Molesworth & Featherston In The Loop

Lobby Edition, 29 April 2005

Molesworth & Featherston comes to you delayed this week by the shortened ANZAC week, though it was a quiet week. The Reserve Bank held interest rates. We investigated how seriously to take reports of falling business confidence and list our top near-term concerns about our economy. We worry things aren't going so well in the ANZAC relationship and we update media tattle.

It's all in this week's complimentary Lobby Edition of Molesworth & Featherston.

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Interest rate and business confidence

The decision of the Reserve Bank to hold official interest rates at 6.75 percent suggests the cycle of rises has truly peaked, even though the Bank's Governor, Dr Bollard, tried to talk tough with a warning 'further policy tightening cannot be ruled out'.

But the talk is all aimed at fears of growing too fast. The Bank is not hearing worries that the economy might be slowing. It expects to see evidence of growth rebounding in the first half of this year, after last year ended sluggishly.

In contrast, business confidence is dark with a National Bank survey showing a net 48 percent of businesses expect conditions to worsen.

So who is right? The Reserve Bank, which is refusing to let interest rates drop to stimulate more investment and let the dollar fall to increase our exports? Or businesses, whose confidence is at its lowest level at any time since the winter of discontent in 2000?

On the track record, it's no contest –confidence is falling because interest rates are up, and interest rates are up because the economy is growing.

No confidence in 'confidence'

In 2000, when business confidence slumped to very low levels, business conditions were getting better, not worse. Some of the business lobby groups and economic pundits might be embarrassed to read their gloomy predictions at the time; They failed completely to pick that New Zealand unemployment would fall to the lowest level in the developed world; while real GDP growth rates in 2000 and subsequently were New Zealand's strongest since the 1960s:

Real GDP growth [Source: OECD]:

2000: 3.61

2001: 2.69

2002: 4.47

2003: 3.23

So the current deteriorating climate of confidence needs to be analysed in the light of recent history where confidence has had no bearing at all on subsequent economic performance.

An NZIER quarterly survey of business opinion, released two weeks ago, said 'a net 28 percent of firms expect business conditions to deteriorate over the next six months.'

Now, we hate to always pick on NZIER, who are only writing up the results of their survey, but go back exactly one year to April 2004's NZIER survey and check out the oddly familiar refrain:

'Gloom descended on the business community in the March quarter,' NZIER then reported. 'A net 29 percent of firms expect general business conditions to deteriorate over the next six months…Confidence has slumped across all sectors and regions.' The consultants added a forecast that GDP growth would fall to 3.1 percent as a result.

Did the slumping confidence produce a slumping economy? Nope.

Here's Statistics New Zealand in its most recent GDP update: 'Economic activity remained at high levels and for the year ended December 2004 the economy grew 4.8 percent, up from 3.4 percent growth in the December 2003 year.'

The record suggests business confidence surveys are almost worthless predictors of anything.

But it's not all beer and skittles.

We think the interest rate tightening and higher dollar will probably slow the economy this year, but GDP growth will remain around or over two percent.

But there remain areas for concern.

Interest rates are keeping the dollar very high, against not just the US dollar (as too many pundits like to claim) but against all currencies.

The current account deficit remains the single greatest risk to our economy. We believe there is a significant risk the high kiwi dollar will push the deficit beyond its current level– it's now up to nine billion dollars – and alarm the market, causing a sharp 'correction.'

Much more probable than a current account blow-out, the high dollar is likely to fund purchases of yet more consumer consumption rather than new capital equipment to transform the economy's base.

Oil prices also pose a significant risk. Further increases seem less likely with sharp falls this week, though no one really knows.

We are less concerned about falling sharemarket prices, despite recent scare headlines. The market has enjoyed a bumper run. On few stocks is there cause to believe valuations exceed rational estimates of future earnings. If the economy merely slows, but growth remains positive, good earnings will continue, and that will keep valuations up.

Relations with Australia

Australian Prime Minister John Howard's decision to go to an Aussie Barbie on the beach instead of up the road to the New Zealand memorial service was a significant slight.

Foreign affairs officials have been working for a month to secure the attendance and the Australian decision was made in full knowledge it would leave noses out of joint.

The harsh reality for New Zealand is that the ANZAC relationship is much more important to us than it is to Australia. Our ANZAC partners will say pleasant things, but when Australia has other priorities it will pursue them, and it's just hard luck for us.

New Zealand's strategy has been to take every opportunity to remain on the Australian radar and to co-operate as closely as we can. But is it time to ask whether we are well-served by the current approach?

There is not much chance New Zealand will soon change course from its current policy of dignified subservience to Australia. But debate around a more assertive approach is overdue.

Media tattle

Cost cutting is underway at TVNZ, with estimates that budget cuts in news could run as deep as ten to fifteen percent. With state broadcasting pouring resources into its Close Up at 7 programme in a bid to out rate John Campbell on TV3 (including the questionable decision to send Susan Wood to Rome), most of the cuts in news are hitting frontline staff like reporters and producers, who are not being replaced when they change jobs. News staff are, understandably, grumpy.

Can it be true that the Dompost is going to take the Newspaper of the Year prize at the upcoming Qantas awards? With a hometown audience to perform to, editor Tim Pankhurst is expected to make an even more rousing acceptance speech than his infamous challenge to other newspaperes in Auckland two years ago.

Lest we forget

This week we remember fallen ANZAC service personnel.

Molesworth & Featherston traditionally also marks International Workers' Memorial Day, a day on which we pay tribute to our fallen workmates. It falls today.

Hundreds of New Zealand workers are estimated to lose their lives as a result of workplace accidents and illnesses every year.

Don's Diary returns next week

More depth, more stories, earlier

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