31 August 2017

Growth Stronger, Inflation Weaker

- **NZ activity indicators portend strong growth**
- **Pushing profits higher**
- **Encouraging employment and investment**
- **Chewing into capacity, but not creating inflation**
- **And aiding the NZD lower**

We've said it time and time before, and we're forced to say it yet again. We are in a rather unusual environment where growth continues to escalate, capacity is being fully utilised, businesses are investing and hiring, and yet inflation remains an abstract concept. This, again, was the message from today's ANZ Survey of Business Opinion.

At the headline level, both business confidence about the wider economy and its own-activity outlook diminished. But this is purely a seasonal phenomenon with optimism usually hitting its depths as winter does likewise. What proved surprising wasn't that the confidence measures drifted lower but that they didn't fall by more. Indeed, with rising uncertainty around the upcoming election, the possibility of a large decline loomed large. But when adjusted for seasonality, optimism actually rose - so much so that own-activity expectations climbed back to the highest level seen over the last twelve months and back to the heady levels previously observed back in late 2014.

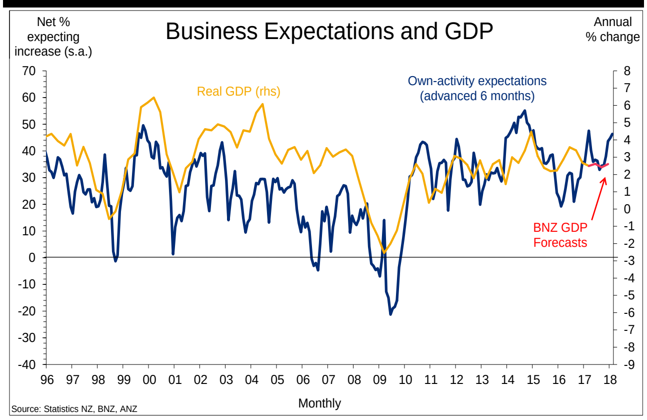
Own-activity confidence has pushed to a level which is consistent with GDP growth approaching 4.5%. This is miles above what we are forecasting and even higher than the more optimistic forecasts produced by both the central bank and New Zealand Treasury. Importantly, confidence is strong across all sectors. When compared with historical norms, agriculture leads the pack no doubt buoyed by the resurgence in dairy prices. Retail is least optimistic which is no surprise given that the windfall gains of the Lions tour are now history and competitive pressures remain intense.

ANZ Bank Business Outlook				
Net balance - next 12 months				
(All sectors)	**August**	**July**	Change	Average
General business outlook	**18.3**	**19.4**	-1.1	11.1
Own business	**38.2**	**40.3**	-2.1	27.8
Profits	**29.3**	**24.9**	4.4	10.4
Employment	**17.1**	**25.7**	-8.6	8.7
Investment	**22.8**	**23.0**	-0.2	14.2
Pricing intentions	**20.5**	**27.6**	-7.1	21.1
Inflation expectations	**1.88**	**1.98**	-0.10	2.61
Exports	**26.8**	**32.7**	-5.9	30.4
(Own activity outlook)				
Retail	**28.3**	**31.7**	-3.4	25.4
Manufacturing	**38.0**	**44.0**	-6.0	29.6
Agriculture	**40.0**	**48.4**	-8.4	23.2
Construction	**30.8**	**31.8**	-1.0	19.6
Services	**39.3**	**44.0**	-4.7	30.9

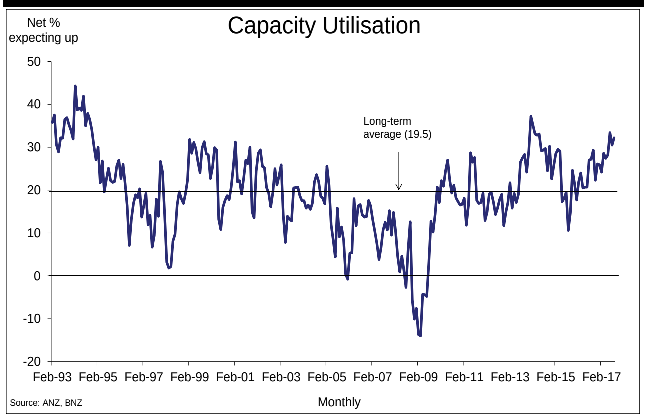
The good news is that activity expectations are also feeding into strong optimism about future earnings with all sectors anticipating profit growth. This is a big plus for corporate New Zealand and potentially helps justify the current strength in New Zealand equities.

All this growth continues to impose capacity pressures with the expected increase in capacity utilisation continuing to trend higher. Given increased growth, solid profitability and rising capacity utilisation, it should be no surprise to learn that businesses continue to intend taking on more staff and to invest more. Notwithstanding this, there was a sharp drop in employment expectations. There is some evidence to suggest this is predominantly seasonal in nature but we will keep an eye on it, nonetheless. And, anyway, the series is still strong enough to suggest upside risks to our employment forecasts and further declines in the unemployment rate.

Confidence portends strong growth



Capacity pressures rising



What the strength in activity is not doing is converting into higher prices. Pricing intentions actually dropped to +20.5 from +27.6 a month earlier. Moreover, the total is being held up by heightened expectations for future agriculture prices. Pricing intentions for both retail and manufacturing have fallen to levels well below their norms. Retail's weakness, in particular, is most likely to be reflected in the Consumers Price Index. Additionally, inflation expectations fell to 1.88% from 1.98%. In the past we may have seen this as cause for the RBNZ to get jumpy about the prospect of deflation but the Bank has recently said these expectations' series are "unreliable" so we can only assume they are equally unreliable when they fall as well as when they rise. Whatever the case, there is nothing in the pricing data that warns of an impending surge in interest rates. Businesses themselves are recognizing this with the net number of businesses expecting rate increases dropping to 39.9 from 50.6 a month earlier.

Today's survey did little for fixed interest markets but the trend decline in the NZD got another boost from those more interested in the inflation story than the growth story. Of course, the irony in this is that if the currency falls when the economy remains strong, the potential for future rate increases rises. As things stand, the NZD TWI is sitting at 75.5, some 3.0% lower than the level the RBNZ has assumed for Q4. If sustained, this is worth 0.3% on the inflation forecasts and 30 basis points on the interest rate track.

For now, though, it was yet another piece of data confirming the relative strength of, and confidence in, the New Zealand economy.

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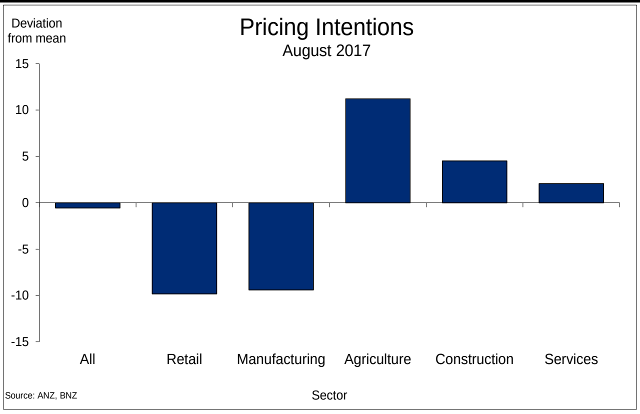
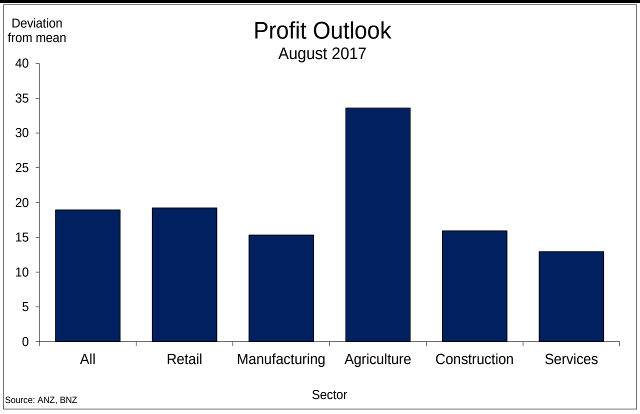
No sign of inflation



Profits solid



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