29 May 2024

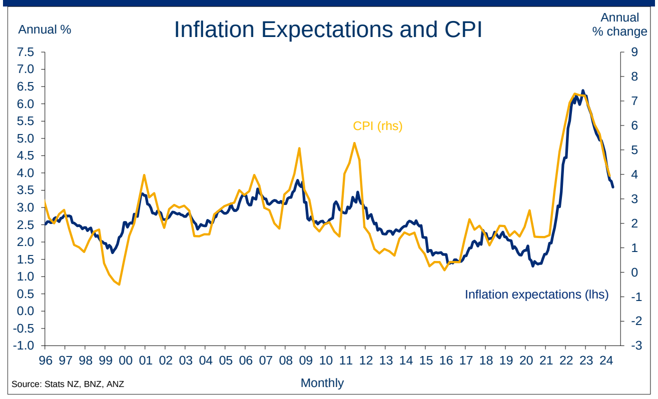
Painful

- **Businesses see soft activity, lower profits**
- **Firms reduce investment and employment intentions**
- **Business pricing power waning amid softer demand**
- **Inflation gauges moving in right direction for RBNZ**

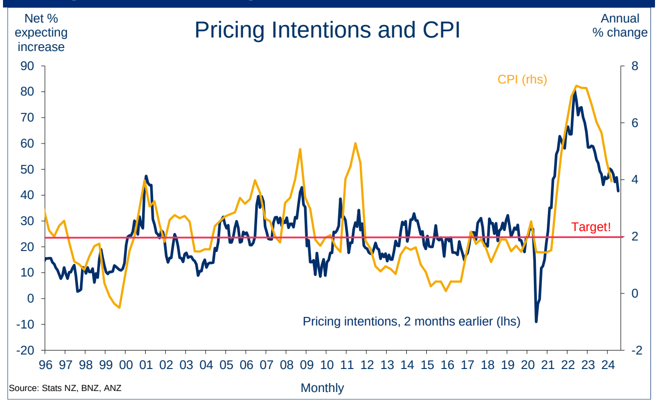
Most interest in today's ANZ business survey was in its inflation gauges. Inflation expectations have been steadily and consistently falling each month for well over a year, but firms' pricing intentions had become a bit sticky. Both eased in May.

Inflation expectations fell to 3.59% from April's 3.76%. This is at a level consistent with annual CPI inflation falling into the mid-3s in Q2. Indeed, a further decline in the final month of the quarter would raise some downside risk to the RBNZ's (and our) current Q2 CPI inflation forecast of 3.6%.

Inflation falling



Pricing intentions budge a bit



Pricing intentions dipped to 41.9 in May from 46.9 in April, to reach its lowest level in more than three years. Intentions dropped by more in the domestic focused sectors like retail and services and remain lowest in construction. Pricing intentions in all of these sectors are getting closer to their long-term averages. This suggests business pricing power is fading as demand weakens. Agriculture bucked the trend with higher pricing intentions, perhaps a sign of how low some prices have recently been.

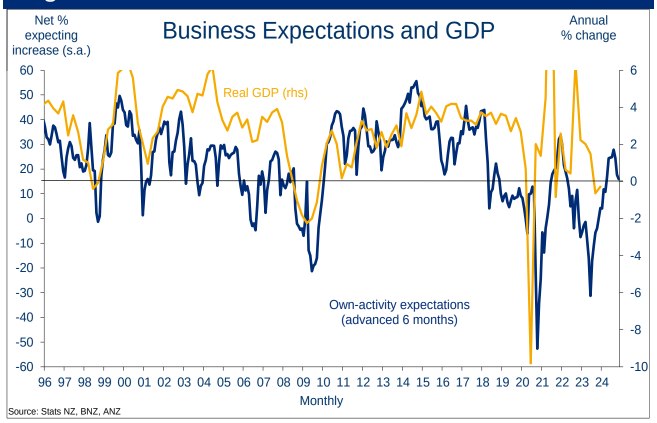
The pricing indicators are above what would be consistent with 2% CPI inflation, but they are clearly moving downward overall. A direction that will be welcomed by the RBNZ. The same can be said for the survey's wage inflation measures with both the backward looking and forward-looking measures easing.

Moving in the right direction for the central bank is one thing but compelling enough to alter its outlook is another. We see easing pricing indicators as another step toward giving the bank more comfort to eventually ease policy. The easing inflation gauges follow weak growth and a softening labour market. But we get the feeling the RBNZ will only be convinced inflation is under control when it sees it inside its target band.

Of course, there are other factors to watch in the meantime. Idiosyncratic price increases still present some risk to near term inflation and the Government's Budget tomorrow will be assessed for monetary policy implications not already accounted for by the central bank.

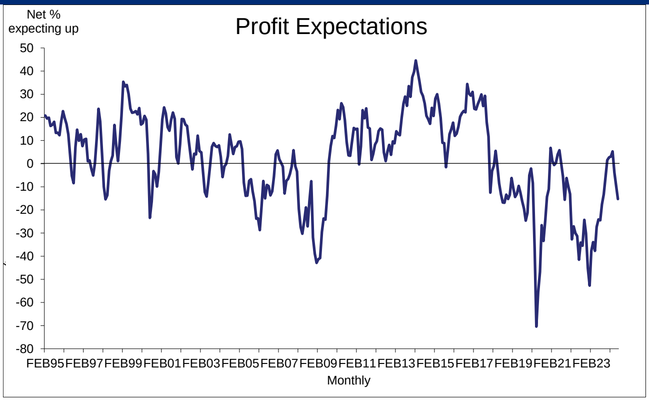
The rest of the business survey was a litany of distress. Confidence eased a bit further as did firms' own activity expectations. The latter dipped to 11.8 from 14.3 and is at a level that is consistent with annual GDP growth of about zero. We have been talking for a while about lowering our already low GDP forecasts and today's figures do nothing to dissuade us in that regard.

No growth



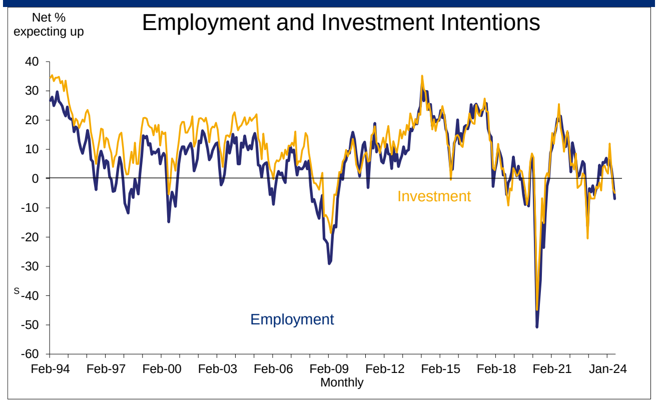
Firms' profit expectations have become more negative, dropping to -15.3 in May from -9.8 in April. They were +3.1 at the start of the year. This is obviously a concern for business and strongly suggests that pressure on the corporate tax take is likely to persist and remain a headwind to Government revenue.

Profits under pressure



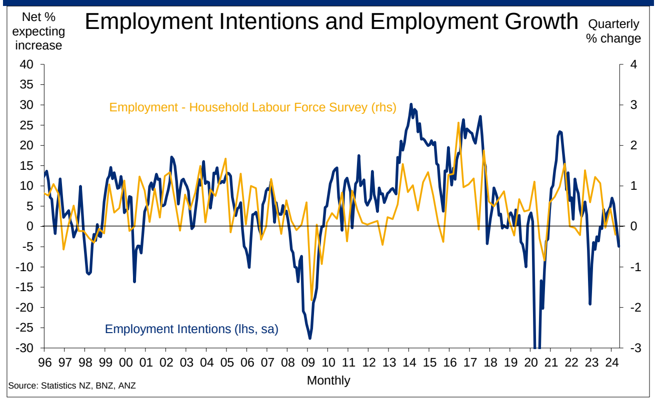
Pressure on profitability and waning pricing power is consistent with firms responding with lower intentions to employ and invest. Employment intentions became more definitely negative dropping to -6.9 in May from -0.9 in April. Investment intentions eased to -4.9 from -3.5. No signs of growth there.

Employment and investment intentions negative



Employment intentions have dipped to a level consistent with employment contracting. It is only one month but it puts some downside risk to our broadly flat employment forecasts. We already think the unemployment rate will rise by more than the RBNZ forecasts over the year ahead. The dip in firms' employment intentions increases that risk with flow on implications for broader demand and inflation pressures.

Downside risk to employment



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