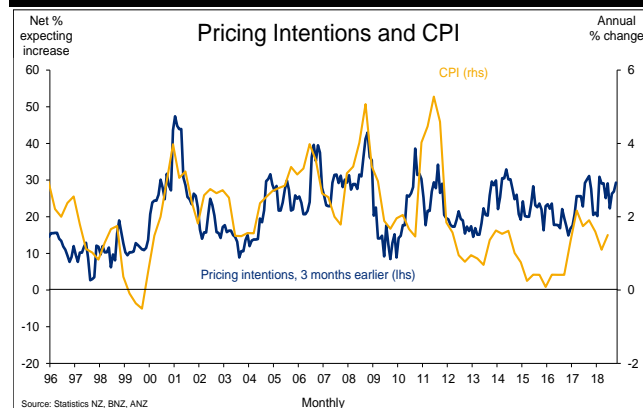


a) curbing enthusiasm for expansion and b) looking to lift selling prices.

Disconcertingly, there were more signs in today's survey that pressure on profits is influencing employment and investment decisions. Employment intentions remaining weak and investment intentions have eased further. It squares with firms' own activity expectations easing to 3.8, from 9.4.

This presents downside risks to growth ahead. While we remain comfortable with our view that Q2 GDP will improve from a softer Q1, ongoing weakness in activity indicators is calling into question the idea of a growth pickup in the second half of 2018. That view contained a material fiscal stimulus mostly kicking in from July. Maybe

### Inflation Upside Potential



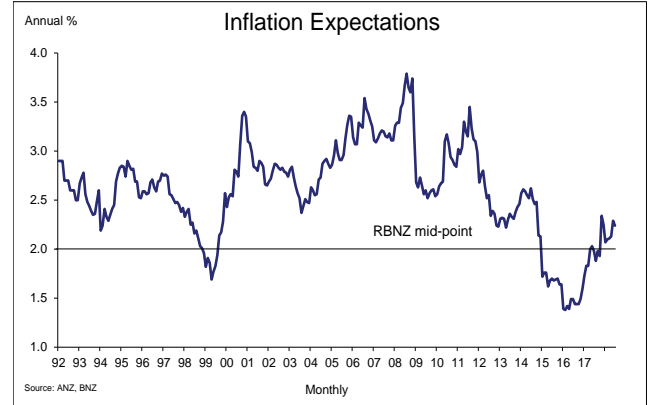
it is just too early for it to show up in the indicators yet. But perhaps the benefits have been swallowed by the likes of higher fuel prices such that any boost will be offset and is netting close to zero. Whatever the case, the lack of bounce in both business and consumer confidence in July is a worry for those looking for a growth pick up later this year.

At the same time, inflation pressure continues to brew as firms attempt to maintain margins by lifting prices. Pricing intentions have edged up further to 29.3, from 26.9 in June. This supports the idea that annual CPI inflation will continue to push higher over coming quarters. That said, inflation expectations did ease back a touch, but largely held last month's gain. Inflation expectations still look to be on a rising trend.

A mix of slower growth and rising inflation is a tricky path for the RBNZ to navigate, especially with the new policy targets agreement explicitly containing both real (employment) and price objectives. We may well see a

similar dynamic in tomorrow's Q2 labour market reports with somewhat slower employment growth but rising wage inflation. What is a central bank to do? Answer: nothing in the first instance.

Rising Trend?



doug\_steel@bnz.co.nz

## 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

**Jason Wong**

Senior Markets Strategist  
+64 4 924 7652

**Nick Smyth**

Interest Rates Strategist  
+64 4 924 7653

### Main Offices

**Wellington**

Level 4, Spark Central  
42-52 Willis Street  
Private Bag 39806  
Wellington Mail Centre  
Lower Hutt 5045  
New Zealand  
Toll Free: 0800 283 269

**Auckland**

80 Queen Street  
Private Bag 92208  
Auckland 1142  
New Zealand  
Toll Free: 0800 283 269

**Christchurch**

111 Cashel Street  
Christchurch 8011  
New Zealand  
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**

Head of FX Strategy  
+61 2 9237 1848

**Skye Masters**

Head of Fixed Income Research  
+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

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