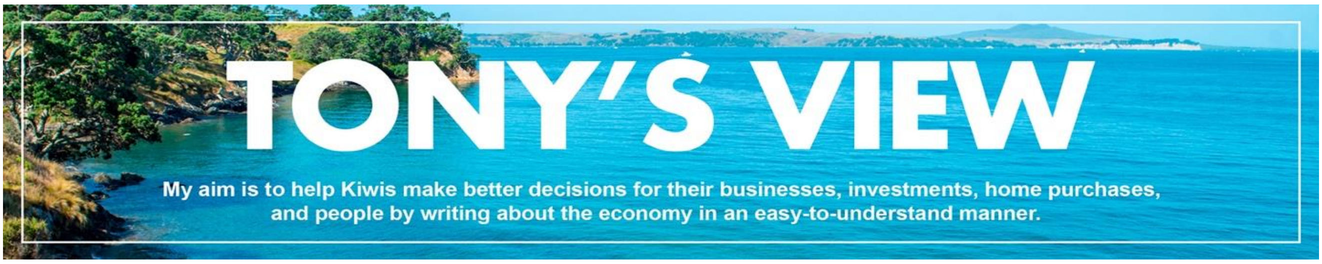

Input to your Strategy for Adapting to Challenges

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ISSN: 2703-2825 Wednesday 13 April 2023
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Slowing down enough yet?

For a few months now we have been living in a period when none of us can comfortably say that interest rates have gone high enough to send inflation comfortably back towards 2% within two years. Any who were comfortably thinking that before October 18 – as in almost all of us – quickly shed that optimism when the annual inflation number turned out to be 0.6% higher than expected at 7.2%.

The rate remains at that level, but we will get an update on April 20 and whatever the result we're going to either say it is biased upward by the flooding effects, or such upward bias is set to come because those effects have yet to show through.

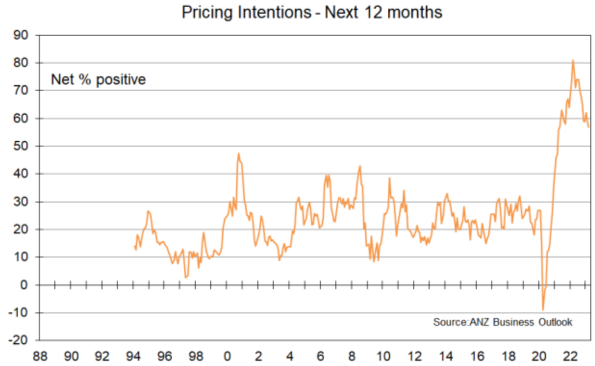
So, unless the outcome is vastly different from expectations you should expect us economists to remain well focussed on the underlying things which will most influence inflation over the next 18 months. In particular, we're going to be looking at the range of things implied by the Reserve Bank in their comments surrounding the cash rate rise of 0.5% to 5.25% last week.

Last week the RB removed their warning that they expected to raise the cash rate further and instead made future moves data-dependent. Specifically, they said this.

"Looking ahead, the Committee is expecting to see a continued slowing in domestic demand and a moderation in core inflation and inflation expectations. The extent of this moderation will determine the direction of future monetary policy."

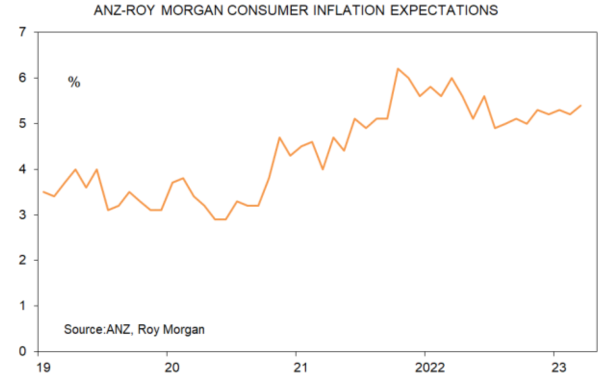
The extent of the moderation is what matters. So, what can we look at to gauge whether the easing coming in inflation expectations and domestic spending is enough, keeping in mind that we don't know the extent of moderation which the Reserve Bank expects to see?

A much-looked at measure comes from the ANZ's monthly Business Outlook Survey regarding business plans for raising their selling prices. On average over the past three decades when inflation has averaged 2.2% a net 25% of businesses have said they plan raising their selling prices n the coming year. The latest reading taken in a survey a month ago was 57%.



This is down from a peak of 81% exactly a year ago but is still much too high. In fact, it has essentially been steady since reaching 59% last November. At a minimum this measure will need to resume its decline.

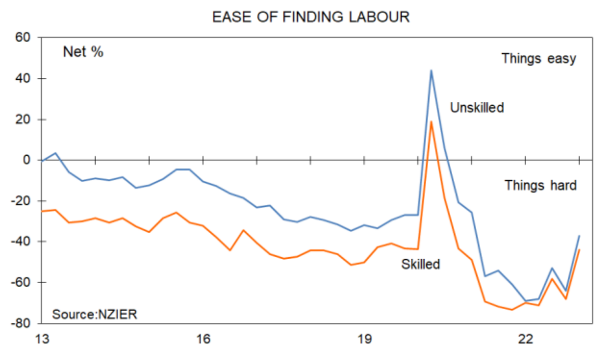
The ANZ's survey of consumers with Roy Morgan also yields an inflation expectations measure. But this is more something which changes with or after actual inflation rate changes rather than a leading indicator of where inflation is headed. Nonetheless, it is the sort of thing which can influence wage demands so is worth casting a quick eye at but not fixating on.



The latest reading of 5.4% was up from 5.2% a month earlier and the trend is not down.

Inflation is strongly driven by capacity availability relative to growth in demand. In that regard we need to focus our attention on the labour market and that is where the NZIER's Quarterly Survey of Business Opinion released last week is very useful. It gives the best measure of labour resource availability and only really suffers because it is quarterly and not monthly.

On average over the past ten years (more relevant for employment than the 30 years for inflation used above) a net 44% of employers outside agriculture have said that they are finding it hard to get skilled labour. The latest reading is exactly that average and down from 68% in the December quarter and a peak of 73% at the end of 2021.



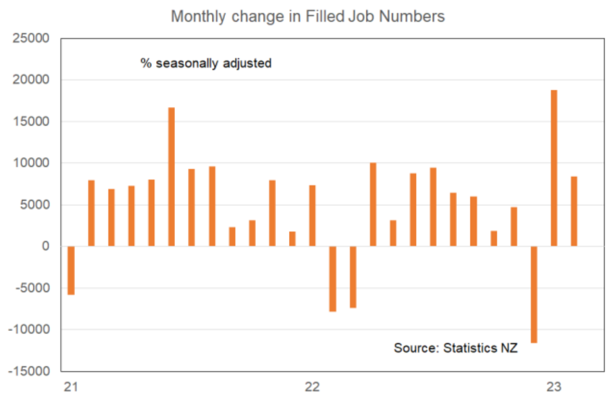
A net 37% of employers have said that unskilled staff are hard to find. This is above the 27% ten year average but down from 64% in the 2022 December quarter and the peak of 69% a year ago.

These outcomes are a very positive sign for future inflation and were made public the day before the cash rate review last week. They likely encouraged the wording change by the Reserve Bank.

The easing hiring problems will reflect the combination of household spending cutbacks alongside a rapid surge in migrant inflows making more people available. The importance of the result is reinforced by the way it helps explain the slowing in wages growth reported here a few weeks back.

Private sector average ordinary time earnings rose just 0.9% in the December quarter from 2.6% in the September quarter and 1.4% a year earlier.

We're going to have to wait three months now for the next NZIER measure of labour availability, but before then we will have the March quarter Household Labour Force Survey data in hand. It is likely to show some better jobs growth than the 0.1% recorded in the December quarter. The monthly Filled Jobs data series released by Statistics NZ shows seasonally adjusted jobs growth on 0.8% in January and 0.4% in February. The December total was down 0.2% from September – hence my expectation for positive jobs growth in the March quarter.



But the unemployment rate is likely to rise because of the accelerating labour force growth courtesy of the new migration boom.

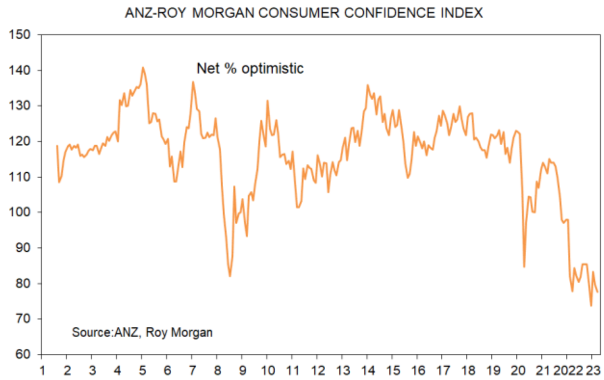
Just to finish off though. The ANZ's Business Outlook Survey showed a net 5% of businesses plan laying off staff. The ten year average is a net 10% planning hiring. This is good news for inflation.

What about the ultimate driver of domestic demand in our economy – household spending? For that we have a number of measures which we need to keep an eye on, and an unfortunate situation. The actual data on household spending are not timely. Monthly spending measures can go all over the place and sometimes give near no guide to what the more comprehensive quarterly Retail Trade data from Statistics NZ show.

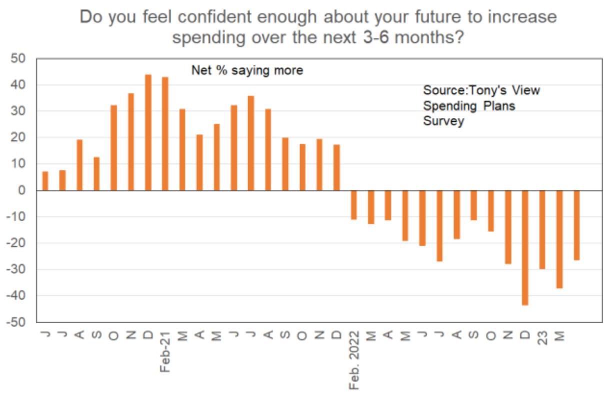
The latest data tell us that in the old days of the December quarter last year core retail spending volumes in seasonally adjusted terms fell by 1.3%. The average change is a rise of 0.9% so we can say householders are pulling their horns in.

But the Reserve Bank are going to take their guide not from these out of date numbers but measures of consumer sentiment and spending intentions. The readings there firmly suggest further spending cutbacks.

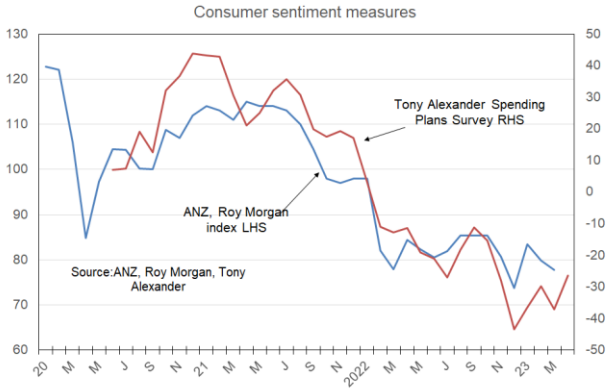
The ANZ Roy Morgan Consumer Confidence Index has just eased to a reading of 77.7 from 79.8 in February where 100 is neutral. The graph shows that following the big step down right at the start of 2022 consumer sentiment has remained bad.



My own monthly Spending Plans Survey has revealed a small lessening in pessimism this month from last with the net spending intentions measure moving to -27% from -37%. But as the following graph shows, sentiment remains very poor.

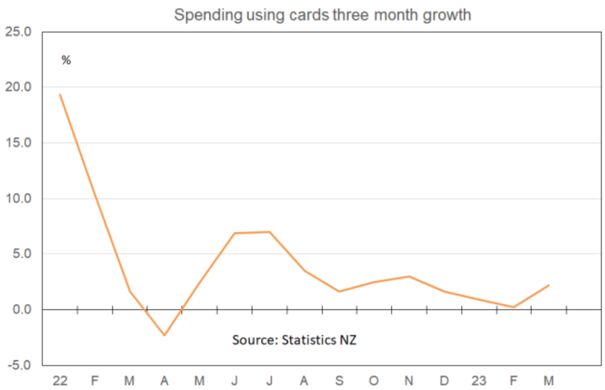


This graph shows both my measure and the ANZ's.



Especially pleasing for the Reserve Bank will be the very negative spending intentions which people reveal regarding durable goods. On average these past three years a net 8% of people have said they will cut spending on furniture and appliances. The latest reading is -22%. A net 7% on average have said they will cut spending on motor vehicles. The latest reading is -12%.

The Electronic Card Transaction data from Statistics NZ shows nominal spending growth in the past three months seasonally adjusted of 2.2% from 1.6% in the three months to December and 1.6% before that. The data do not show that consumer spending is being crunched.

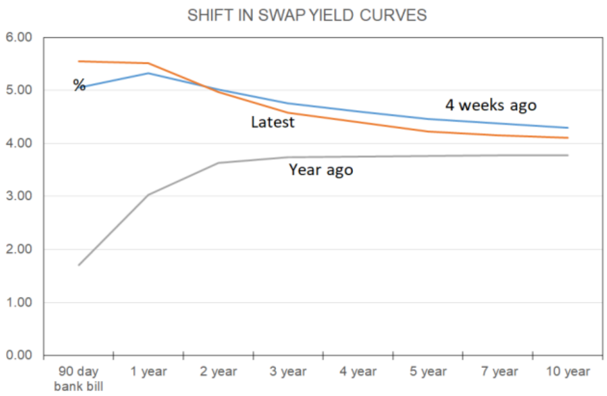


For the next few months we are going to be analysing the entrails of all indicators of inflation, capacity availability, and consumer spending to see if things are tracking the way the Reserve Bank wants. But because we don't know what changes in these things the Reserve Bank is looking for, we will remain in an uncertain monetary policy environment for a long time yet. Borrowers should take this uncertainty into account when making their interest rate risk management decisions.

If I were a borrower, what would I do?

It has been a fairly quiet week with no major data releases of events to move NZ wholesale interest rates. Compared with the Thursday before the Reserve Bank raised the official cash rate by 0.5% the one year swap banks pay to borrow fixed one year has risen from 5.29% to 5.51%. This is applying some understandable upward pressure to one year fixed mortgage rates. But while one bank has moved this rate up the increase may not be followed by others in a market where sales are hard to come by.

The three year swap rate has fallen from 4.63% to 4.58% with a growing view that the Reserve Bank will probably tighten monetary policy too much having eased it too much (they get paid for this rubbish?).



If I were borrowing at the moment, I'd probably fix one year but not turn my nose up at a discounted two year rate. After all, no-one has got their monetary policy predictions rate for about one and a half decades now.

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.