BNZ Lowers Forecast OCR Track

- ANZ business opinion solidly miserable
- Downside risks to growth will probably sway the RBNZ
- Inflation indicators benign
- And evidence capacity constraints may soon ease
- Rate cuts now forecast August and November

For us, today’s ANZ business opinion survey was the straw that broke the camel’s back. It joins a long list of leading indicators that suggest growth in New Zealand is likely to slump to levels well below that which the Reserve Bank is expecting. This survey, our own PMI and PSI surveys and NZIER’s QSBO all portend sub 2.0% growth. While we do not expect forecasters to necessarily adopt such a pessimistic stance, they will have to acknowledge the risk that this might eventually be the case. Most importantly, the RBNZ has already cut interest rates because of the risk of a slowdown. We think it will do so again next week and we now concede that an August cut is unlikely to be the last. Accordingly, we are now formally forecasting a further 25 basis point reduction at the Bank’s November meeting taking the cash rate down to 1.0%.

In making this adjustment we think our forecasts better represent our central view. There’s still a chance the November reduction does not happen but there is probably a near equal chance that November is not the last.

We should point out that, at the headline level, confidence and own activity expectations were no worse than last month’s readings but the level of sentiment has now been entrenched at current levels for around twelve months and shows no sign of a pick up. With global uncertainty still elevated, ongoing frustration in the construction sector, rising environmental cost impacts on the agriculture sector, ongoing capacity issues, the cost of eradicating mycoplasma bovis, rising input costs and an inability to pass on price increases this may yet be the order of the day for some time to come.

Consequently, even the areas that have caused us to question any further rate cuts are starting to show signs of weakness. For example, employment intentions in today’s survey intimate that employment growth may fall sufficiently to result in the unemployment rate ticking higher. This concern has recently been reinforced by a drop in job ads and an uptick in unemployment benefit claims.

And while capacity utilisation is a well-known problem today’s return shows that the increase in capacity utilisation has fallen away to nothing. Indeed this is the
Capacity constraints about to ease?

The apparent alleviation in capacity issues is also consistent with pricing indicators remaining benign. Pricing intentions have been softening and inflation expectations have dropped to just 1.81%. They are not as low as the trough reached in 2016, which spooked the Reserve Bank back then, but both in level and direction they will be starting to raise a few eyebrows.

Of particular concern to us is the ongoing slump in construction sector sentiment. Relative to averages, construction is the most pessimistic sector by quite a way. It’s sentiment level is also back at near GFC readings. We continue to believe this reflects a combination of frustration at the inability to turn activity into profitability (as evidenced by slumping profit expectations) and capacity bottlenecks rather than an indication of loss of momentum but, either way, this level of pessimism is negative for the economy.

The softest capacity-shift reading since the GFC and one of the weakest on record.

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Inflation expectations nervously low

Putting all this together, we thus reiterate that, if the RBNZ keeps to script and business conditions do not bounce any time soon then the downside risks to growth will ultimately force the RBNZ’s hand. We remain unconvinced that rate reductions will have the desired impact but, unless the RBNZ reaches that same conclusion the possibility of a protracted slide in rates is now very real.

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