SALT INSIGHT

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By: Bevan Graham, Economist

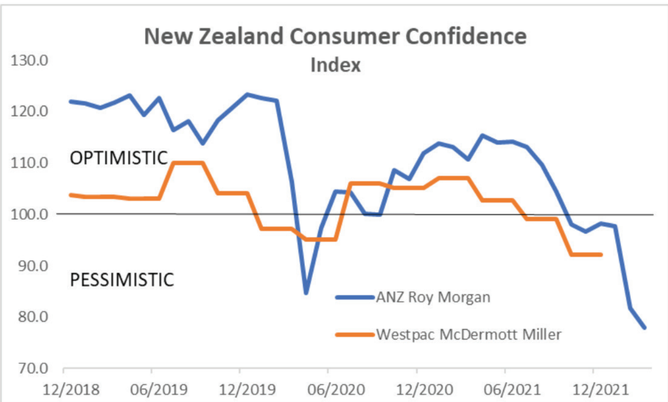
Confidence blues

It's not often I find myself waiting for the release of business and consumer confidence with a degree of trepidation. That's not to say they're not important – they are. If a business isn't confident, it won't invest or hire, and if a consumer lacks confidence they will likely keep their wallet or purse firmly shut.

The recent tumble in both business and consumer confidence has therefore been of some concern, but also not surprising. The litany of factors contributing to the downbeat mood include the current Omicron wave of Covid, the "virtual" lockdown, soaring inflation, higher interest rates, lower house prices, supply constraints and rising input costs.

The ANZ Roy Morgan index of Consumer Confidence has fallen sharply over the last few months. The latest reading of 77.9 is well below the 100 that is the dividing line between optimism and pessimism. The only good news was the index didn't fall as much in March as it did in February. That's called cold comfort.

Consumer confidence has a particularly immediate effect on activity. Indeed, indicators such as card transactions are pointing to a weak quarter for retail spending that will likely see GDP growth flatline over the quarter, if not deliver a small contraction.

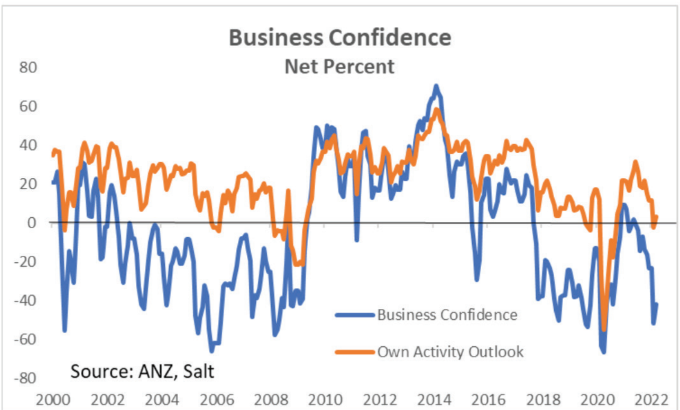


The question is whether the recent pessimism is being dominated by temporary factors (Omicron, lockdown), or longer-lasting factors (higher interest rates, softer house prices) and whether the tight labour market and rising wages could provide an offset.

We think consumer confidence does recover some ground in the months ahead, though probably only sufficiently to paint consumers as less negative rather than outright positive. But that remains to be seen and trepidation will remain high.

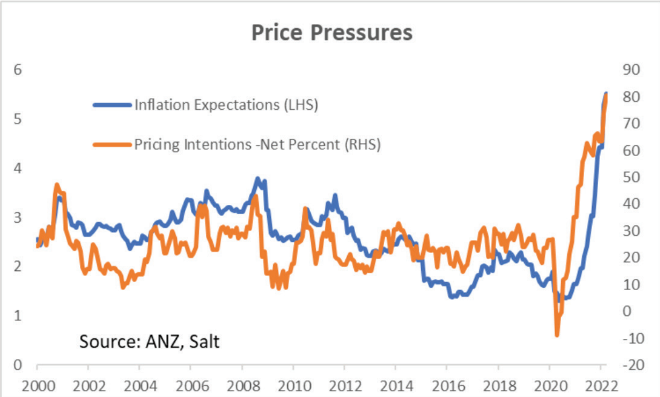
It was, however, great to see business confidence as recorded by the ANZ Business Outlook Survey didn't get any worse in March. We tend to focus on firms' expectations of their own activity rather than the overall confidence level as this series has the closest relationship with economic activity and GDP growth.

After a dip into the negative in February, firms' expectations about the outlook for their own business moved ever so slightly positive in March. Still weak, but the change was in the right direction.



This in turn gives us some confidence that business confidence will recover further as the Omicron peak passes, restrictions ease and things return to whatever normal is now. Importantly, this would make us feel more comfortable about the stronger GDP growth we expect to see over the second and third quarters of this year.

However, the survey won't have given the Reserve Bank any comfort on the inflation outlook. Inflation expectations rose again and a net 80.5% of businesses expect to raise prices over the next three months.



Furthermore, while it was great to see a significant improvement in employment intentions in the March survey, the labour market is already exceptionally tight, and the supply of labour is exceptionally constrained.

Labour supply is about to become even more constrained if our assumption that as our borders open, we're more likely to see Kiwi's leave than foreigners arrive proves correct. This will continue to put upward pressure on wages and inflation.

That reinforces our message that there is simply no justification for stimulatory monetary conditions right now, and many of the factors that continue to undermine business and consumer confidence are inflation related. The RBNZ needs to get the Official Cash Rate to neutral (2%) as quickly as possible. That calls for 50bp hikes in April and May.