Pressure For Negative Rates Gains Momentum

- QSBO portends 1.0% GDP growth
- Weakening profitability and heightened uncertainty slam investment activity
- Pricing power continues to weaken
- Signs that demand is under pressure
- Two rate cuts by February looks a near done deal

The chances of New Zealand ending up with negative interest rates took a big step up today with the release of NZIER’s Quarterly Survey of Business Opinion. Given the rhetoric in the August MPS, we made the point that it was now a matter of looking for reasons why the RBNZ wouldn’t cut its cash rate rather than seeking reasons why it might do so. Today’s findings not only provide no reason for the RBNZ to pause but, instead, imply accelerated action.

The basic premise of the RBNZ’s prognosis for the economy is that the combination of the rate cuts that we have already seen and the fiscal easing that is occurring will result in economic growth bouncing back towards potential (a number approaching 3.0%) relatively quickly. In so doing this will see CPI inflation head back to 2.0% and the unemployment rate sit near full employment.

We have argued that this was unlikely to be the case. Inflation may tick up but growth will remain below potential for some time. In particular, we have been highlighting that business confidence would have to push significantly higher, and quite soon, for this to be the case. Neither yesterday’s ANZ survey nor today’s NZIER QSBO offering say anything of the sort. In fact they both suggest growth is more likely to hit 1.0% before it hits 3.0%.

One of the main reasons we think that activity will fail to materialise in the manner both Treasury and the RBNZ have assumed is that investment will remain constrained. This is not because interest rates are too high but because profitability is under downward pressure and significant uncertainty is undermining the willingness to invest. This was highlighted again in today’s survey with business plant and machinery investment intentions (at -3.0%) falling to their lowest level since 2009. Even the normally resilient intention to invest in buildings took a sharp turn for the worse.

Again the impact on profitability from rising costs was strongly apparent. A net 33% of businesses reported that their costs were rising but a net 1.0% said selling prices had declined. Not surprisingly, this meant a net 30% of businesses reported declining profitability – the lowest reading since 2010.

Of course the weakness in selling prices portends lower inflation expectations and, potentially, in turn, lower CPI inflation. This scenario echoes what we saw in yesterday’s ANZ survey. There was a chance that the ANZ survey was providing an overly negative picture given its weighting towards the agriculture sector. This is clearly not the case with the NZIER survey missing most of the agriculture sector entirely.

Worryingly, we are now seeing genuine signs that weakening demand is impacting businesses alongside capacity constraints. 55% of businesses said a lack of demand was the single biggest constraint preventing them from increasing output. While this is still a relatively low...
No pricing power

result, and miles below the 80%-type rates normally associated with a recession, the reading is still well above the 42% recorded three quarters ago and is the highest since Q3, 2015.

Moreover, there is clear evidence of labour retrenchment as businesses endeavour to cut costs. A net 10% of businesses reported lowering staff numbers. It was the second consecutive quarter of decline. That said, intentions to hire are nowhere near as soggy and, potentially, still sufficient to keep the unemployment rate where it is.

Interestingly, markets didn’t move much on today’s release. We remain of the view that cutting interest rates further will do little to deter the angst building up in both the household and business sectors and perhaps markets see this too. Or, alternatively, they see the argument for the central bank pausing at some stage to see whether the stimulus provided will gain traction? Or they are taking the bet that there is now upside risk to the global environment as well as downside.

Nonetheless, they are still pricing almost two cuts. For us, though, we’d have the balance of risk weighted to more than two cuts. If we are to take the RBNZ’s recent commentary at face value, then we can only conclude that the 50 basis points of cuts we have penciled in (25 bps in November and 25bps in February) is a bare minimum. In fact, unless confidence bounces soon it will take only a relatively small shock to tip growth projections very close to recessionary levels and, in so doing, put significant pressure on the RBNZ to see red on the interest rate front.

Profitability in decline

Lack of demand a growing symptom

% reporting Sales As Major Factor Constraint

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