

NATIONAL BANK BUSINESS OUTLOOK  
FEBRUARY 2007

Key points

- The NZ economy remains resilient in the face of tighter financial conditions, notably the higher NZ dollar.
- The survey's activity measures suggest 2½ percent economic growth.
- This rate of growth will continue to heighten inflation pressure.
- Inflation expectations are down but pricing intentions have increased, and are strongest in domestic pockets of the economy.
- Collectively, the survey reinforces the case for a March rate hike and hawkish overtures from the Reserve Bank with a view to a follow-up move.

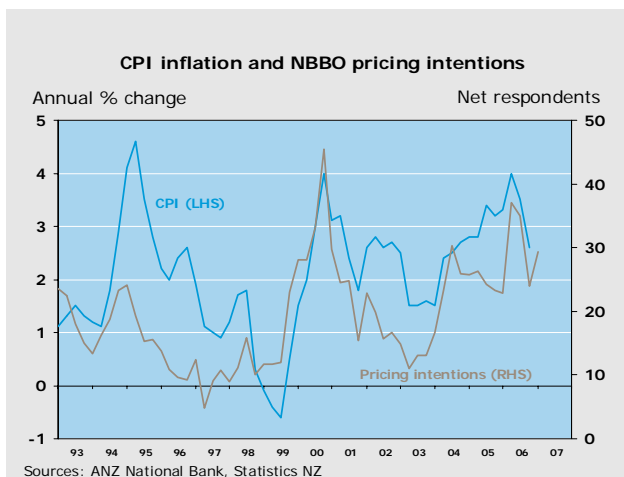
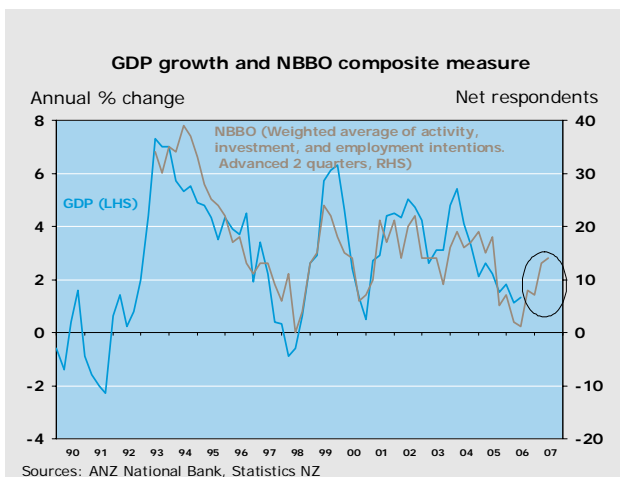
The headlines

	Actual	Previous
Business Confidence	-5.9	-7.7
Activity Outlook	25.7	24.0
Employment Intentions	9.0	11.0
Investment Intentions	12.3	11.1
Profit Expectations	2.0	5.7
Pricing Intentions	29.3	22.9
Inflation Expectations	3.11	3.25

Assessment and implications

**Headline business confidence continues to improve, rising to a three-year high, and firms' own activity expectations have strengthened further.** Sentiment within the economy remains dichotomised, with domestically oriented firms (the construction sector in particular) the most optimistic, while recent strength in the NZ dollar is taking its toll on the export sector.

**The collective picture painted by the NBBO's activity indicators remains one of comfort across businesses.** Firms' own activity expectations have risen to the highest level since March 2005. At an aggregate level, tighter financial conditions, and the stronger NZ dollar in particular, do not appear to be having a material impact on firms' activity outlooks or confidence levels, and the economy appears set to remain on a solid footing. Our composite growth indicator – using firms' own activity expectations, employment and investment intentions – is pointing to annual economic growth around 2½ percent. This rate of growth will accentuate inflation pressure given that resources are already stretched.



**Inflation expectations are down but pricing intentions are up.** We are wary of reading too much into the decline in inflation expectations, as it is likely to be related to the fall in petrol prices in recent months, which has had a material (but likely short-lived) impact on headline CPI inflation. A Reserve Bank study of the relationship between inflation and inflation expectations (RBNZ Bulletin, December 2003) found that the NBBO survey tends to have a stronger relationship with historical inflation than future inflation, and as a result provides only limited new information. Pricing intentions have risen to a 5-month high, with the largest increases coming in the domestic oriented sectors that have shown the greatest rebound in growth and that continue to frustrate the Reserve Bank – namely retail and construction.

**Financial conditions do not yet appear to be sufficiently tight to generate the slowdown that the Reserve Bank desires.**

**Today's survey result reinforces the view that the Reserve Bank will increase the Official Cash Rate and use a hawkish tone at their 8 March *Monetary Policy Statement*, with a view to a follow-up move.**

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