Research
Economy Watch

29 August 2024

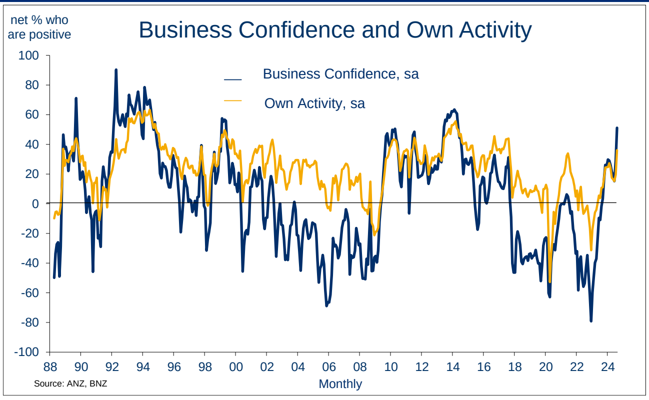
Relief

- **Businesses turn firmly upbeat about the future**
- **On changing monetary conditions**
- **But assessment of now still well behind year ago**
- **Yesterday's filled jobs highlight current weakness**
- **Pricing intentions up; inflation expectations down**
- **We stay with steady 25bp OCR cuts ahead**

We thought there would be a bounce in economic confidence following the dovish tones, subsequent interest rate reduction and projection of more from the RBNZ. Today's ANZ business confidence survey confirmed a bounce. It was sizeable.

Business confidence lifted to a 10-year high, punching up to 50.6 in August, from the 27.1 in July which was already up from a low 6.1 in June. It is interesting that the August business survey details suggest a bounce was well under way before the RBNZ cut the OCR at its August meeting. This suggests the confidence swing was well underway following the dovish pivot in July, as we suggested last month. In any case, it just goes to show what a difference a few months and some relaxation in tight monetary conditions can do following a period of tightness.

Happier days ahead



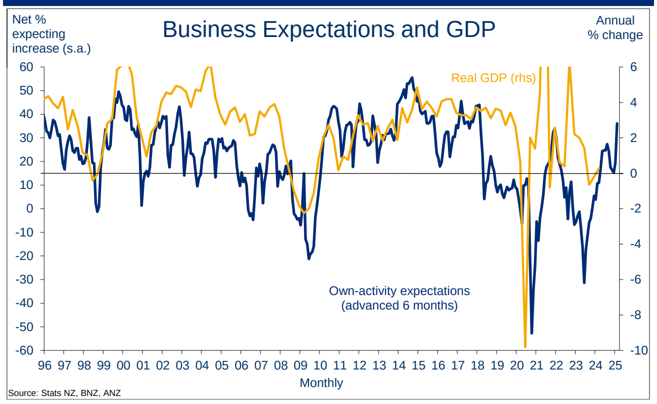
Some of the lift can probably be attributed to relief or removal of fear of higher interest rates in the first instance. Further along that train of thought, it is worth thinking about the risk that the initial bounce in confidence after an extended period of very challenging conditions is a bit overdone. Only time will tell on that and whether economic conditions can live up to the now positive expectations.

But that is not to take away from some genuine optimism about the way ahead. This is good to see. It follows from the suite of business expectations around activity and profit, as well as investment and employment intentions. All of these indicators posted material increases in the month, many to healthy looking levels, portending better times ahead.

Unsurprisingly, the strongest confidence and activity gains in the month were seen in interest rate sensitive sectors like retail and construction. Some influence from recent income tax relief might also be starting to filter through. Agriculture confidence also lifted strongly – no doubt also helped by relaxing monetary conditions. The bounce in confidence was smallest among manufacturers, maybe the result of concern around energy pricing for those that are exposed to the wholesale market.

None of the stronger looking forward indicators should be confused with still very weak conditions underfoot. Activity and employment reports compared to a year ago illustrate this point. The business activity indicator compared to a year earlier was -23.1 while the equivalent for employment was -14.9. That fits with our thinking that GDP and employment contracted in Q2 and Q3 this year. The positive forward-looking indicators need to be considered in the context of the current weakness.

2025 looks better

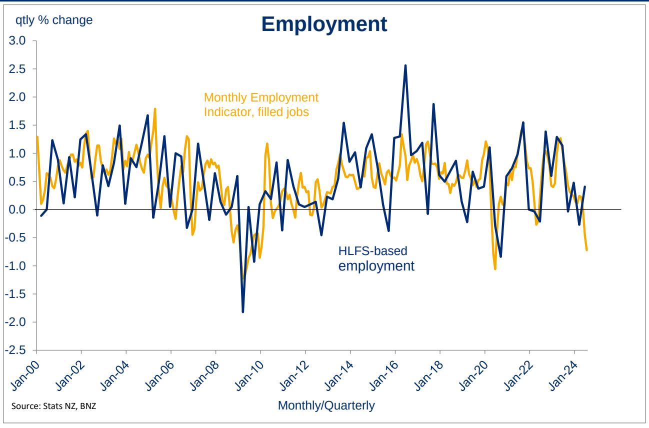


Activity expectations lifted to 37.1 in August from 16.3 in July. This sort of level is broadly consistent with our (and the RBNZ's) one year ahead forecast for economic growth. It supports our thinking that the trough in economic activity is occurring in the quarter that we are currently in.

That is all well and good, but any pickup in actual activity will take time. The influence of changes in monetary policy being fully transmitted to the economy can take quite some time.

We can say similar things about the labour market. Yesterday's filled jobs numbers for July certainly highlighted current weakness. They were down 0.1% in the month, which was in line with our priors. But, once downward revisions were considered, filled jobs were softer than the headline looked. Revisions saw the level of filled jobs in June some 0.4% below previous estimates. July's small decline was off that much lower base, such that the 3 month rolling average change slumped to -0.7%. As a result, we have nudged down our near-term employment view with Q3 employment to -0.4% (from -0.2%) and nudged up our pick for the Q3 unemployment rate to 5.0% (from 4.9%).

Current weakness clear

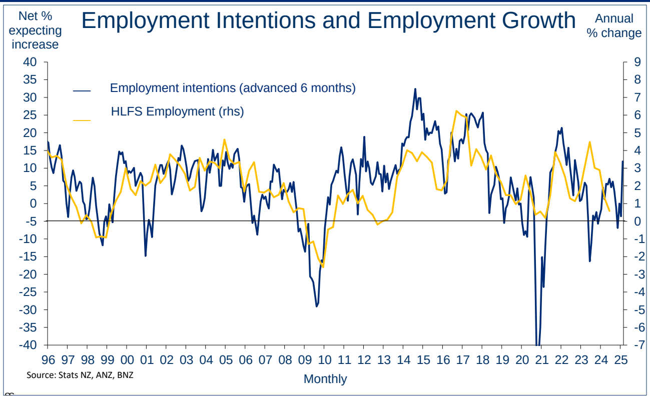


This is a minor change in our long-held view that the unemployment rate will continue to rise into the mid-5's next year, given the usual lags to the economic cycle, and despite our view that employment will rise over the coming year.

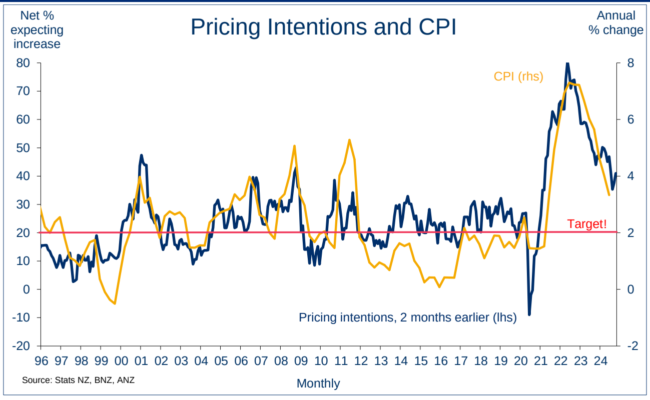
Even with our year ahead employment forecast, today's jump in employment intentions was a surprise. If the 11.9 reading can be sustained over coming months, it would suggest the pickup in employment over the coming 12 months might be larger than we have factored in. That is worth keeping an eye on.

Today's business survey had mixed signals on inflation. Pricing intentions lifted a bit, to 41.0, and are still at a level that would be consistent with inflation above the RBNZ's target band. The details were also mixed. A strong jump in retail pricing intentions will not be welcomed by the Bank, but further easing in construction sector pricing intentions will be viewed more favourably. Manufacturers' pricing intentions rose the most and were firmest outright, at 58.7.

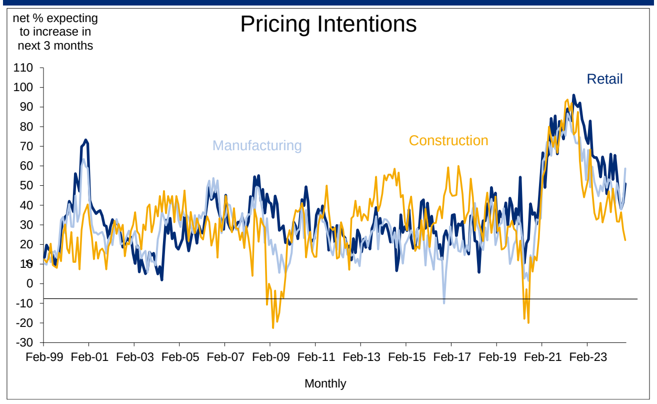
Surprising strength here



A bit niggly



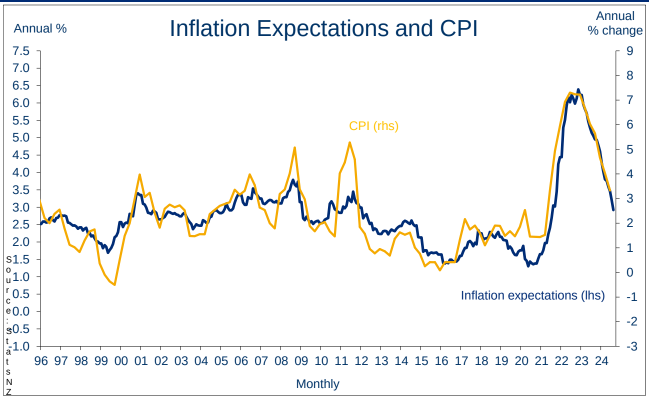
Not uniform



More clearly positive news on the inflation front was inflation expectations continuing to steadily decline, to 2.92% in August from 3.20% in July. This is consistent with annual CPI inflation inside the target band in Q3.

We don't see these monthly inflation indicator wriggles as throwing the RBNZ off its intended course of action in easing the cash rate in 25bp clips. Pricing behaviour is certainly being closely watched by the central bank and should continue to be monitored closely. Today's bounce won't encourage the RBNZ to quicken the pace of easing it has outlined. Neither would the bounce in activity and employment expectations for that matter.

Favourable trend here



We stick with our view that the cash rate will be cut in 25bp increments ahead as we continue to monitor the incoming data. This very much includes assessment of the starting point from which the likes of today's expectations are coming off. We wouldn't discount the possibility of a weaker starting point from encouraging the RBNZ from quickening its easing pace at some point.

Yesterday's weak jobs numbers shed some light on that from a labour market point of view. The upcoming Q2 GDP data will provide more colour from an activity perspective, while the Q3 QSBO in early October will give guidance on many areas including critical indicators on resource use.

doug_steel@bnz.co.nz

Contact Details

BNZ Research

Stephen Toplis
Head of Research

Doug Steel
Senior Economist

Matt Brunt
Economist

Jason Wong
Senior Markets Strategist

Stuart Ritson
Senior Interest Rate Strategist

Mike Jones
BNZ Chief Economist

Main Offices

Wellington
Level 2, BNZ Place
1 Whitmore St
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