14 January 2020

NZIER QSBO: When Boring Is Good

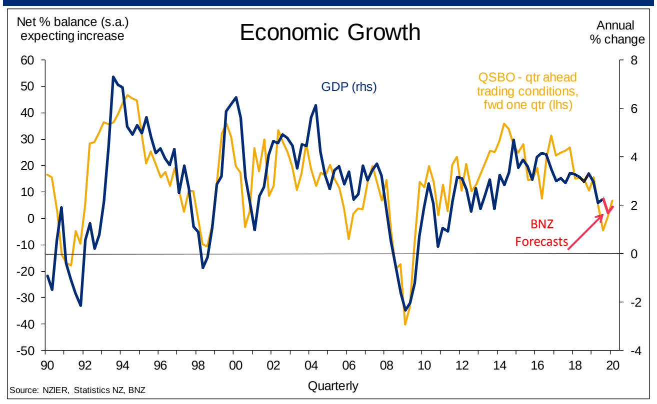
- **GDP growth to sit near 2.0%**
- **Keeping the unemployment rate steady**
- **And price pressures at bay**
- **Rate stagnation to continue**
- **As hurdles to change get higher**

The key economic theme building at the tail end of 2019 was that the risk of a recession in New Zealand appeared to be fading fast. Today's Quarterly Survey of Business Opinion provided even more weight to that argument. As is the case in much of the Asian region, it would appear that growth is stabilizing, after a fall, and the prospect of some acceleration is strengthening.

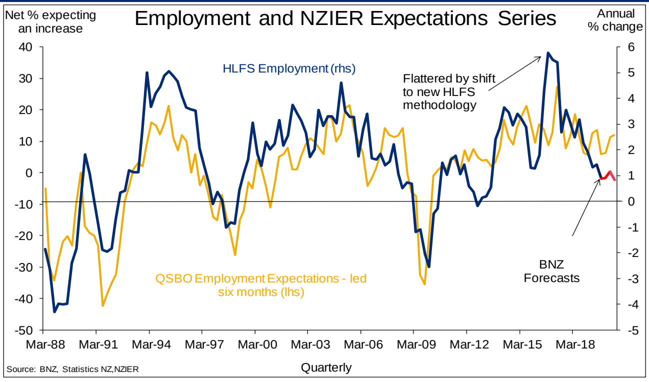
Be that as it may, the indicators that we have (including the QSBO) still suggest that we are not out of the woods yet. In particular, the leading indicators of growth have some way to go before GDP growth returns to trend. Indicative of this, expected trading conditions in NZIER's December report rose to +7 from September's 0. The increase was welcome but the level remains well below the +15 average for this series and is suggestive of annual GDP growth merely approaching 2.0%.

One of the key questions facing us this year is ascertaining what the economy's potential growth rate is. It may well be that the economy simply can't grow much more than 2.0% given the capacity constraints that it currently faces. And there was certainly little in today's data to suggest that spare capacity was opening up in any meaningful fashion.

2.0% Growth



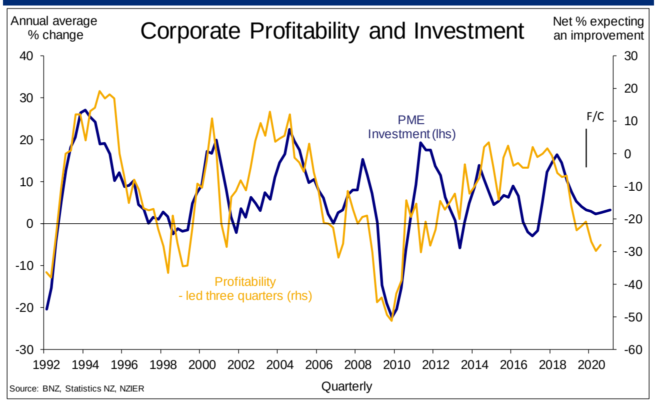
Employment intentions lofty



It is true the difficulty in finding labour might be easing and that this is usually consistent with an uptick in the unemployment rate but employment intentions remain strong. NZIER's reported hiring numbers for the December quarter were relatively weak and consistent with our view that annual employment growth will stay sub 1.0% for calendar 2019. But future hiring intentions indicate prospective employment growth much higher than this. If the intentions turn into actual hiring then the unemployment rate would plummet.

Whatever the specifics, the combination of strong employment intentions, elevated labour turnover, ongoing difficulty in finding labour and the tight starting point for the labour market suggest that the RBNZ will maintain success in achieving maximum sustainable employment through calendar 2020.

Investment growth muted

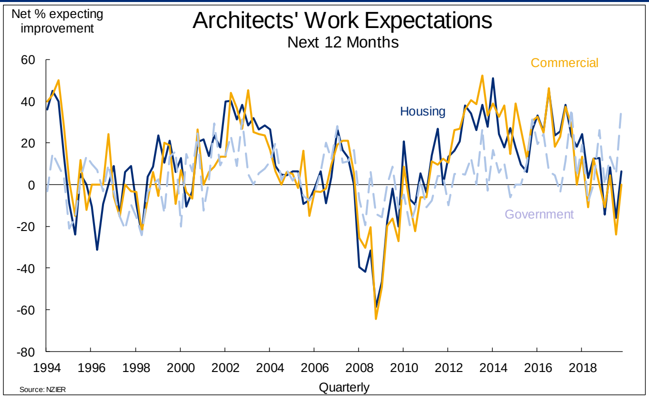


Moreover, it doesn't yet look like investment activity will provide the safety valve needed to alleviate capacity constraints and increase the economy's potential growth rate. Business investment intentions (at -3) remain at their lowest levels since September 2009 and profit expectations remain weak. Accordingly, we are expecting only modest growth in plant and machinery investment in the year ahead.

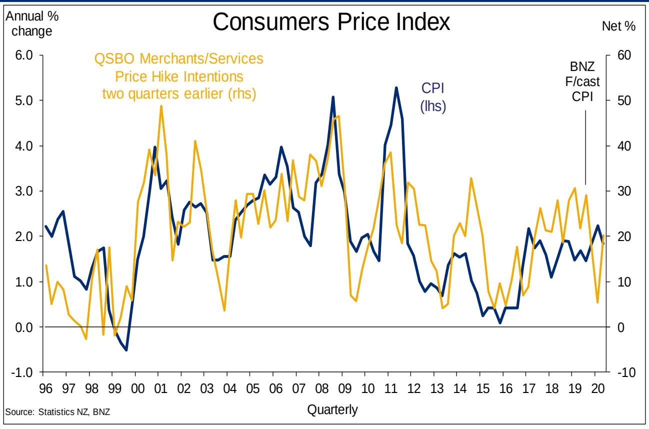
Building intentions are similarly weak though there is some suggestion that we are being too pessimistic in terms of our non-residential construction forecasts. Moreover, architects (who often provide a long leading indicator of construction activity) are getting more optimistic about the way ahead particularly with respect to government-led activity.

From an inflation perspective, the survey readings were broadly balanced. There remain pressures on margins as input costs rise more aggressively than output costs but, overall, pricing intentions and behaviours appear consistent with CPI inflation heading to the mid point of the RBNZ's target band but no higher.

Architects more upbeat



2.0% CPI inflation?



The hawk will read this as the RBNZ meeting its target and, in so doing, opening the door to the prospect of prospective rate hikes. The dove will continue to see the downside risks to inflation that pervade and the freedom for the RBNZ to give the economy another nudge.

From our perspective, the QSBO will provide no pressure either way for the RBNZ to awaken from its slumber. To us it delivers further evidence that the Bank can sit on its hands for a long time yet. For now the economy seems uncannily stable and boring:

- Growth is looking to settle near trend
- The labour market is creating just enough jobs to keep the unemployment rate steady
- Fears of deflation are dissipating while there are minimal signs that it might become problematic to the topside
- So interest rates can stay where they are until such time as there is a clear catalyst for them to move.

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