

Research Economy Watch

31 October 2024

Growth Expected Next Year

- **Businesses optimistic about the future**
- **But still reporting weakness in the here and now**
- **Consistent with an output gap still widening**
- **Inflation expectations edge down**
- **But pricing intentions elevated**

Businesses remain very upbeat about the outlook over the coming year, according to this afternoon's October ANZ business survey. Indeed, business confidence hit its highest level since March 2014.

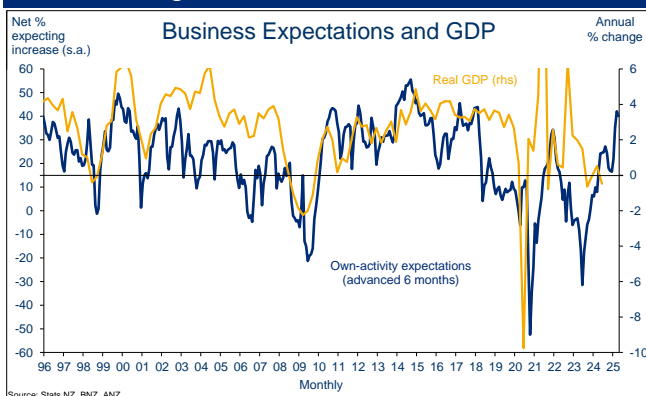
One can't help but feel a chunk of this reflects an exceptionally weak starting position in a 'things will surely get better than now' kind of way. Regardless, the positivity is a supporting signal for some pickup in growth next year.

More encouraging for the growth outlook is that firms' own activity expectations maintained their strength from last month. October's 45.9 was little changed from September's 45.3, which is a strong reading even adjusting for normal support when a right-leaning government is in power.

Firms' profitability expectations have become more positive and are consistent with investment intentions pushing higher, with the latter's 20.0 reading in October pushing well above average.

We already forecast annual economic growth to pick up to around 3% by the end of next year. However, if these sorts of business expectations persist and are realised, it would suggest a touch of upside to our view.

Good vibes for growth ahead



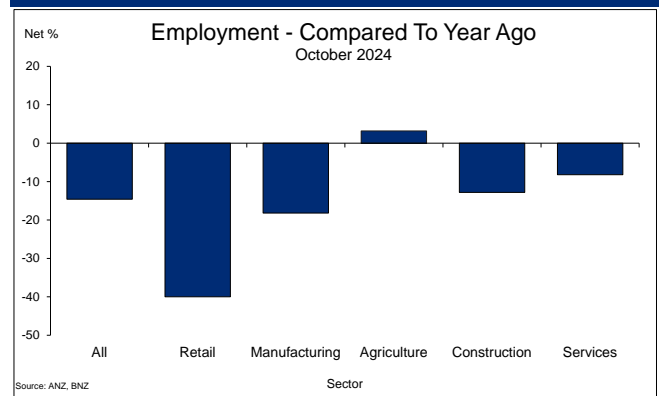
For all the positivity on the way ahead, there remains a very sharp contrast between expectations for activity and

current conditions. Activity still looks soft underfoot. A net 10.5% of businesses report lower activity than a year ago, with weakness centred in retail (-41.7%), construction (-12.8%), and manufacturing (-8.9%). Agriculture stood out on the topside with at +25.8%. While the overall reading is less negative than in September, when a net 18.5 reported a decline, it is consistent with a weak starting position.

The same dynamic is true for employment. Employment intentions for the next 12 months are strongly positive, with October's 14.2 a nudge higher than September's 11.7, but firms still report employment as being lower than a year ago. It is the latter that is yet to show up in the official statistics and is consistent with our long-held view that the unemployment rate will continue to lift for a while yet, including to around 5% in next week's figures for Q3.

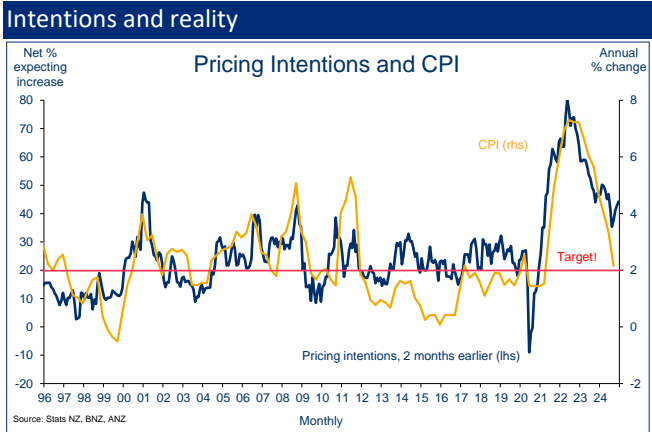
We expect the latter to show up in next week's Q3 labour market data, via lower employment and a higher unemployment rate.

Business reports of employment contraction widespread



All that is consistent with a negative output gap still widening and general downward pressure on inflation. As for this month, there were mixed messages from the business survey on inflation.

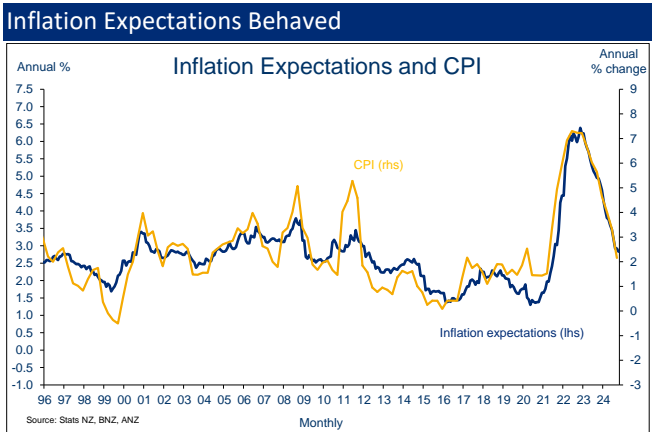
Firms' pricing intentions pushed higher, to 44.2, from an already elevated level. At face value, history suggests that sort of level has been consistent with annual CPI of over 4%. This series continues to be in sharp disagreement with a similar measure from the QSBO. The latter has softened significantly as CPI inflation itself.



Some of the pricing intention difference could be because the QSBO does not directly survey farmers whereas the ANZ survey does. Pricing intentions amid agricultural firms in today’s survey pricing intentions were above the average, at 58.1, as commodity prices improve. But that is nowhere near enough to explain all the divergence, with average pricing intentions excluding agriculture edging higher and still elevated relative to history.

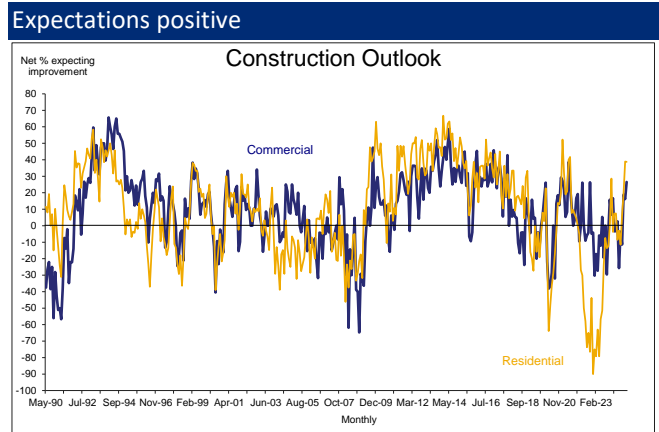
The disagreement will not resolve the ‘uncertainties about firms’ price-setting behaviour’ that RBNZ Governor Orr discussed last week when in Washington. That fits with the idea of ‘incremental’ policy adjustment on the way down.

However, the RBNZ will be pleased to see inflation expectations edge a touch lower, to 2.83% from 2.92%, probably influenced by recent headline inflation outcomes. That sort of level is consistent with annual CPI inflation settling well inside the Bank’s target range, judging by the historical relationship. We see nothing there to stop the Bank from continuing to ease monetary restraint.



Lower interest rates are one of the factors buoying business confidence and firms’ brighter activity outlook. We don’t think business optimism will come as a major surprise to the Bank, which has forecast economic growth of a bit over 3% next year. However, it does not look like reason to further quicken the pace of easing restraint.

Finally, a brief comment on construction. Firms in this sector have maintained their recently found optimism for activity ahead for both residential and commercial building activity. A net 38.7% of these firms see more residential activity ahead. Given the lengthy decline in residential building consent numbers, and associated softening in activity, this is as good an example as any of a positive outlook coming of a low base. The positive outlook in this interest rate sensitive sector is consistent with our view that residential building consents are in the progress of forming a base and our expectation of some improvement next year.



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