31 May 2010

Rate Hike No Surprise to Business

- Business confidence foreshadows above-trend growth
- Recent agriculture news should push it even higher
- Hiring intentions support a sustainable expansion
- Even investment hopes are rising
- Growing inflationary threat says "hike now"

If ever there was a reason why the RBNZ should start raising its cash rate sooner rather than later, today's National Bank Survey was it. In short, this survey implied that: GDP growth will soon be above trend; inflationary expectations are pushing higher; businesses know that rates are headed higher; capacity utilisation is rising; and even the lagging indicators of employment and investment are proving to be robust. This being so, we feel more assured in our view that the RBNZ is likely to pull the trigger at next week's MPS.

We always look to the own-activity indicator as the best all-encompassing picture of the health of the business sector. At 45.3 this was the strongest reading since May 1999 and consistent with GDP growth headed through 4.0%. This is stronger than our own forecasts and, probably, a tad stronger than that expected by the more optimistic RBNZ. (It's certainly indicative of a more robust profile than Treasury's Budget view.)

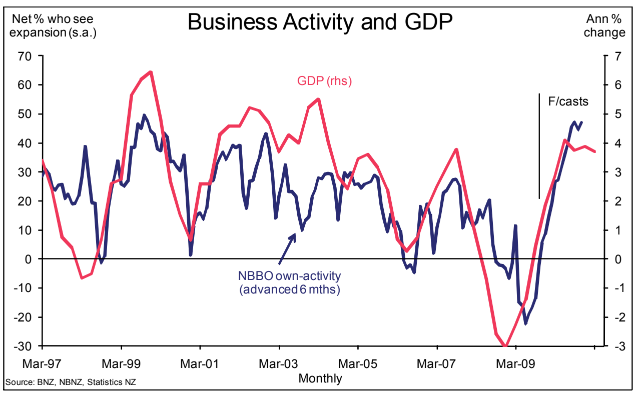
Interestingly, back in May 1999 (when the reading was last this strong) the cash rate was 4.5% shortly to embark on its ride to a peak of 6.5%. Clearly this cycle is not the same as that one but a worthy point of comparison nonetheless.

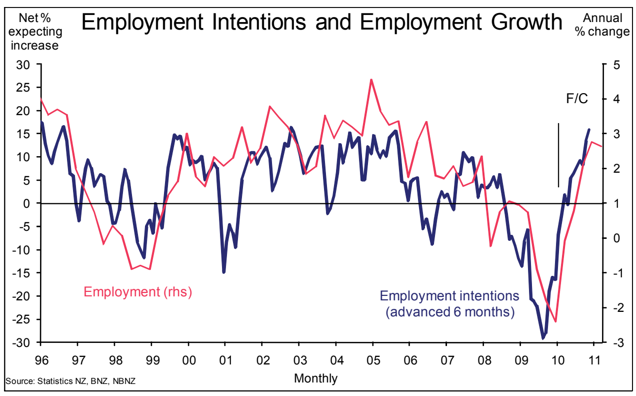
Relative to average, the most optimistic sector was construction followed by retail. The laggard was agriculture. Since this survey was conducted Fonterra has raised dairy payout hopes above previous expectations, the drought has ended and the NZD has fallen a couple of cents. This combination of events can only have boosted rural sector confidence. Moreover, we believe that, at the margin, the business sector will have approved of the 20 May Budget.

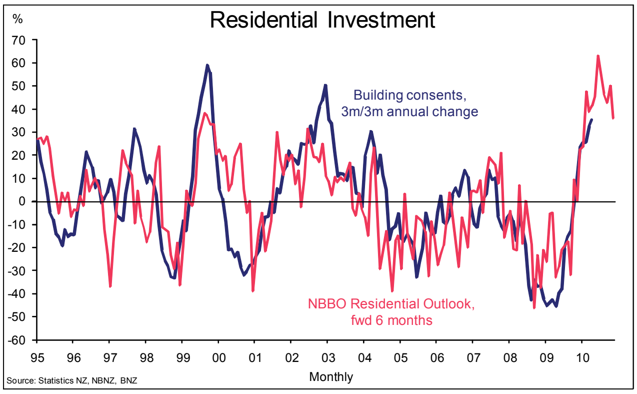
National Bank Business Outlook				
Net balance - next 12 months				
(All sectors)	**May**	April	Change	Average
General business outlook	**48.2**	49.5	-1.3	6.1
Own business	**45.3**	43.0	2.3	25.3
Profits	**24.4**	26.1	-1.7	6.8
Employment	**15.9**	13.4	2.5	6.0
Investment	**13.6**	10.2	3.4	13.5
Pricing intentions	**28.1**	26.4	1.7	20.2
Inflation expectations	**2.69**	2.67	0.0	
Exports	**32.7**	34.5	-1.8	32.8
(Own activity outlook)				
Retail	**46.9**	36.5	10.4	23.2
Manufacturing	**46.5**	50.0	-3.5	26.9
Agriculture	**22.0**	28.3	-6.3	23.9
Construction	**51.4**	56.1	-4.7	12.2
Services	**48.5**	42.1	6.4	28.6

It was particularly heartening to see that two traditional lagging indicators of economic growth were positive. Employment intentions rose to 15.9 from 13.4 and are now at their highest level since October 2002. At these levels, intentions would tend to suggest annual employment growth rising to around 3.0%. This is modestly higher than our own pick and consistent with further significant falls in the unemployment rate.

This is good news for the sustainability of the recovery and, in particular, should support retail spending and residential construction. Moreover, it is consistent with heightened wage pressure from a tightening labour market.



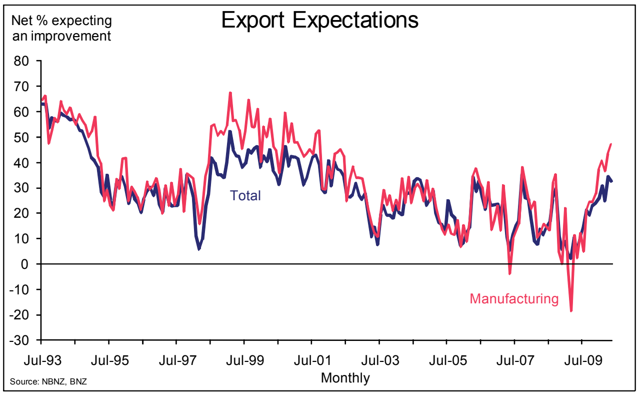




Investment intentions also poked their head above water. It was the first time intentions had been above average since November 2007. While it's far from suggestive that businesses are about to spend up large, at least the series continues to trend in the "right" direction. It is also consistent with the fact that capacity utilisation growth is headed along the same path.

We have long believed that some of the strongest investment this cycle would be in the residential construction sector. Today's survey reveals a drop in residential investment intentions but to a level that still portends annual residential investment growth rising to around 30%. Indeed we are forecasting exactly this growth by the end of this year.

In stark contrast, non-residential expectations remain low also supporting our view that this sector will contract across 2010. This should come as no surprise as first the economy needs to grow, then people need to be hired, and then existing space needs to be filled before folk can start thinking about commercial building.



Another positive sign in today's release was the strength in export intentions. While bang on average overall, a net 47.1% of manufacturers remain optimistic about their export prognosis consistent with the strength we are seeing in the BNZ-BusinessNZ PMI.

With all this confidence, it should perhaps come as no surprise to see business pricing intentions rising. In fact they have risen to the extent where they suggest an upcoming breach of the RBNZ's target band. The problem is we don't know how much this reflects GST-increase expectations as opposed to a return to pricing power. It was interesting, nonetheless, to see that the agriculture sector, witnessing rising commodity prices, felt most confident that prices would be pushed higher followed by the construction industry, as activity in residential activity picks up. The sector most obviously impacted by the GST increase, retail, was one of the laggards in pricing behaviour.

Putting all this together, we have to conclude that, despite the growing risks from a European implosion, New Zealand businesses still feel relatively confident that their lot is about to improve. Given the normal implications of this for both growth and inflation, it presents a very strong argument for the Reserve Bank to at least start the process of pushing interest rates back towards neutral. And given that a net 79.4% of businesses believe rates are moving up also, then such a move will hardly come as a surprise to the business community either.

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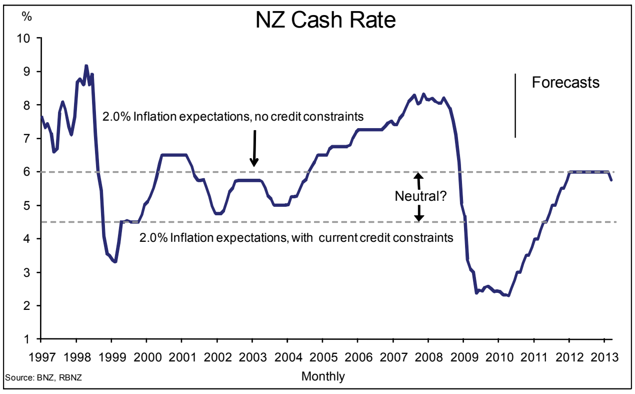

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