29 July 2021

Firms' Inflationary Messages Too Big to Ignore

- **ANZ business survey still highly inflationary**
- **As inflation expectations jump further to 2.70%**
- **And pricing intentions point to more CPI heat to come**
- **Activity expectations slower but better than average**
- **Albeit before the worst of Australia's lockdown known**
- **We still expect a string of OCR hikes starting August**

Sure, net confidence in this afternoon's ANZ business survey dipped to -3.8 in July, from -0.6 in June. But there was nothing new in that. It's averaged around zero all year.

Own-activity expectations, meanwhile, slowed to +26.3, from +31.6. However, as such, they were still a bit above their long-term average of 25.3. Most interesting about that is how the economy can be expanding anywhere close to a normal rate, when supply constraints are as severe as they are.

That demand is far outstripping supply was again evident in the survey's inflation pointers.

The cost-pressure variable was already enormous in June, with +86.2, but managed to add 2 points to that in July, in reaching +88.2. That's white hot in anyone's book.

With this, it was no surprise to see pricing intentions remained extremely high, at +61.3, from +62.8. And note the word "intentions" rather than "reported"; inferring more upside pressure yet to come on the CPI.

Yes, there will be transitory elements to these pricing and cost pressures. But it would be a brave person to presume it explains most of the bulge and that, in any event, it will naturally dissipate to untroubling levels with short shrift.

This is certainly not the story of the survey's inflation expectations (for the coming 12 months). These kept picking up, hitting 2.70%, from 2.41% in June. Back in February they were only 1.76% and based at 1.36% in August 2020. It's quickly become very strong, in other words, testing the top of the 1.0 to 3.0% band.

Indeed, in its report ANZ noted that responses in the later part of the survey, inflation expectations were running up at 3.3%. While this is only one measure of inflation expectations it is, strictly speaking, inconsistent with the Bank's duty of keeping annual CPI inflation between 1.0 and 3.0% with a focus on 2.0% over the medium to long

ANZ Bank Business Outlook

Net balance - next 12 months (All sectors)	Jul	Jun	Change	Average
General business outlook	**-3.8**	**-0.6**	-3.2	6.4
Own business	**26.3**	**31.6**	-5.3	25.3
Profits	**0.0**	**5.8**	-5.8	7.2
Employment	**21.4**	**19.7**	1.7	7.3
Investment	**17.4**	**25.5**	-8.1	12.4
Exports	**7.6**	**13.4**	-5.8	27.3
Pricing intentions	**61.3**	**62.8**	-1.5	21.7
Cost expectations	**88.2**	**86.2**	2.0	
Inflation expectations	**2.70**	**2.41**	0.29	2.52
(Own activity outlook)				
Retail	**6.9**	**26.3**		22.3
Manufacturing	**22.5**	**27.3**		27.0
Agriculture	**18.2**	**15.4**		21.0
Construction	**36.4**	**43.3**		18.3
Services	**33.3**	**35.3**		28.3

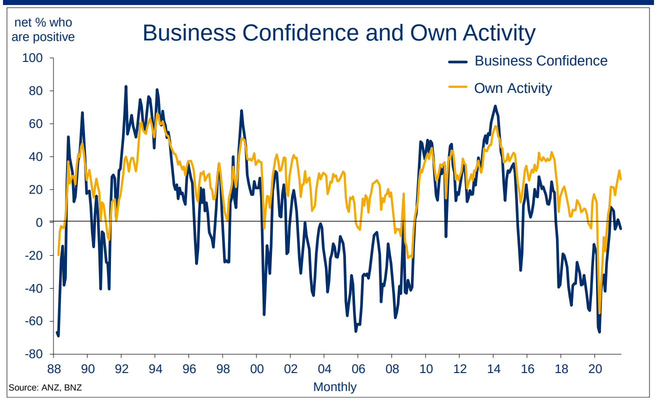
term. As a test of symmetry, would the Bank ignore this series if it was running at 0.7%?

And perhaps this suite of inflation pointers from the ANZ survey – like for many other surveys – will be taken more seriously now, after the big jump that occurred in the Q2 CPI. That was a big wake-up call.

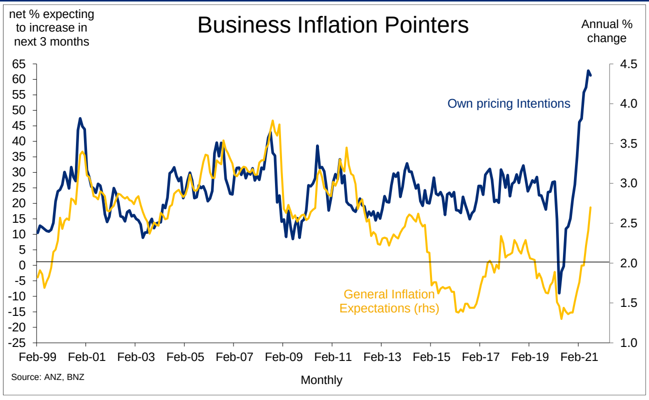
Underpinning the local inflation story is what's occurring in the labour market. We've seen so many jobs indicators over the last month or two that have really stepped up the pace (including yesterday's Employment Indicators for June).

This has caused us to strengthen our expectations for next week's June quarter Household Labour Force Survey, for which we now expect employment growth of 0.7% and a dip in the unemployment rate to 4.4%, from 4.7% in the

Proceed with Caution



Up she goes



March quarter. These are clearly stronger/tighter than the RBNZ anticipated in its May MPS.

And by the look of today's ANZ survey, demand for workers is only going to get more heated from here. A net 21.4% of firms expected to increase staff numbers. That's about as strong as this series gets, in historical context, and its norm, for reference, is +7.3%.

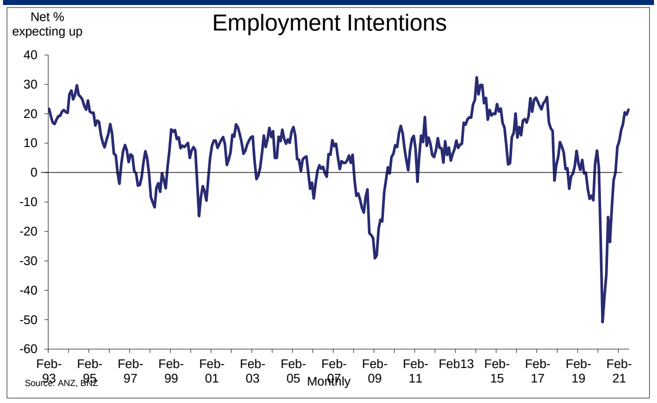
Having said all this, it's not all one-way traffic on the economy. Responses to the ANZ business survey are typically concentrated in the early part of the month. As such, this month's batch would have largely pre-dated the worst of Australia's transition into lockdown, and certainly the NZ announced full suspension of the trans-Tasman travel bubble Friday last week.

There was also a bit of a muddle in the survey's detail. For instance, activity expectations amongst retailers slumped a lot, to be clearly trailing the national results, while construction firms remained ahead of the pack. Profit expectations were broadly recovered but were hardly upbeat. Export volumes were anticipated to expand at a moderate, rather than strong, rate.

However, all considered today's ANZ business survey portrayed an economy that was fundamentally pressing on, and headlong into some serious inflation.

This is consistent with our view of the need for the RBNZ to markedly reduce monetary stimulus, albeit while maintaining that the Bank will hike just +25bps at next month's MPS, with another +25bps in November. And so on at MPS windows until a 2% level is reached early 2023. Broadly speaking, that would trace a very gradual path back to neutral, when there is a strong argument to get them much sooner.

Beefy



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