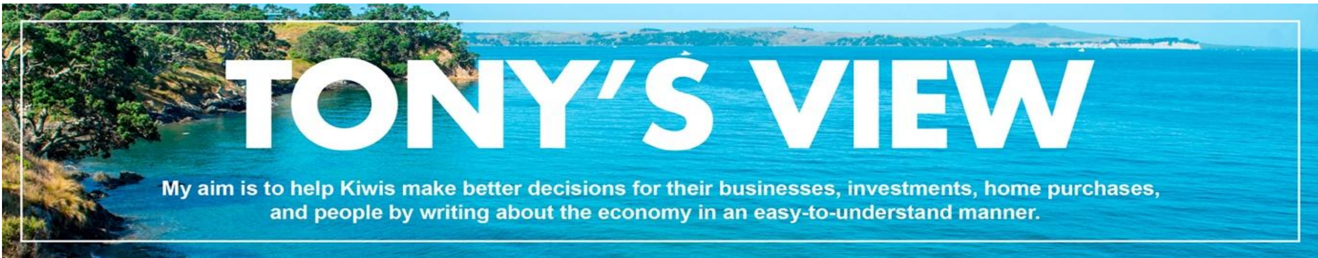

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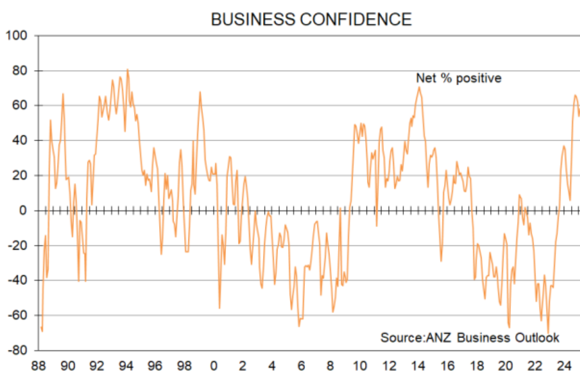
Businesses probably too optimistic

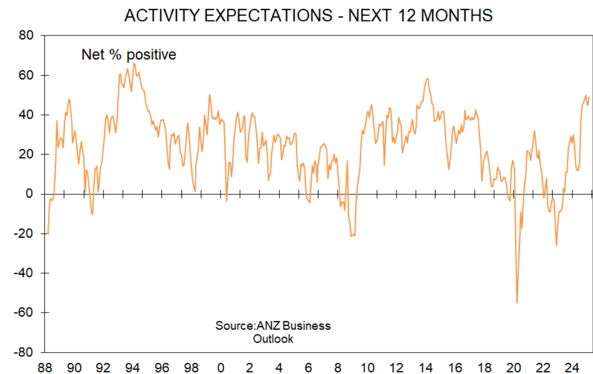
This week ANZ released their monthly Business Outlook survey. The survey has been running for a few decades, and I often analyse outcomes in terms of how they compare with averages since inflation in New Zealand fell to 2% in 1992 and has averaged about 2.3% ever since.

My main comment since the middle of August has been that people are over-estimating the likely strength in our economy over 2025-26. Does the ANZ survey show the large surge in optimism over the second half of last year easing off? No.

A net 58% of businesses are confident about the economy over the coming year which is little changed from the ten year peak of 66% reached late last year. In mid-2024 this measure stood at just 6%. Interest rate optimism has caused sentiment to soar.

This high optimism can be seen also in business expectations for their own level of activity. A net 49% expect to be busier a year from now compared with 12% nine months ago and a 50% peak at the end of last year.





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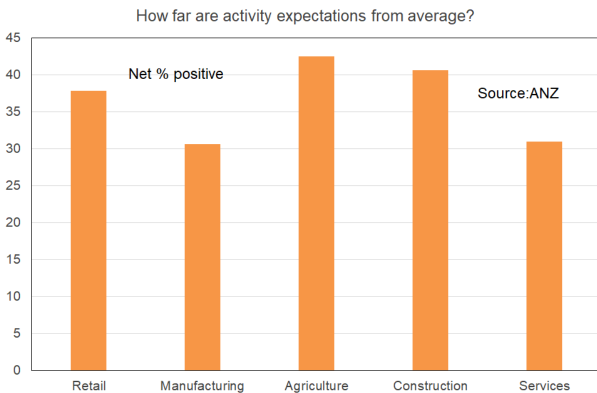
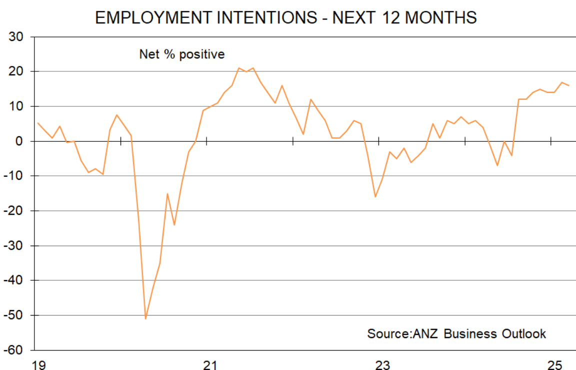
This graph shows how much expectations of own activity levels are above average for each category of business covered. Note how far sentiment in the agriculture sector is above average – courtesy no doubt of high dairy prices and a low currency offsetting concerns about drought and rising costs.



The level of optimism for our economy is so great a strong net 16% of businesses expect to hire more people (the ten year average is 6%) and a net 17% expect to undertake more investment (also 6% average).



The extremely high levels of sentiment and intentions measures somewhat bely two things. The first is the still constrained levels of activity currently being experienced by businesses I speak with around the country. Clearly the currently situation is expected to radically change.

Second, businesses may be downplaying the likely effects of a still struggling Chinese economy, and the effects of the US-initiated tariff/trade war.

I expect a correction downward in the sentiment and intentions measures at some stage in the next few months. But it is impossible to know exactly when the reality check truly gains ascendancy.

With regard to the measure I am currently paying most attention to in the ANZ's Business Survey – pricing intentions – the news is not positive, and I discuss it in my Interest Rates section.

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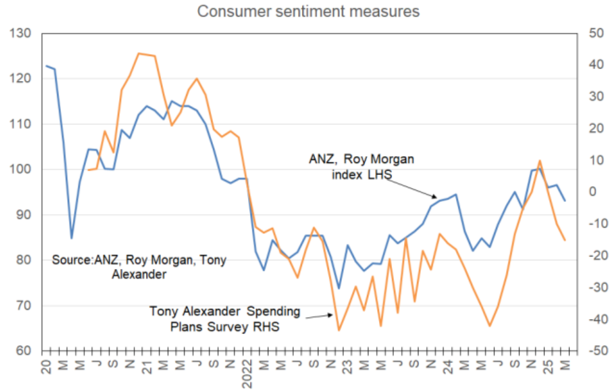
Consumers more pessimistic

Confirmation of the recent decline in consumer spending plans contained in my monthly Spending Plans survey came this week in the form of the ANZ Roy Morgan Consumer Confidence gauge. It weakened to a five month low of 93.2 from 96.6 in February where 100 is neutral.



My own survey last month weakened to -15% net from -10% in February and +10% plans for boosting spending in the next 3-6 months in December.

The message to retailers I've been delivering is therefore reinforced. Do not plan for a decent uptick in household until perhaps late this year. Note that the sentiment decline comes before people have probably realised this is almost as good as it is going to get this cycle for borrowing costs.

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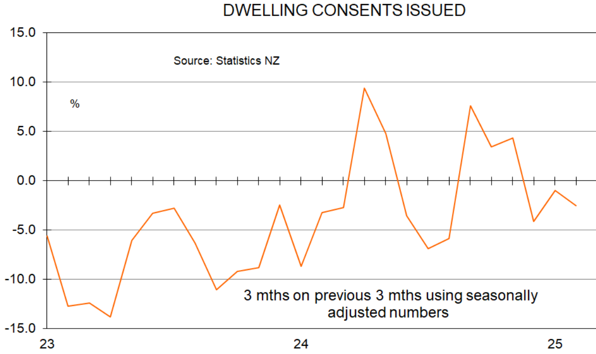
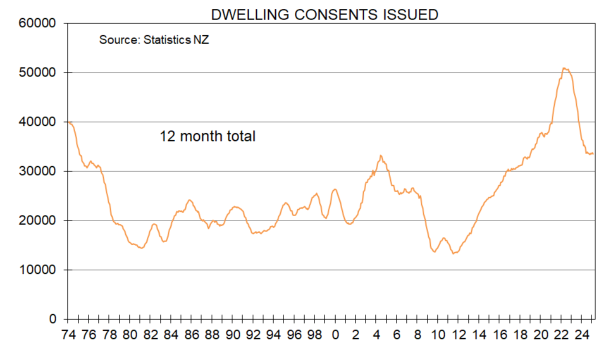
Home building flat

This week Statistics NZ released their monthly data on the number of consents issued around the country for new dwellings to be built. The monthly numbers can be quite volatile even after adjusting for seasonal factors and it is best to smooth things over a three month period to truly see what is happening (which is why a monthly GDP reading would largely be a waste of time).

With consents rising 0.8% in February we see growth in the three months to that month was -2.5% which followed a rise of 4.3% in the three months to November and fall of 5.8% in the three months to August.



There is no consistent rise or fall underway and this is why the annual total of 33,600 is the same as it was in June. But a year ago the total was 36,300 so there has been weakness this past year but it was mainly when the economy was shrinking 1.1% a quarter.

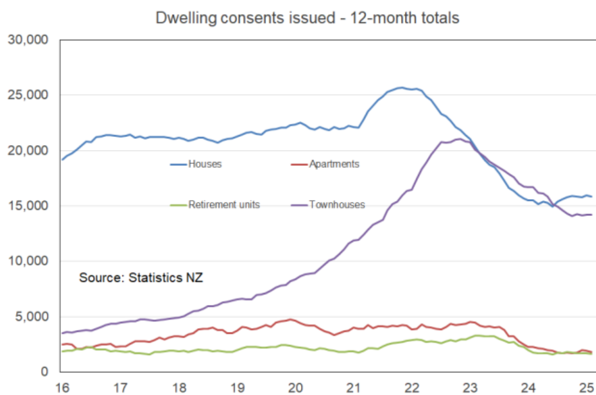


Things have plateaued overall. Most of us expect an upturn in standalone house construction to get underway later this year but for townhouses the track is likely to be down until well into 2026. That is because there is an over-supply of townhouses in our two biggest cities and factors such as these which I included in an email to someone asking about townhouses this past week.

"It looks like a combination of recent media exposure to the issue of upper floors getting too hot in the afternoon and expenditure having to be undertaken on cooling systems, lack of garages in some built in Christchurch, the appearance of many complexes (they look like prisons someone said to me), some feeling too skinny, lack of outdoor space for when kids come along, reports of townhouse developers collapsing and worries about project completion for off the plan purchases, and the increased availability at this point in the cycle of standalone houses.

I place hefty weight on the last factor and expect that once the listings numbers fall people will increasingly look again at townhouses. They'll have to as there is not enough land people are willing to devote to new suburbs."

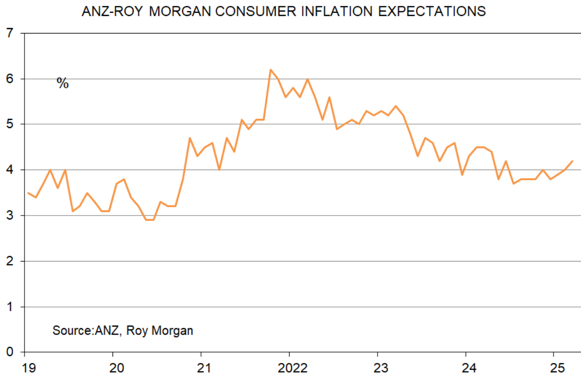
This graph shows the annual number of consents issued for different home types since 2016. Note the strong rise for townhouses and the fall now underway (purple line). I suspect the flattening of this line recently may not continue – but I could be wrong. We don't have more than one townhouse construction cycle to analyse.



If I were a borrower, what would I do?

Of interest this week was the ANZ Roy Morgan Consumer Confidence index which I discussed above. When asked what they expect inflation to be in a year's time the average expectation was 4.2%.

This is up from 4.0% in February and the first reading above 4% since June last year. It comes after a fall in the reported inflation rate to 2.2% but with knowledge of planned increases in two key household charges – council rates and electricity.



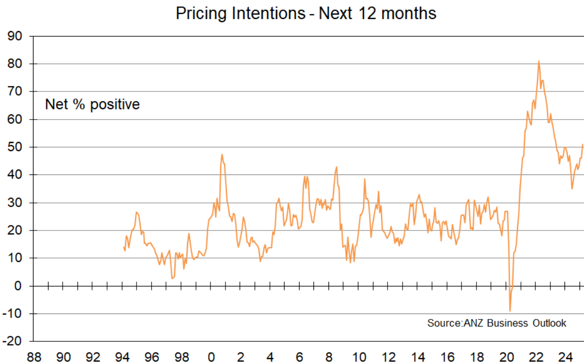
The result won't reflect a general expectation of better times ahead because consumer sentiment has declined. That extra boost to inflation expectations will come later this year.

The result is certainly not a game-changer, and things can flip around from one month to the next. But I highlight it to again reinforce my concern that the outlook for inflation and therefore interest rates is not as benign as people might be thinking.

Speaking of which, on Monday ANZ released the results of their latest Business Outlook survey. I have been talking and writing about this survey's pricing intentions measure for over a year now and most recently have highlighted the signal it is delivering that businesses will raise their prices to rebuild margins once consumer demand becomes strong enough.

The latest survey reading causes me to reinforce this view. On average since inflation reached 2% in 1992 a net 26% of businesses in the survey have said that they plan to raise their prices in the coming 12 months. That reading hit 80% early in 2022. It fell to 35% in the middle of last year then ended 2024 at 43%.

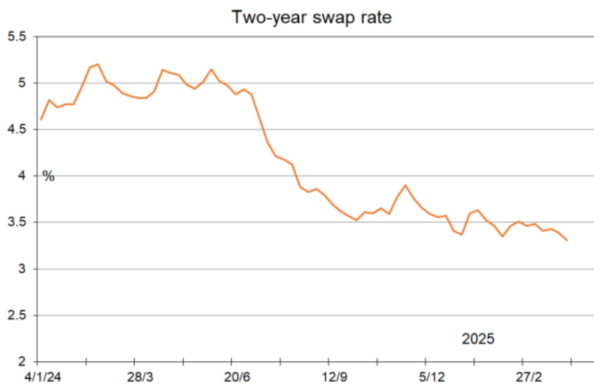
It rose to 46% come February and now sits at 51%. This is too high, and the direction of change is going to become a cause for concern by the Reserve Bank at some stage. It is impossible to now when that will be – especially given their inability to read where the economy is at until up to five months after it has shifted – or longer in the case of 2021-22.



The graph would not look like it does if inflation were truly beaten. What it is telling us is that underlying inflationary pressures are stronger than the headline inflation number of 2.2% is telling us.

A very high net 74% of businesses are saying that they expect their costs to rise over the coming year.

This week wholesale interest rates have declined slightly in response to data-induced falls in US rates and worries about the global growth impact of today's tariff announcement. High uncertainty exists with regard to the track of the US economy this year and next and it may be some time before we get a good feel as to how negative the impact will be of higher tariffs boosting production and consumption costs in the United States. Think of it as a round of higher tax rates.



If I were borrowing at the moment, I would probably fix two years at 4.99% but might wait a bit in case the 4.99% three year rate were to return again.

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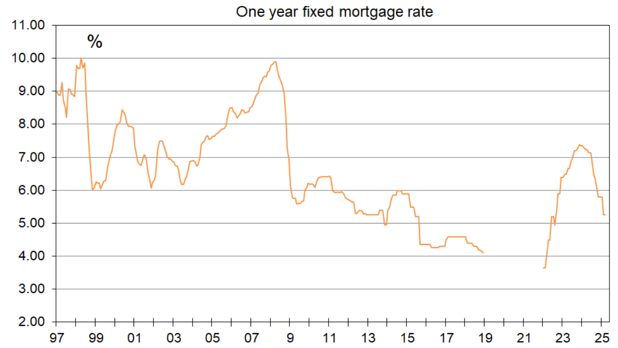
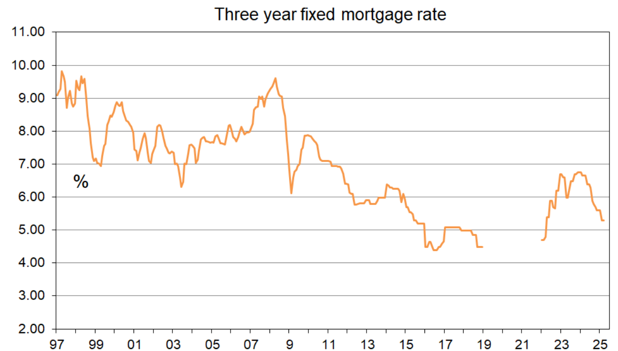
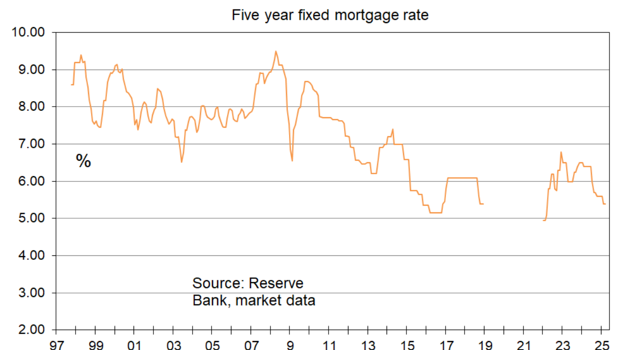
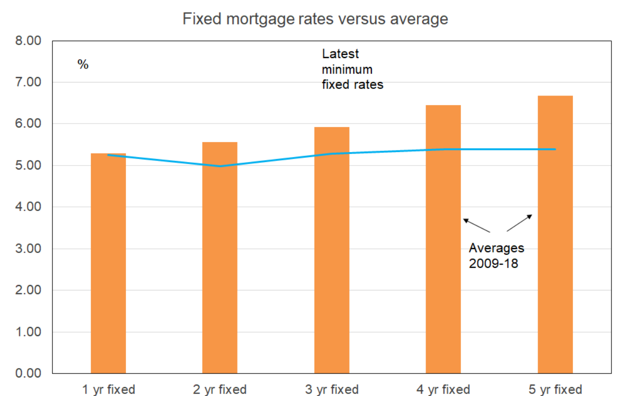
These three graphs show mortgage rates since 1997 excluding the period of deflation worries (2019) and the pandemic.







This graph shows how current rates compare with averages from 2009-19.



To see the interest rates currently charged by major lenders go to www.mortgages.co.nz

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