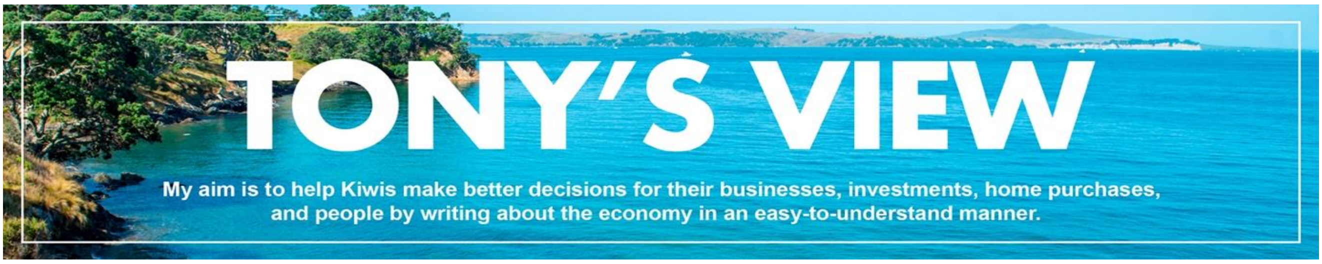

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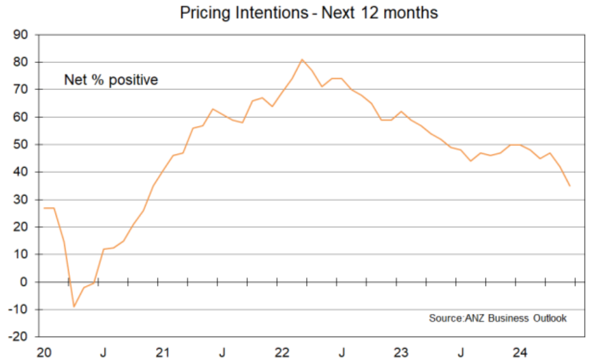
Box 3 improving

The main thing worth noting about releases of economic data over the past week was in the ANZ's Business Outlook Survey released on Thursday.

You may recall that last week I wrote about monetary policy in terms of four boxes representing interest rates going up, household spending being crunched, business pricing behaviour changing, and then inflation falling. The data are relevant to box number 3.

The net proportion of businesses saying that they plan raising their selling prices over the coming year has just fallen to 35% from 42% in May and 47% in April.



This measure has averaged 25% during the period since 1992 when inflation has averaged about 2.3% a year. So, to be consistent with that desired low inflation rate it seems reasonable to believe that the Reserve Bank won't have any interest in sending a signal of monetary policy easing soon unless the measure is at least down at 25%.

However, don't get optimistic about interest rates falling sharply soon (though when they move, I think the initial decline will be rapid). The average rate of growth in our economy over the past three decades has been about 2.7% a year. So, the equilibrium situation is one where inflation is just over 2%, growth above 2.5%, and the net proportion of businesses saying they will raise their prices in the coming year is about 25%.

But our economy has flat-lined. You would expect that in the absence of any growth and with a sharp decline underway in per capita output, that the business pricing measure would be appreciably below 25%.

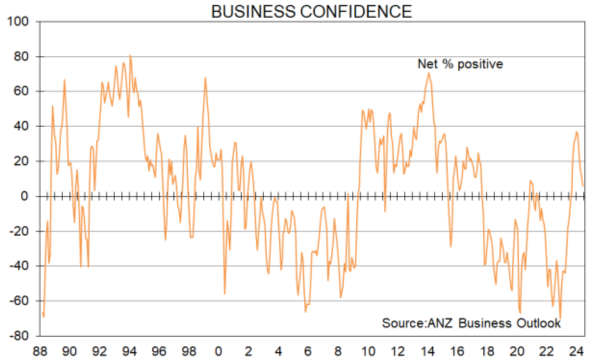
The Reserve Bank is not going to hint at a smile on their face regarding the inflation fight until the business pricing gauge is well below 25% and we are probably many months still away from that.

Until then we can expect the number of stories in the media about struggling businesses to grow. More restaurants will close - and the issue there is not just high interest rates but the food cost nowadays outweighing the desire to celebrate one's special occasion.

House construction will decline further and getting a tradesman will be a lot easier. But willingness and ability to do so will be compromised by soaring household expenses for insurance and rates with promises of rates bills becoming unaffordable for many in just a few years.

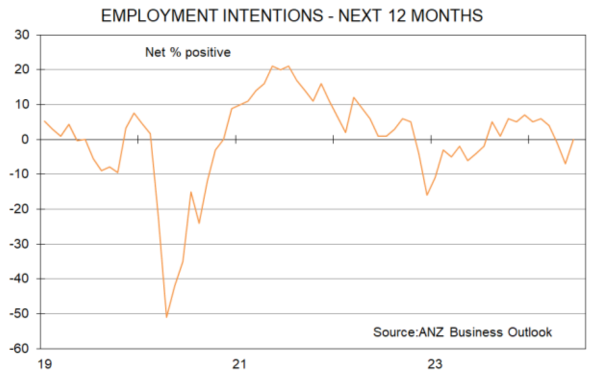
More retailers will close down and restructure and for those with the capital to spare some good opportunities will open up for locations and perhaps securing franchises on offer.

The ANZ survey shows that the net proportion of businesses having a positive outlook for the coming year has fallen to just 6% from a recent peak of 37% in January. Again we see a variable which has fallen sharply in the first half of this year.

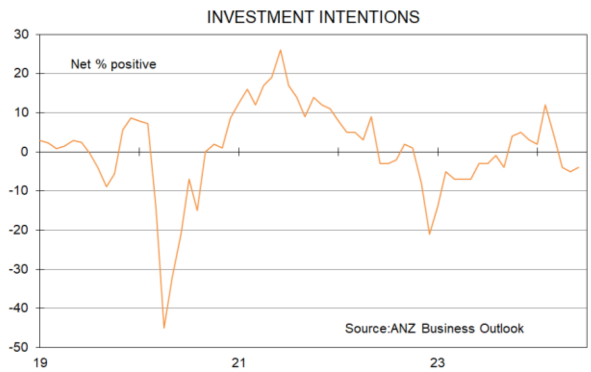


This type of deterioration would not have been anticipated by the Reserve Bank when setting monetary policy and given the slowness with which they tend to realise the ground is shifting under them they may not understand the economy is tanking until very late this year. That is when they will likely ease quickly with permission to do so delivered by the low pricing intentions measure come the December quarter.

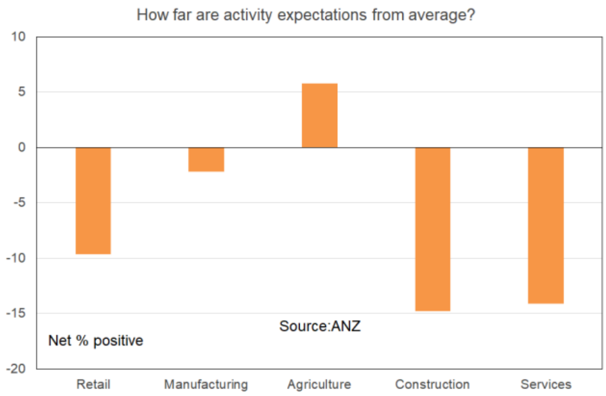
The net proportion of businesses planning to hire more people recovered to 0% in June from -7% in May. But like all these monthly measures the actual outcome can vary quite a bit around whatever the trend is – which in this case is downwards.



Net investment intentions came in at -4% from -5% in May. Businesses plan spending less on boosting their capacity and/or productivity and this is a result which comes through in my own monthly survey also.



This next graph shows the extent to which expectations of one's own levels of activity in the coming year are above or below average. I like it because it allows us to place some perspective around commentary coming out of particular sectors.

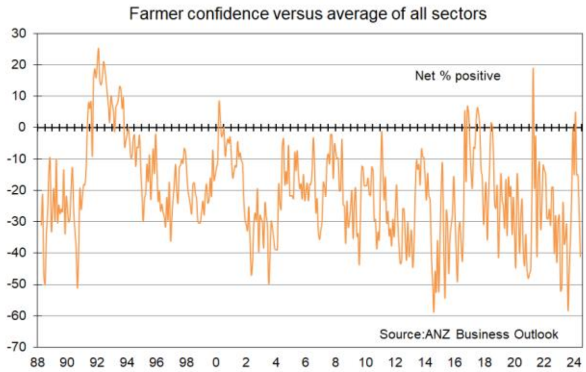


Things are genuinely on the very weak side for the construction and services sector and weak for retailing. But manufacturing is not expected by operators in the sector to be all that different from average in the coming year. In farming things are expected to be better than average.

Farmers are very good at painting a negative outlook for their still subsidized sector in the media, even when the exchange rate is well in comfortable territory, and they are not experiencing the customer collapse hitting the

retailing, hospitality, and home building sectors. Costs are rising, as they are in all sectors.

This final graph compares the confidence level of farmers with confidence across all sectors in the ANZ survey from 1988. It is extremely rare for farmers to be more confident that other businesspeople. In fact, on average since 1988 a net 15% of them have had a bad outlook versus average 10% positive outlooks for operators in construction and services, 7% in retail, and 4% in manufacturing.



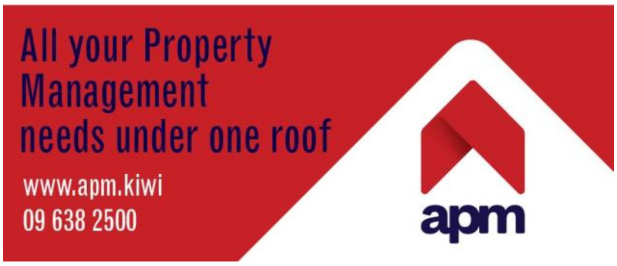
In case you missed it

Nothing new this week

If I were a borrower, what would I do?

Assisted by some weaker than expected data in the United States raising expectations of rate cuts there from September, from good pricing intention measures here in NZ, wholesale interest rates have edged lower this week at the shorter end of the yield curve.

But the movements have been small as the markets await the next review of monetary policy by the Reserve Bank on July 10. No change in the 5.5% official cash rate is expected and no hint of bringing forward their planned timing for the first rate cut from the third quarter of next year is envisaged.



If I were borrowing at the moment, I would take a mix of 6 and 12 month fixed rates and expect to make a similar decision in 6-12 months time.

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.