16 January 2024

Disinflationary pulse evident

- **Stronger growth**
- **Yet weaker inflation**
- **As labour market constraints further dampened**
- **Unemployment rate set to spike?**
- **Shouldn’t fundamentally change RBNZ’s view of the world**

Today’s NZIER Quarterly Survey of Business Opinion paints a picture of an economy that is stronger than we are forecasting. Yet, at the same time it appears entirely consistent with our view that inflationary pressures are dissipating and dissipating rapidly. How can this be so?

In short, survey responses simply support the hypothesis that soaring net migration continues to alleviate capacity constraints in the economy and in so doing takes the pressure off prices. Concurrently, the increased availability of labour is allowing businesses to fill vacant positions, enabling them to produce output that was previously supply, not demand, constrained.

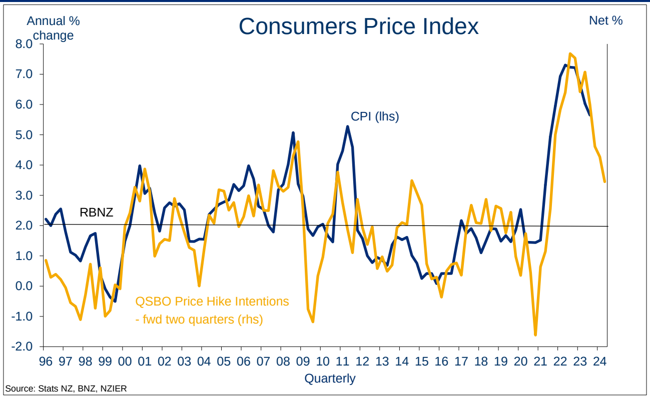
But, as we know, not only does net immigration push activity higher via the supply side but it also supports economic activity from the demand side. The debate will thus continue: is supply-side disinflation going to win the battle or is demand-side inflation going to dominate? We lean towards the former but caution that demand side influences could yet slow the decline in inflation enough to worry the RBNZ.

Given the evidence of this ongoing tug of war, we doubt very much there is enough leverage on either side to shift the Reserve Bank’s view of the world. That said, we note that the Bank has a clear tightening bias at the moment. While we think today’s data are not sufficient to disavow the Bank of that view, equally, we do not see it as disconcerting enough for it to pull the trigger and actually raise rates.

The core inflation data in the QSBO unequivocally points to further downside in annual inflation. Cost and selling price indicators remain elevated but continue their run of sharp declines. A net 44% of businesses still expect costs to rise but this is the lowest reading since December 2020.

“Only” a net 37% expect to raise selling prices. This is a far cry from the net 71% which said they would be raising prices when surveyed this time last year. Also, it is only marginally higher than the 32% average reported for this series. The data are consistent with annual CPI inflation falling to below 3.5% by June 2024. As a point of reference, the RBNZ is currently forecasting 3.7% for the period. Of course, pricing intentions will need to keep falling but, for the time being at least, they are doing the “right” thing.

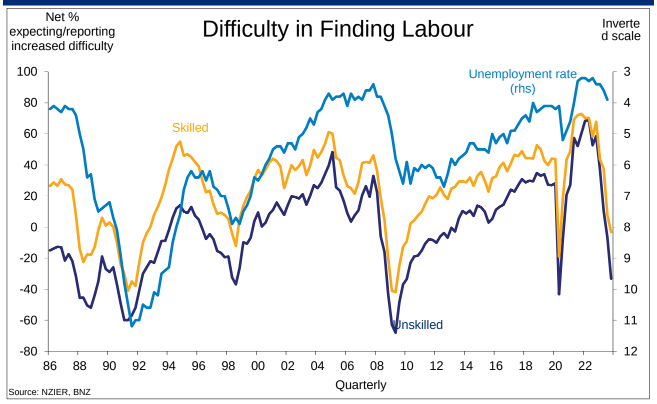
Pricing intentions behaving



While pricing intentions are just behaving, the labour market has turned outright strongly disinflationary. Sure, the net 21% of businesses which intend to hire more folk is strong and indicates higher employment growth than we are forecasting but, more importantly, it would appear that the increase in the supply of labour is dwarfing this.

Finding staff has become outright easy, especially in so-called non-skilled sectors. The ease of finding labour for both skilled and unskilled are at levels last seen in March 2010 when the unemployment rate was 5.9%. The data are therefore consistent with a rapid increase in the unemployment rate from current levels.

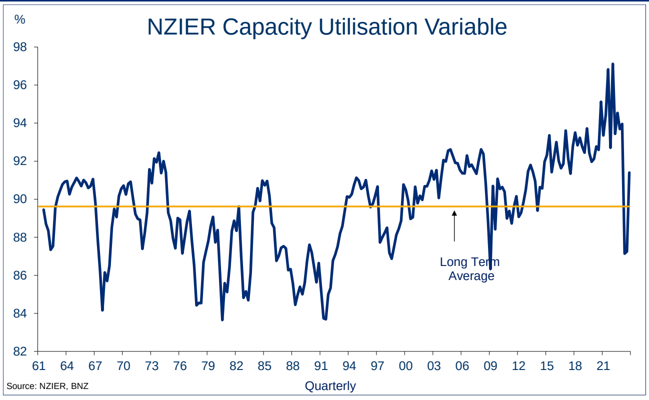
Staff easier to find



A similar theme played out in this morning's SEEK job data, which showed the job applications to job ads ratio surging as labour supply growth outweighed demand. In this environment, pressure on wage growth must be downward. As wage growth was a major contributor to rising selling prices, it also means pressure on the CPI is increasingly downward.

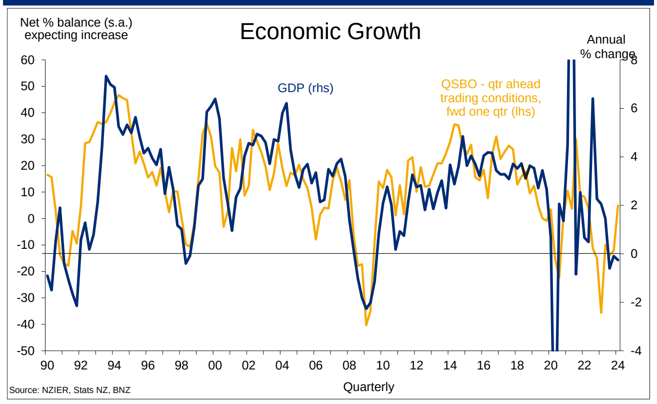
The RBNZ will be happy with wage and inflation indicators but will not be quite so happy with the jump in capacity utilisation to 91.4% from 87.3%. It's nowhere near recent highs but the direction might be a bit disconcerting.

Capacity utilisation bounces



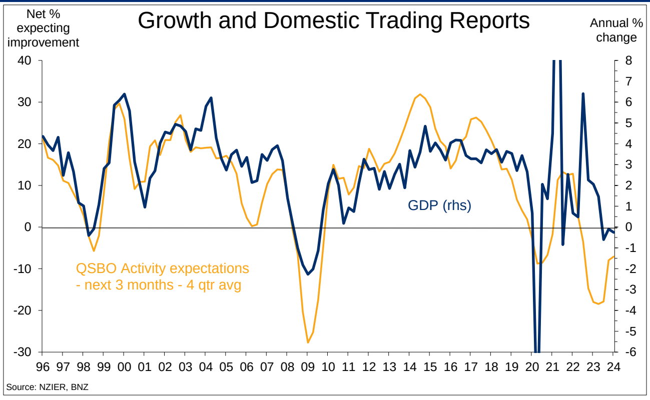
The other set of indicators that might cause the RBNZ some angst are those to do with activity. These were certainly stronger than we anticipated. A net 5% of businesses now believe their trading activity will improve. At face value, this suggests annual GDP growth will soon hit 2.0%. Mathematically, this is highly unlikely, but the risks are clear. That said, don't forget that with population growth currently sitting at 2.7% this would reflect little more than the expansion in migration that is occurring.

Growth indicators positive



Then again, there is also the chance that the survey data bounce is simply a reflection of undue pessimism over the previous twelve months. The lows in expectations were certainly not reflected in GDP so, perhaps, the highs won't be either. If one smooths the expectations series, then our relatively pessimistic view for calendar 2024 still holds up to scrutiny.

Perhaps not so positive



And last but not least, don't forget businesses tend to like National Governments more than they like the Labour equivalent. The pickup in General Business Confidence and Own activity indicators is probably being impacted as much by hope that a change in regime will deliver better outcomes than it is a true expectation of an improving economy. For now, then, we will treat the growth indicators with a pinch of salt.

On balance, today's data have given us plenty to think about but little to change our big picture view of the world. We think that the same will apply to the RBNZ.

Talking of the RBNZ note that Chief Economist Paul Conway will deliver a speech which will be hosted on the RBNZ website at 9am Tuesday January 30.

According to the RBNZ, the speech will focus on "how significant changes to the global economy since the COVID-19 pandemic have created new uncertainties and challenges for monetary policy." While this will no doubt be interesting in an academic sense, market watchers should have their interest piqued by the fact that the RBNZ also says "In this speech, Mr Conway will also make brief comments on domestic data developments since the November *Monetary Policy Statement*." It has become unusual for the Bank to do this since its decision-making process has been by means of the Monetary Policy Committee. Worth keeping an ear open for, we think.

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