Research

Economy Watch

14 January 2025

QSBO Not Earth Shattering

- **Confirmation of economy at a turning point**
- **From a very low base**
- **Labour market deterioration slowing**
- **Inflationary pressures muted**
- **Relief for RBNZ against an otherwise volatile background**

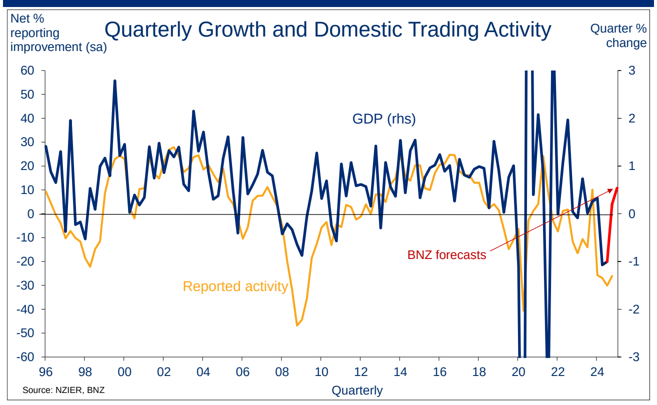
There was nothing in today's QSBO to change our view on anything. Our main themes for 2025 are that the economy will witness a slow recovery as the year progresses, the labour market will continue to deteriorate but at a slowing pace, inflation will remain contained (though not dead and buried), allowing the cash rate to keep falling.

From what we can tell the QSBO ticks all the boxes.

As has been the case for some time, the data continue to show things are far from pleasant in the here and now but there are increasing hopes that the worst, at least in an activity sense, is now behind us.

A net 26% (seasonally adjusted) of businesses still reported that activity deteriorated in Q4. This indicator has now been in a range of -25% to -30% over the whole of 2024. This was consistent with the economy being in a protracted recession. But the "good news" is that the pace of the decline is not getting any worse.

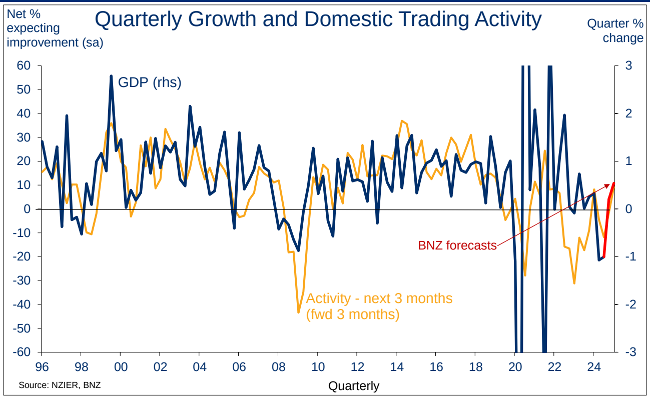
Deterioration stalling



More importantly, a net 9% of businesses now expect activity to improve. If you abstract from post-COVID gyrations then this is the highest degree of optimism expressed by businesses since December 2018.

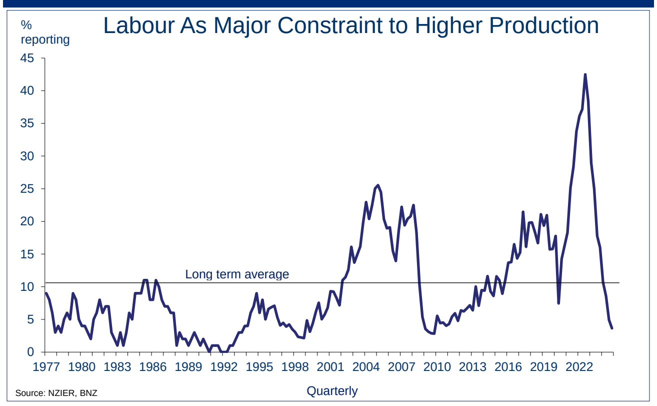
Currently we estimate the economy edged higher by around 0.2% in Q4 and growth will accelerate to 0.5% growth in the current quarter. The QSBO broadly supports this hypothesis.

Better times ahead



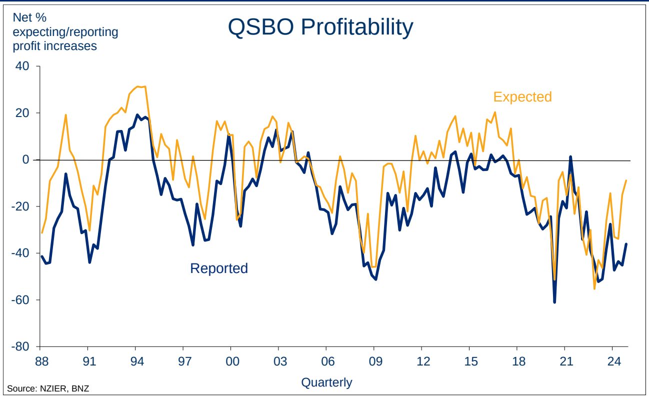
Against this backdrop, it should come as no surprise that the pace of deterioration in the labour market appears to be diminishing. Following two negative quarters a net 5% of businesses say they are looking to hire staff. This suggests our employment growth expectations might be a bit light. Be that as it may, the labour market looks extremely soft. On a seasonally adjusted basis, the ease with which employers can access labour remains at a very high level and only 4% of businesses now cite labour as their biggest factor constraint. The last time a lower reading was reported was back in September 2009. And note that the state sector is not surveyed by NZIER. If it was the overall data might have an even weaker tone.

Labour a lesser concern



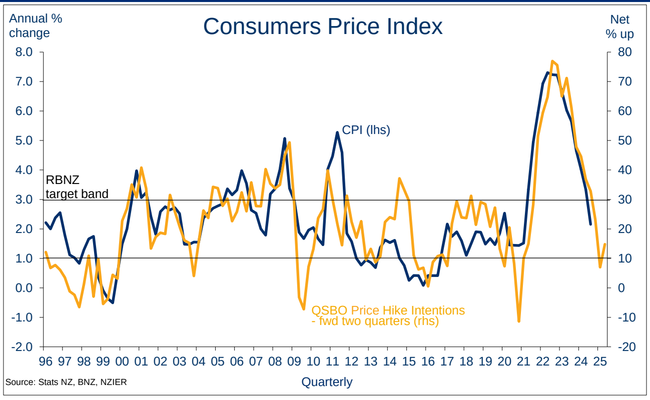
The good news for businesses is that an easier labour market reduces cost pressures. The combination of lower cost inflation and an improved sales outlook means expectations for profitability have moved higher. A net 9% of businesses still expect profits to deteriorate but this is the "best" COVID-unaffected reading since September 2018 and, while the number might look miserable at face value, the reading is only a smidgen below the long term average for this series. The question is: will this prove to be a false hope or not? It's certainly a far cry from the net 36% who reported declining profitability in the December quarter.

Profit hopes improve



With input cost pressures diminishing, and pricing power far from healthy, pricing expectations remain muted. A mere net 15% of businesses say they expect to raise selling prices. This is consistent with annual headline CPI inflation falling to around 1.5%. This is lower than the trough in inflation we are forecasting but we won't be scurrying to lower our forecasts as we doubt businesses have yet fully incorporated into their expectations the recent surge in oil prices and the weakening in the New Zealand Dollar. Moreover, NZIER does not survey the agriculture sector which has experienced solid commodity price growth and which will inevitably find its way into the New Zealand food chain.

Inflation no concern



We doubt any of the above will come as a surprise to the Reserve Bank of New Zealand. There are many challenges to its November Monetary Policy Statement forecasts including the Q3 GDP outturn, the surge in oil prices, the fall in the New Zealand dollar, the steepening in yield curves globally, the strength in the US economy and the Trump policy dilemma. By comparison, today's QSBO will probably just offer some welcome relief and a sense of stability against an otherwise volatile background.

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