Research

Economy Watch

2 July 2024

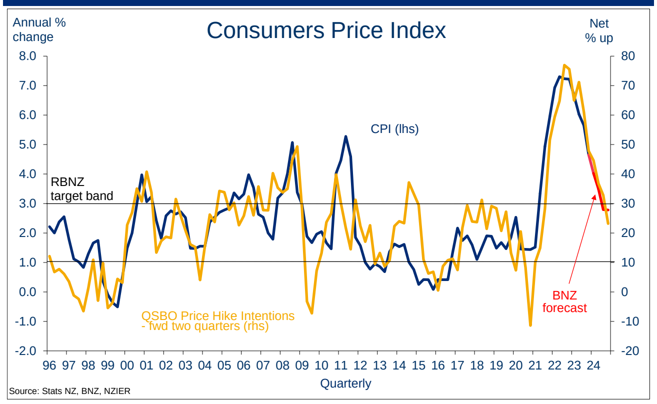
QSBO says inflation beaten

- **Pricing intentions slump**
- **Labour market easing aggressively**
- **Growth dead**
- **Market sees rate cuts soon**
- **RBNZ may not**

In our humble opinion, today's Quarterly Survey of Business Opinion (QSBO) screams cut rates sooner rather than later. Indeed, this is our central view. But we still think the RBNZ will want to see inflation within its target band before it pulls the trigger and that could be some time away.

For us the key data in the QSBO were the price expectations series. We noted in our Markets Outlook that further declines in pricing intentions were necessary to be consistent with annual CPI inflation progressing towards the mid-point of the Reserve Bank's target band. And it did, in spades.

Pricing intentions behaving



A net 23% of businesses intend increasing prices. This was a marked drop on the net 33% who thought likewise a quarter ago, and the lowest reading since December 2020. It would be a rarity for headline inflation to be outside the target band with this level of intention. Moreover, there is no reason to believe the drop in pricing intentions is yet complete. The momentum is viciously downward.

The problem is, these intentions will tend not to capture well the sticky non-tradables prices that are, and will continue, to keep headline inflation (and more so non-tradables) aloft. Businesses, generally, may be struggling to raise selling prices but local authorities (who aren't surveyed) and insurers don't seem to be having much difficulty in hiking prices at a double-digit pace.

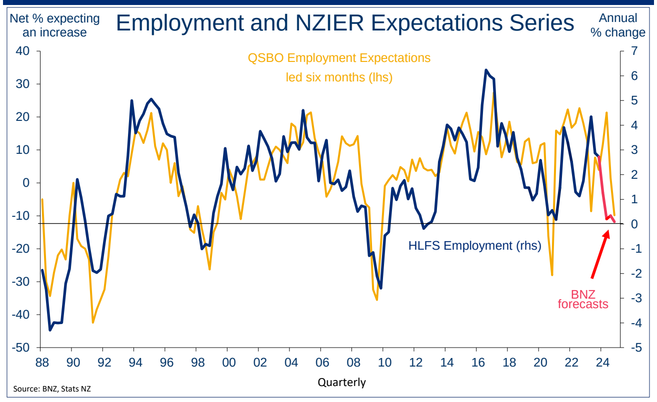
Nonetheless, the RBNZ simply must be overjoyed with what it sees here.

The next most important data set was that to do with the state of the labour market. If non-tradables inflation is to be contained wage growth needs to moderate. Ongoing weakness in the labour market is a sure way to achieve this. Again, there were clear and accelerating signs that this is happening.

To start with, a net 10% of employers say they will be reducing staff. Excluding the COVID outbreak, this was the weakest reading since June 2009. This leaves us confident with our expectation that there will be no employment growth in the year ended December 2024 and that the unemployment rate will surge to 5.3% by year's end.

Interestingly, a net 25% of businesses said they reduced staff in the quarter just been. That implies some upside risk to our unemployment rate forecast. And don't forget that government departments are not surveyed in the QSBO.

Employment growth disappears



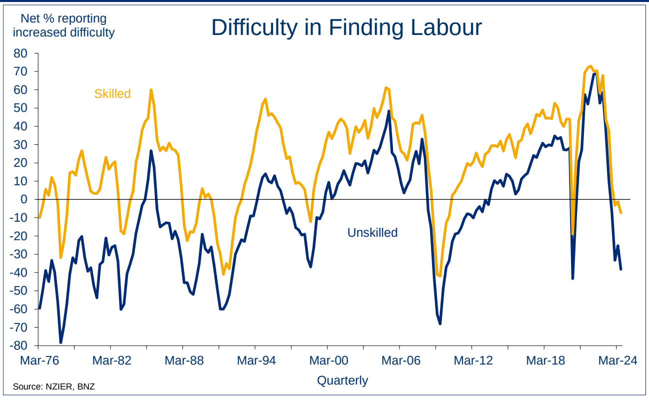
Whichever way you look at it, the labour market is easing wickedly. In addition to the employment outlook already discussed:

Only a net 9% of businesses reported labour as their major factor constraint. That's the lowest (non-COVID) reading since December 2012. On the flipside, sales (read demand) were reported as the biggest constraint to increasing output by 61% of businesses, the highest reading since September 2014.

A net 42% of businesses report that overtime hours worked fell. Another GFC-type outcome that, in combination with declining employment, suggests hours worked (an input into GDP) has been clobbered.

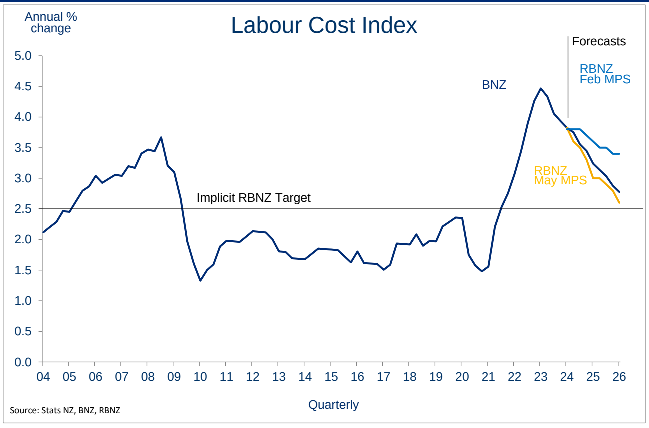
A net 25% of businesses reported labour turnover fell. No longer are employees able to jump ship easily to progress in the labour market. It's back to holding onto the job you've got while you can.

Labour shortages extinguished



All of this says wage growth will soften. Indeed, this is what we expect. But it's also what the RBNZ expects and we're not sure that the parlous state of the labour market is any more parlous than the RBNZ is currently banking on.

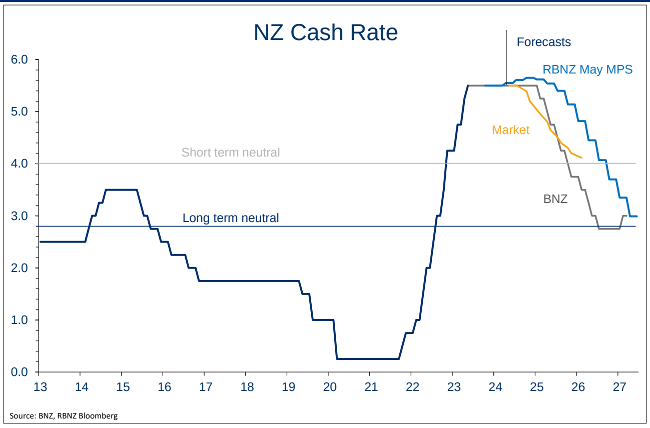
RBNZ already expects weak wage growth



Of course, while the pricing and labour market data are the key points of focus for the RBNZ and financial markets, the real economy is what matters most to businesses and households alike. Unfortunately, the news here is not great. A net 10% of businesses believe their activity will contract in the quarter ahead. It's no worse than the last reading but still consistent with the economy going nowhere through Q2 and Q3. This is our central view, but we do acknowledge that the own-activity series implies downside risk to our forecasts and, certainly, downside risk to the recovery that both New Zealand Treasury and the Reserve Bank are expecting as the year wears on.

Not surprisingly, today's outturn encouraged the market in its thinking that the RBNZ will be forced to move much earlier than it has indicated. While the Bank touts Q4 2025 for its first cut, the market continues to voice certainty that the RBNZ will cut rates in November of this year. In fact, there is a 45% chance of an October cut priced in.

Market and RBNZ poles apart



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