TONY'S VIEW

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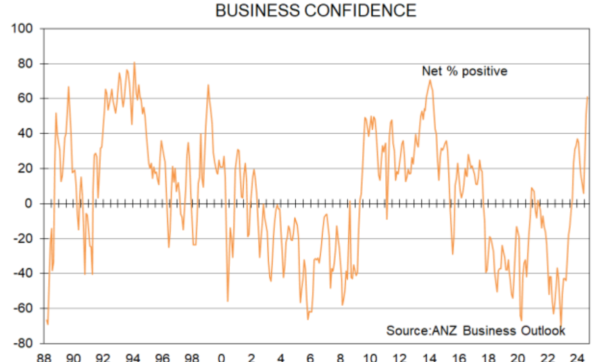
Mixed price pressure signals

This week ANZ released their monthly Business Outlook survey and as regular readers will know there is one measure I am keeping an especially close eye on, and it isn't the confidence gauge. Their confidence measure soared to a net 61% of business sector respondents expecting the economy to be better in a year's time.



Technically I can see how this result comes about. But it would be very unwise for anyone to look at past times when the confidence gauge was at such a level and conclude that our economy is about to power ahead at a superlative rate.

Businesses have been and remain under a lot of strain as they adjust to the absence of irresponsibly loose fiscal and monetary policies giving them unsustainably high customer numbers and cash flows, and the presence of high interest rates recently.

They are also being pressured by the IRD chasing up tax debts, still rising costs in our economy, and the need to make some big changes to get margins back in shape.

They are also surrounded by the most negative discussions about the general state of affairs in our economy and society that I can recall since the painful parts of the 1980s reform period.

In fact, this week I did my exercise of typing "NZ crisis" into Google search and seeing how many things I could find described as being in crisis in our economy in the seven minutes it took to get to the end of what Google offered up. Here are the 33 in the order they appeared. No mention this time of rugby referees and dog food nutrition.

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Aged care
Citizens Advice Bureau
Fruit & vege prices
Health sector
Food waste
Hawkes Bay Reg. Cncl
Methamphetamine

(I ran the same exercise for "Australia crisis" and got 24 things in the six minutes it took for Google to stop presenting new results.)

So, as businesses eye the positive cashflow impact of falling borrowing costs for them and their customers, and having absorbed the multitudinous tales of woe attributed to mortgage rates above 7%, their expectation of falling interest rates is making them believe a nirvana lies ahead.

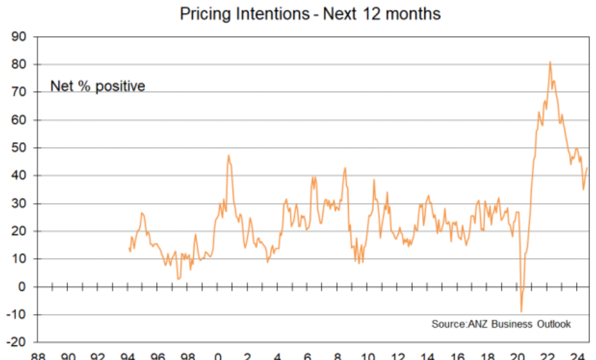
But as outlined here over a month ago, there are many factors which will limit the speed of upturn in our economy over the next couple of years. They include but are not limited to these factors.

- Absence of a large NZ dollar decline
- Weakness in the Chinese economy
- Lack of productivity growth
- House construction falling until late-2025
- The tourism recovery has stalled
- Fiscal policy is being tightened
- Electricity security in NZ has gone
- Sheep numbers are falling
- Job insecurity will stay high through most of 2025
- Net migration is declining rapidly
- Pandemic savings buffers have probably all been used up

And now back to the ANZ Business Outlook Survey to discuss one more factor which I think will limit the strength of the upturn – a scenario in which interest rates do not necessarily fall as fast or as low as people are thinking.

On average since inflation fell to 2% in 1992 the net proportion of businesses in the ANZ survey who have said that they plan raising their selling prices over the coming 12 months has averaged 26%. That is the rate consistent with inflation averaging 2.3% and economic growth 2.7%.

Two and a half years ago as supply chain disturbances and excess monetary and fiscal stimuli ran through the economy this measure peaked at a record 81%.



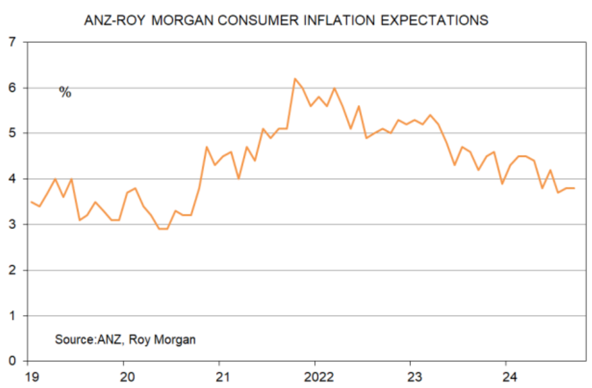
The latest reading is well below that at 43%. But there are two problems.

First, this is well above average and comes after a period when the economy has shrunk by 0.2% - not grown near the average of 2.7%.

Second, this outcome is up from 41% in August and a low of 35% in June. Pricing intentions by this measure are rising. In fact, on average since this series started in 1994 and stripping out the 2020 pandemic-affected result, between June and September each year this measure usually falls by 1%. Rises are relatively rare. The 8 gain this year therefore represents a firm seasonally adjusted increase in this partial leading indicator of inflation.

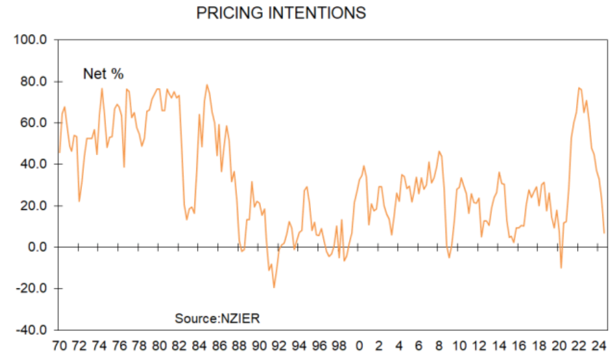
There is not a close relationship between the pricing intentions measure and the official cash rate so you wouldn't want to solely base your predictions for monetary policy on this variable. Instead you'd want to look at other indicators of where inflation may be headed.

One is inflation expectations. The ANZ Roy Morgan year ahead inflation expectation for consumers has recently increased from 3.7% in July to 3.8% in September. That is a tiny move, but the key thing is that the change is not downward. It's not a game changer but it is enough to make one cautious about interest rate decline predictions.



We can also gain good insight by looking at data in the NZIER's long-running Quarterly Survey of Business Opinion which came out this week. This survey is useful mainly for indicating how much spare capacity might exist in the economy, employment prospects, and inflation influences.

The big question is this. Does the QSBO also show business pricing intentions at unusually high levels? Thankfully the answer is no. It is just the opposite. Whereas in the June quarter a net 23% of non-farming businesses said they plan raising their selling prices, this fell to just 3% in the September quarter.



This is a result well below the three decade average of 21%.

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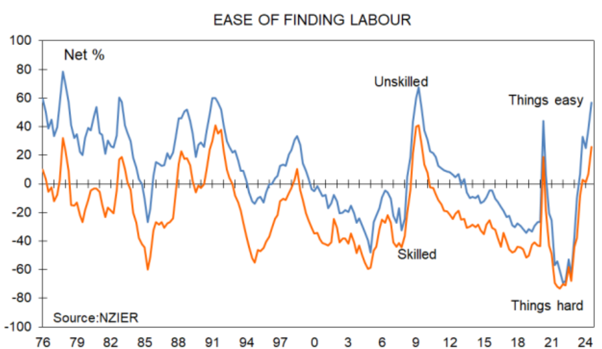
This survey asks businesses about just the next three months whereas the ANZ survey asks about the next year. If push were to come to shove, I would favour use of the NZIER QSBO and in that regard view the results as meaning a steady pattern of cash rate cuts lies ahead for the coming year.

However, if businesses accurately take the time period into account, then there is a risk the intense weakness in our economy still currently prevalent is viewed as suppressing the ability to raise prices now, but not further down the track when things are expected to be a lot, lot stronger.

Therefore, the official cash rate looks likely to be cut at least 0.25% come October 9 with a high chance the RB may opt for a 0.5% reduction. But market confidence that the bottom for the cash rate is 2.5% is still a brave call at this stage of the cycle.

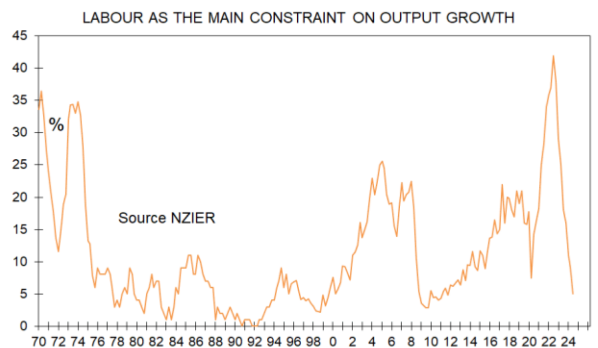
There are a large number of other useful measures we economists gather from the NZIER survey and here are a few of them.

The labour market is now well in favour of employers. A net 26% of businesses say that it is easy to get skilled labour. This is a sharp turnaround from a net 44% 18 months ago saying finding skilled labour was hard.



For unskilled labour shown as the blue line in the above graph, a net 57% of businesses say such people are easy to find. 18 months ago this was a net 37% finding it hard.

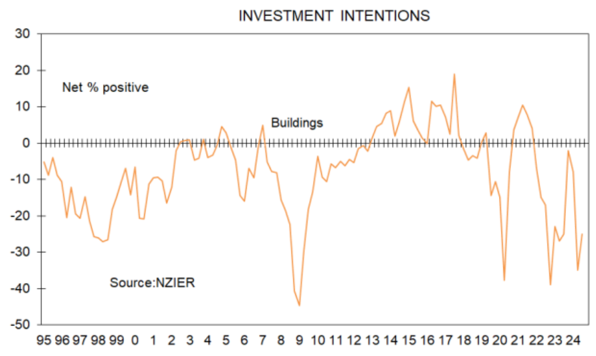
Only 5% of businesses now say that growth in their output is largely constrained by a lack of staff. 18 months ago this was 29% with a peak at 42% in the September quarter of 2022.

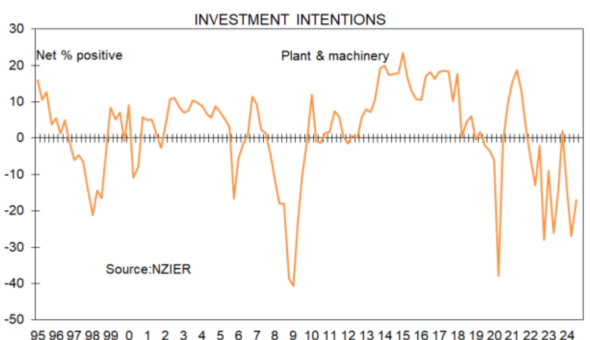


The labour market is on the mother of all roller coaster rides and for young employees this is a situation which they have not encountered before.

What about prospects for the business investment our economy needs in order to boost our low and not improving much level of productivity? Not flash.

A net 17% of businesses still say they plan cutting back on purchasing plant and machinery while a net 25% plan spending less on buildings. There is no improving trend evident yet for either measure and that will reflect the strong cashflow problems affecting businesses.





Whereas a net 61% of businesses in the ANZ survey expect the economy to improve in the coming year, a net 1% in the NZIER survey still expect things to be worse in six months.

In a nutshell, businesses have embraced the “survive to ‘25” mantra and expect woe for a couple more quarters then surging customer flows. We’d better not see a new shock hit our or the world economy come the June quarter of 2025 as the dashing of very strong expectations of an upturn will be ugly to watch.

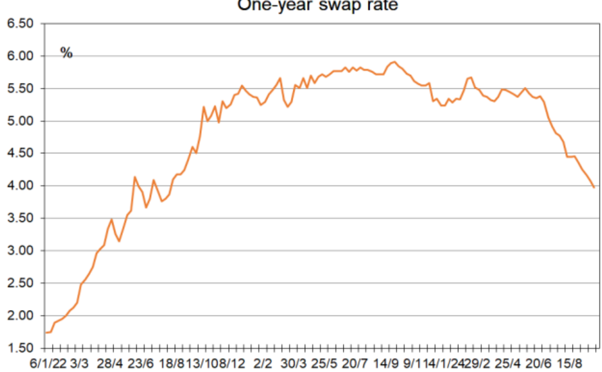
If I were a borrower, what would I do?

For another week wholesale interest rates in New Zealand have edged slightly lower. The relatively weak capacity and pricing numbers contained in the NZIER’s QSBO played a role along with the passage of time bringing us closer to the next expected cut in the official cash rate.

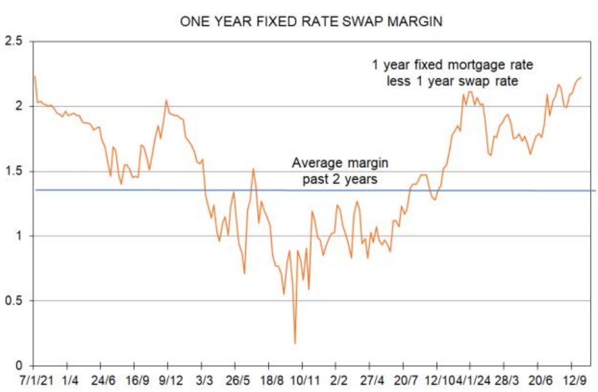
The markets have priced in a cut next Wednesday of 0.5% rather than the previously expected 0.25% partly because of the recent 0.5% cut in the United States and the generally weak data in New Zealand.

Personally I still see it as a 50:50 call because not all data here are weak. The numbers for dwelling consents for instance are flattening out at higher levels than expected and the upturn in residential construction may start earlier than very late in 2025.

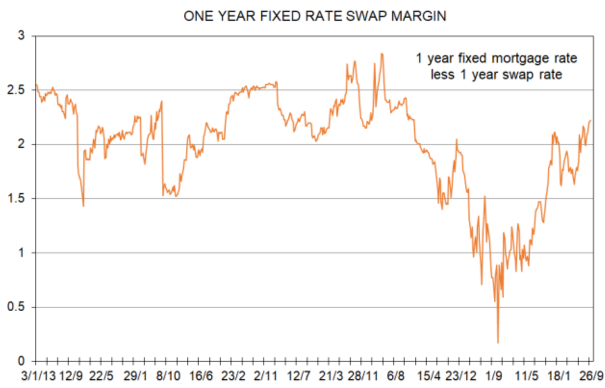
The one year swap rate which banks borrow at to lend fixed has edged down to just below 4% for the first time since July 2022.



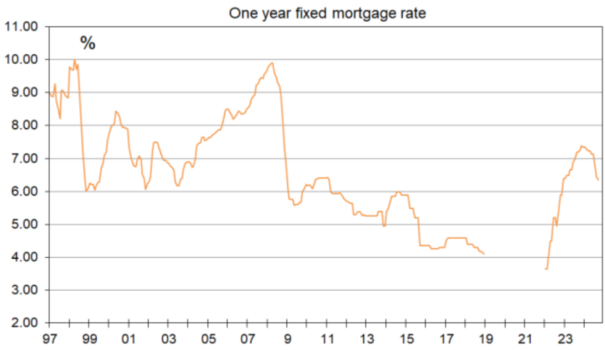
The margin on bank lending fixed one year has blown out so scope exists for rate discounting if the oligopoly members feel inclined.

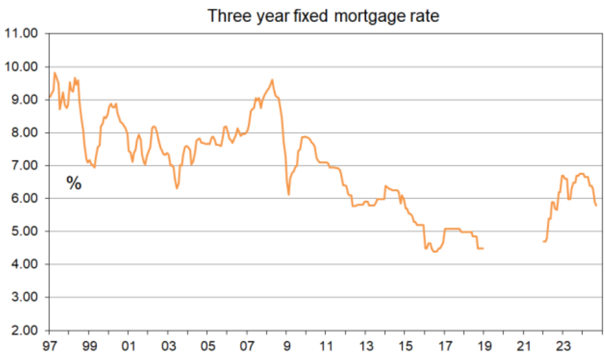


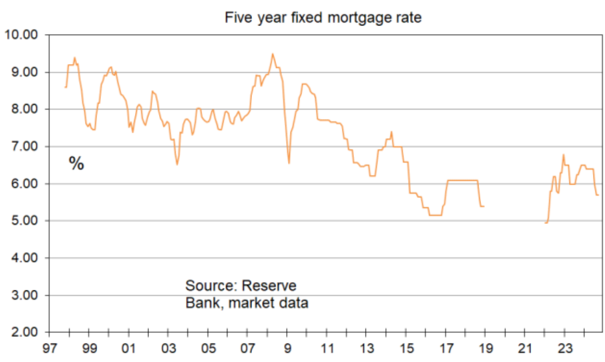
However, if their frame of reference is the past 11 years rather than the two years I use graphically for simplicity then the extent of potential rate cuts is more limited. It all comes down to whether competition between them is changed from earlier years alongside allowance needing to be made for increases in non-borrowing costs such as for IT, capital levels and lots of layers of compliance.



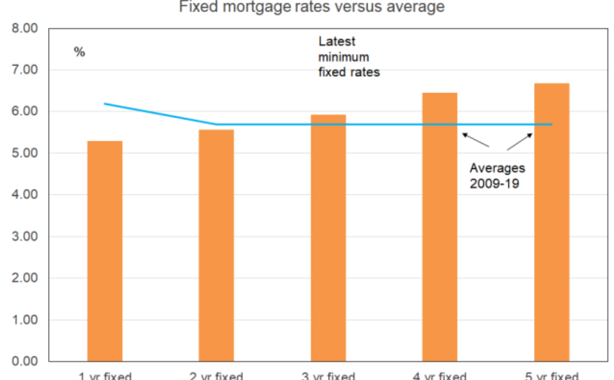
These three graphs show levels of the one, three, and five year fixed mortgage rates over the past few years excluding the 2019-21 period when rates were absurdly low because of worries about deflation and then the effects of the pandemic.







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



If I were borrowing at the moment, I would be fixing for either 6, 12, or 18 months looking to eventually fix for 3-5 years perhaps in 2026, perhaps 2027. It is impossible to say at this stage.

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

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