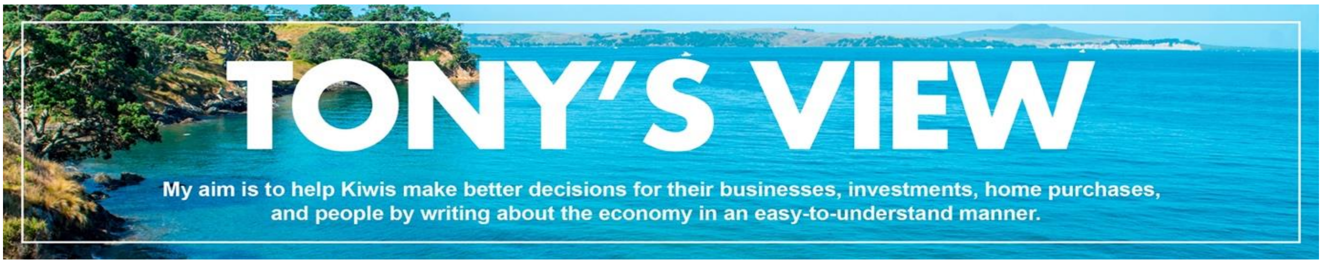

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Thursday 2 March 2023

Businesses slightly less pessimistic

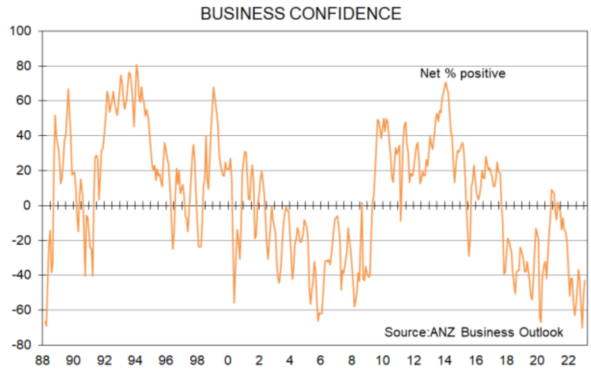
This week we got an update on how businesses are seeing the world at the moment from my restarted monthly Business Survey and the ANZ's long-running Business Outlook Survey. Let's start with the latter because it contains useful numerical gauges of business sentiment and plans.

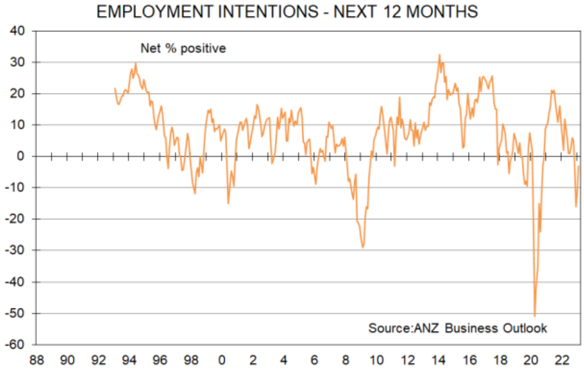
Back in December a record net 70% of businesses in ANZ's survey said that they have a negative outlook for the economy over the coming 12 months. This bad result reflected underlying long-running issues such as labour shortages, cost pressures, and margin compression being added to by the Reserve Bank's November 23 record tightening of monetary policy and prediction of a recession being necessary to contain inflation.

That high pessimism reading was accompanied by 16% of businesses saying they would lay people off compared with 4% in November and an average positive hiring intentions reading of 11% for the past decade. Similarly, a net 21% said they would cut capital spending versus 8% saying so before the cash rate rise and an average 14% planning more investment.

We saw all three of these measures improve a bit in the special January survey run by ANZ which attracted a smaller response rate than normal given the time of year. That makes the latest result – traditionally their first for the year – important in terms of either solidifying and strengthening the January improvement or revealing it to be an ephemeral summer mist.

Fortunately it is the former. The net proportion of businesses feeling positive about the next 12 months improved from January's low 50% negative to 43%. This is still well below the ten year average reading of -3% and on its own in the old days would tell us a recession is definitely coming. But these are strange times with a disconnect opening up between what we say in surveys and what we actually do with our household finances and businesses.



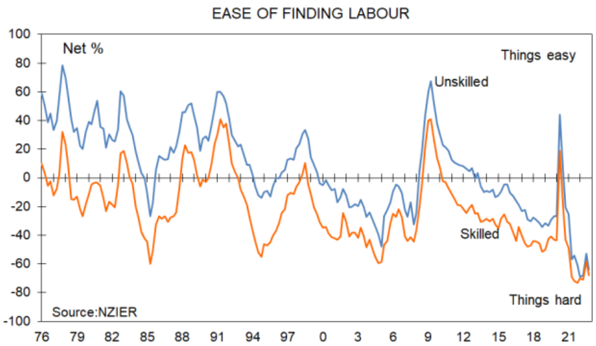


Suffice to say however that at -43% the result is weak enough for the Reserve Bank to feel that the economy is on track towards a potential recession which will suppress inflation.

But they, like us private economists, tend to brush aside the headline confidence reading and look at what businesses intend to do. A net 3% of businesses now say that they will layoff staff. This is well up from December's -16% but below the 11% ten year average and hardly suggestive of labour market strength in the near future.

The importance of the result is that it is going to make more people back away from forecasts that the unemployment rate will reach the near 6% levels predicted by the Reserve Bank and Treasury. Those forecasts always appeared to be based on models of the economy not just pre-pandemic but pre-GFC as well.

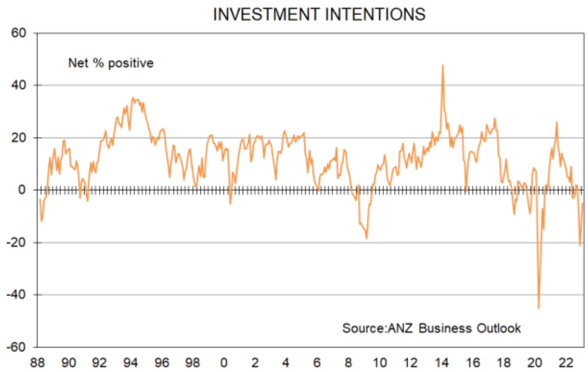
They fail to take into account the structural reduction in labour availability not just here in New Zealand but offshore also. Specifically, even though business sentiment is appallingly bad, in the NZIER's Quarterly Survey of Business Opinion for the December quarter near record proportions of businesses said that they are finding it hard to get both skilled and unskilled labour.



It is likely that as we retreat from the immediate rection to November's monetary policy tightening businesses yet again are remembering their underlying difficulties sourcing and retaining staff – just as happened when the initial shock of the pandemic's arrival passed.

The shifting away from more pessimistic scenarios for labour market strength mean better outlooks will be generated eventually for consumer spending, business investment, and the housing market. But the chances of wages growth remaining firm reinforce the message given here repeatedly that the path of interest rates retreating from this cycle's highs will be a very slow one.

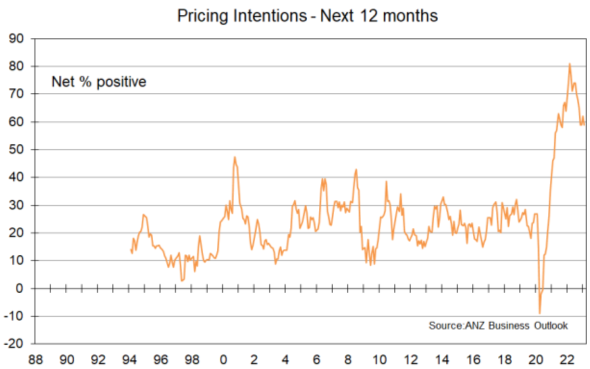
The other intentions measure to look at beyond employment is business investment. A net 5% of businesses plan cutting their capital spending in the next 12 months. This is well up from 21% planning cutbacks in December but still well below the ten year average of 14%.



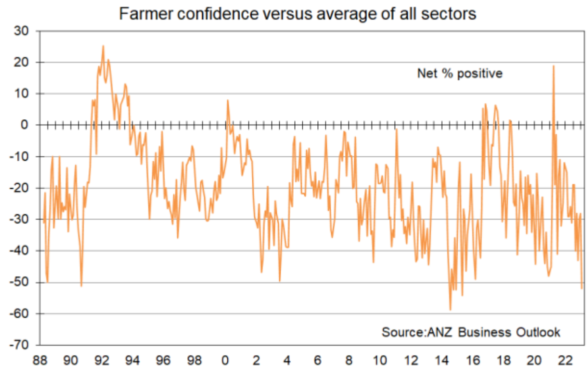
The other important set of numbers which we economists extract from the ANZ's long-running business survey relate directly to pricing prospects. The average year ahead inflation rate expected by respondents is now 5.94%. This is down from 5.99% in January and a peak of 6.23% last July.

But this downward move is so minor as to be meaningless. Inflation expectations remain highly elevated and were I on the Reserve Bank's Monetary Policy Committee I would not feel assured that inflation risks are well in hand as yet.

That would be especially so when we consider the net proportion of businesses planning to raise their selling prices. At 59% this measure is off it's peak of 81% last March. But as the graph here shows the level is still extremely high. Given that the intention of the Reserve Bank in tightening monetary policy is to remove the ability of businesses to raise their selling prices the graph below tells us that there is a long way to go yet.



There are other interesting bits in the survey, especially the extreme pessimism of farmers which outside of flood-affected areas does not gel with the reality of a low exchange rate and improving offshore demand, especially as China's economy bounces back up. Farmers are almost always more pessimistic than every other group. But the current gap is unusually large. Climate change worries maybe?



We can also gain some insight into current business sentiment from my restarted Business Survey available here.

https://www.tonyalexander.nz/wp-content/uploads/Business-Survey-February-2023.pdf

Key results include staffing problems continuing, still rising costs, crunched profitability, weakness in retailing, and residential construction headed for a sizeable retreat.

If I were a borrower, what would I do?

Bank wholesale borrowing costs have increased again this week to now sit 0.25% - 0.5% higher than a month ago when cuts to fixed mortgage rates had just been made. Borrowing costs have been pushed higher mainly because of reduced optimism in the United States that inflation will prove as easy to tame as previously hoped. The slight improvement in some NZ indicators such as business pessimism and hiring intentions may also have added a wee bit of upward pressure to NZ interest rates.

If I were borrowing at the moment I would fix one year but not look askance at a discounted two year rate should one be offered.

Nothing I write here or anywhere else in this publication is intended to be personal advice. You should discuss your financing options with a professional.