

First View

Kiwibank economics.

It's now a crisis of confidence.

- Business and consumer confidence is weakening. Outside of 2020, both are sitting at GFC levels. Supply issues darken the activity outlook amongst firms. And household consumption is contending with higher cost of living, rising rates and falling house prices.
- Despite softening confidence, the RBNZ is unlikely to veer off course next week. We still expect the RBNZ to lift the cash rate by 50bps to 2.50%. The RBNZ however may soften its tone around the outlook.
- Our chart of the week highlights the disparity between key Kiwi housing metrics and international peers. The Kiwi market is the least affordable, due to a chronic shortage of supply.

Scarce labour. Scarce materials. Rising rates. Rising cost of living. Falling house prices. There's lots weighing on confidence. Firms' activity and profitability outlook is looking weaker by the day. And for households, inflation and rising mortgage rates are claiming bigger and bigger chunks of the budget. Given the strong correlation between confidence and economic activity, the outlook for the Kiwi economy is dimming.

The latest ANZ business outlook survey was yet another sobering read. For the fourth straight month, business confidence has been on a downtrend. In June, confidence fell to the lowest level since the pandemic began (-63 vs -55.6 in May). Across the board, the activity indicators continued to flash red. Compared to a month ago, a greater share of the firms surveyed expect their own activity to deteriorate in the coming months (from a net 4.7% to a net 9.1% expecting a decline). Profitability expectations also weakened and fell to 2008/09 GFC lows (-41.5 vs -31.3 in May). Supply-side issues remain at the core of the growing pessimism across firms. Top of the list is the difficulty in finding skilled labour. Cost and wage inflation too are weighing on the profitability outlook. And the ongoing supply chain disruptions are still creating logistical nightmares. Given the lack of resources, it's no surprise to see investment intentions slip into negative territory – the first time since August 2020. A pullback in investment points to weaker economic growth ahead.



Pricing intentions remain uncomfortably high, especially across retail. In June, a record 96.1% of retailers expect prices to go up in the coming months. That's well above the previous high of 89%. In aggregate, the suite of inflation indicators – pricing intentions, cost expectations and inflation expectations – may be slightly off their peaks, but they are yet to moderate. The combination of a weak activity outlook and persistent inflation pressures underscores the current state of the Kiwi economy: severely supply-constrained.

On the household side, consumer confidence too is down in the doldrums. The ANZ-Roy Morgan consumer confidence index plunged 1.8 points to 80.5 in June, just a few points above the record low (77.9). Perceptions about next year's economic outlook deteriorated and a net 3% expect to be worse off in a year's time. With rising mortgage rates and reduced credit availability, households are also second-guessing splurging on big-ticket items.

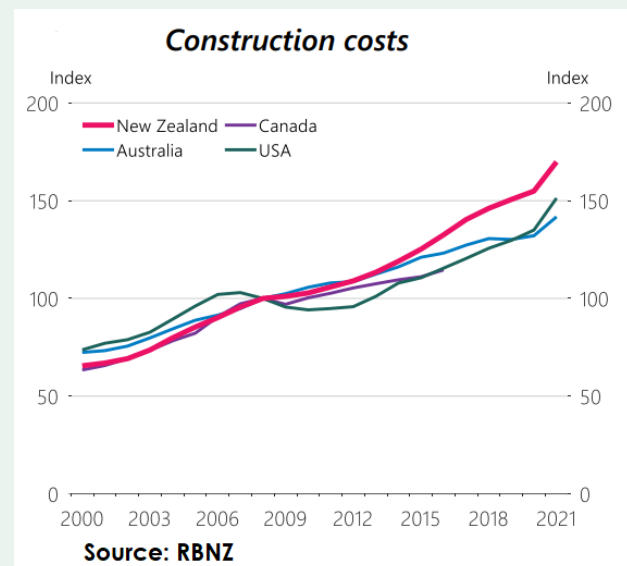
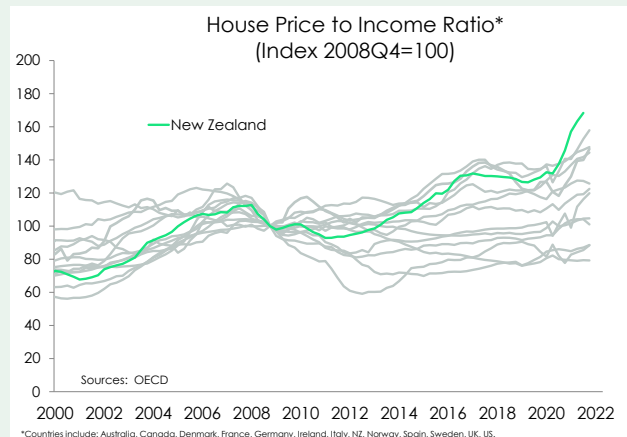
Despite softening confidence, the RBNZ is unlikely to veer off course. Reining in inflation is the name of the game. Inflation indicators may be plateauing, but they're plateauing at elevated levels. We suspect the RBNZ would want to see these indicators moderate before easing up on their current tightening pace. We expect the RBNZ to lift the cash rate through neutral next week, by delivering another 50bp hike to 2.50%. The July meeting would mark the third straight 50bps hike. But similar to offshore central banks, the RBNZ may soften its tone around the outlook, acknowledging the waning strength in the forward activity indicators.

Charts of the week: An unfavourable comparison.

Last week the RBNZ released a series of research papers related to NZ housing. Included was [a comparison with a dozen other developed countries](#). RBNZ's comparison further demonstrated how out of kilter the NZ housing market is.

Since the GFC of 2008/09 housing demand has been supercharged by the largest decline in mortgage rates and among the strongest population growth compared to other developed nations. At the same time, the supply of new housing has not responded fast enough. The result is the highest real house price gains since the late 2000s relative to comparable countries. The world beating housing price gains, combined with NZ's low-income growth performance, has translated into a marked deterioration in housing affordability. In fact, the house price boom of the covid period has pushed NZ house price to income ratio to the highest in the RBNZ's study.

NZ's unfavourable comparison seems hard to reconcile. We have low population density and land isn't in short supply. It seems NZ's ability to convert resources into much needed housing has been severely restricted for years. As the RBNZ's paper showed, NZ's building cost inflation tops the list. Most likely due to overly restrictive local government development rules, and the structure of the building sector. The current plasterboard fiasco that builders are struggling with appears to be yet another symptom of a broken market.



Financial Markets

The comments below were provided by Kiwibank traders. Trader comments may not reflect the view of the research team.

In rates, growth concerns dominate:

"The lofty top has finally come off kiwi rates, a combination of factors at play with weaker global data combining with weaker domestic forward indicators. The kiwi rates market feels like a deflating bouncy castle, yields are nearly -50bp lower than two weeks ago which in turn has seen exuberant OCR expectations for a 4.50% OCR recoil back to around a 3.92% peak now. Remember the RBNZ had a 3.95% peak forecast in their May MPS, it certainly doesn't feel like things have accelerated since then on the inflation front, arguably the NZD/TWI is lower though. The constant

pricing in the market is front loaded hikes, with annual CPI sitting at around 7.00% the RBNZ don't have a choice but to keep the foot on the floor, and at the moment that is 4*50bp hikes by year end taking the OCR to 4.00% (currently 3.85% priced). The unknown here is how quickly inflation and/or employment react to slowing growth, NZ 2Q CPI is released 5 days after the RBNZ meeting on 18 July which will remain elevated if you believe the various forward indicators. RBA meet tomorrow, +50bp is priced and highly likely to be delivered with a hawkish message, but that outcome is largely priced with +43bp, and a total of +235bp priced for this year of the next 7 meetings. It certainly feels like the worm has turned for lofty yields with the global picture not quite as rosy and oil falling as a result, but we have been here before so some caution is advised. The US market has moved to price in an increasingly aggressive rate cut profile for the Fed into 2023 and 2024, consistent with a growing chance of recession, around -

60bp of Fed cuts are now priced in for 2023. The curve shape is stuck in no mans land, seemingly wanting to flatten on domestic factors and steepen on offshore ones." **Ross Weston, Senior Portfolio Manager.**

In currencies, recession fears dominate:

"It was a relatively lacklustre week for the NZ Dollar last week, and we traded within a fairly tight range, which ultimately reflected the mood of market participants. Equities ended the first half of the year on a downer, with the S&P posting its worst first half of the calendar year in 50 years. The lack of risk sentiment bled through into currency markets, and riskier currencies struggled to find footing in the higher end of their ranges. The NZ Dollar topped out at 0.6326 at the start of the week, spending the remainder of the week hovering at the 0.6200/0.6250 level. And then on Friday we saw the full brunt of the fall in risk appetite, with the NZDUSD trading below 0.6200 cents, reaching a low of 0.6146 before finding some footing just shy of 0.6200 again. With this in mind, we are altering our expected range for the week ahead to 0.6100-0.6300, with some initial support likely around 0.6150. Should we see this support level breached early, this definitely opens some more downside risk, to even perhaps below 60 cents. With data again relatively thin on the ground until later in the week, headlines will drive currency markets. US Non-farm payrolls is due out on Friday, and this will be a key piece of data as the market awaits next week's key US CPI print.

For NZDAUD we have been trading again in a tight range between 0.8950 and 0.9120, but pressuring to the upside towards the end of last week. On Tuesday afternoon, we have the latest RBA monetary policy decision. Market participants are expecting a 50 basis point hike, but the key information will lie in the accompanying statement. We see some potential downside for NZDAUD, should the RBA come through as more hawkish. Otherwise a more dovish statement should lend some support to the NZD vs AUD, given that the likely trajectories of central banks and hikes are still of vital importance to market participants. With it looking increasingly unlikely that central banks will be able to deliver a soft landing as they tighten monetary policy, pessimism is likely to remain in the week ahead. It would take some very strong headlines indeed to see us move out of the doldrums." **Mieneke Perniskie, Trader – Financial Markets.**

Weekly Calendar

Date	Economic Indicator	Last	Consensus	Comment
Mon, Jul 04	EZ ECB Speakers - Nagel, Guindos	-	-	We'll let central bank officials speak for themselves.
Tue, Jul 05	NZ Jun Qtr NZIER Business Opinion Survey (DTA Net % of Firms)	-9.3	-	Judging by the ANZ's business outlook surveys already released for the June quarter, business confidence worsened. The recent series of supply-side shocks is eroding profitability and forcing firms to hike prices. Worryingly for future growth investment intentions have fallen. Fortunately employment intentions are holding up.
	AU RBA Cash Rate Target (%)	0.85	1.35	The RBA is expected to deliver another 50bp hike this week as it fights uncomfortably high inflation.
	UK BoE Speaker - Tenreyro	-	-	We'll let central bank officials speak for themselves.
Wed, Jul 06	UK BoE Speakers - Pill, Cunliffe	-	-	We'll let central bank officials speak for themselves.
	EZ ECB Speaker - Rehn	-	-	We'll let central bank officials speak for themselves.
Thu, Jul 07	UK BoE Speaker - Mann	-	-	We'll let central bank officials speak for themselves.
	GE May Industrial Production (% mom)	0.7	-0.3	Ongoing supply constraints related to the war in Ukraine most likely weighed on German industrial production in May.
	EZ ECB Releases Account of June Meeting	-	-	The ECB is set to start hiking interest rates at their next meeting in July. The minutes for June may provide more clues on how big the hike might be.
	ECB Speakers - Lane, Stournaras, Centeno, Herodotou	-	-	We'll let central bank officials speak for themselves.
	US FOMC Releases Meeting Minutes	-	-	Before the media blackout period ahead of the June FOMC meeting, officials had strongly signalled a hike of 50bps was on the cards. The FOMC delivered 75bps. The minutes of the meeting will shed some more light on the reason for the more hawkish move.
	Fed Speakers - Waller, Bullard	-	-	We'll let central bank officials speak for themselves.
Fri, Jul 08	EZ ECB Speakers - Lagarde, Villeroy	-	-	We'll let central bank officials speak for themselves.
	US Jun Change in Nonfarm Payrolls (000)	390	275	The June US labour market report is predicted to reveal a fall in the number of new non-farm payrolls. However, the market is picking a decent 275k new payrolls. The Markets will on the lookout for any evidence that a cooling US economy is starting to feed into the labour market. If so expect a financial market jolt.
	Jun Unemployment Rate (%)	3.6	3.6	
	Fed Speaker - Williams	-	-	We'll let central bank officials speak for themselves.



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