Research

Economy Watch

9 April 2024

QSBO Soft

- **QSBO shows business distress, growth struggling**
- **Labour indicators suggest higher unemployment ahead**
- **Inflation gauges generally heading in right direction**
- **But nothing to materially alter forecasts, on balance**
- **RBNZ on hold tomorrow**

A weak economy and broad disinflationary pulse were writ large across this morning's NZIER Quarterly Survey of Business Opinion (QSBO). Inflation gauges themselves are generally heading in the right direction but remain higher than would be consistent with annual inflation at the RBNZ's target midpoint.

This fits with our broad assessment of economic conditions where growth is struggling, slack is opening up, and inflation pressures are easing. While the survey was clearly of a disinflationary variety, it isn't any more than we might have imagined overall so doesn't fundamentally change our broad thoughts on the economy.

Domestic activity, employment, and investment indicators weakened, and capacity use pointers are at levels consistent with economic slack. These supports the notion of core inflation easing further and, to us, strongly supports the idea of interest rate reduction ahead.

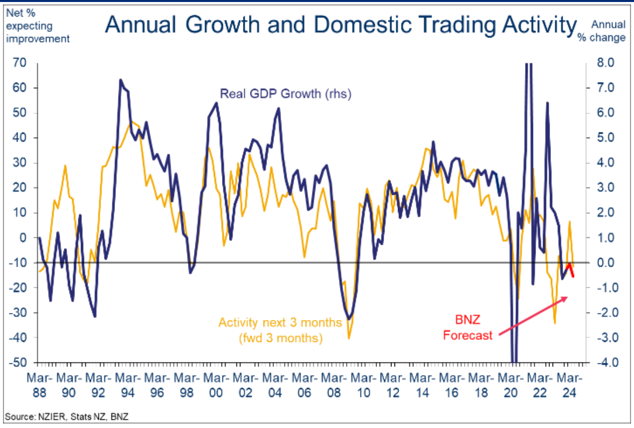
For the RBNZ, there is plenty in the QSBO to discuss when sitting around the table for tomorrow's MPR deliberations. But in the big picture, we suspect the Bank may view this survey as making progress toward its inflation goals rather than a sense of goal achievement just yet. So we continue to expect the Bank to hold the OCR at 5.50% tomorrow.

The softer looking activity indicators now look more in line with our views, after some odd (perhaps election related) looking strength in the previous survey.

Firms' reported activity fell to -23 from +7, while activity expectations dropped to -11 from +7. These are large changes. Through the noise, the activity gauges look consistent with flat-to-negative GDP growth in the first half of 2024 – broadly in line with our growth forecasts and, if anything, a touch weaker than RBNZ projections. The economy still looks like it is bouncing along the bottom.

QSBO reported employment was weak, in falling to -11 from +9, and suggests downside risk to our near-term views on official HLFS employment against other indicators that have been suggesting some upside.

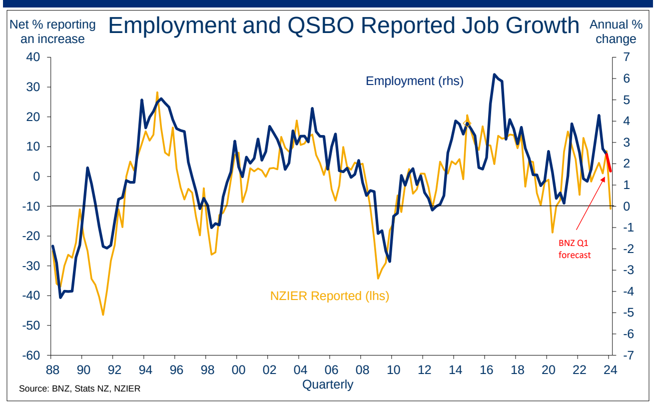
Flat



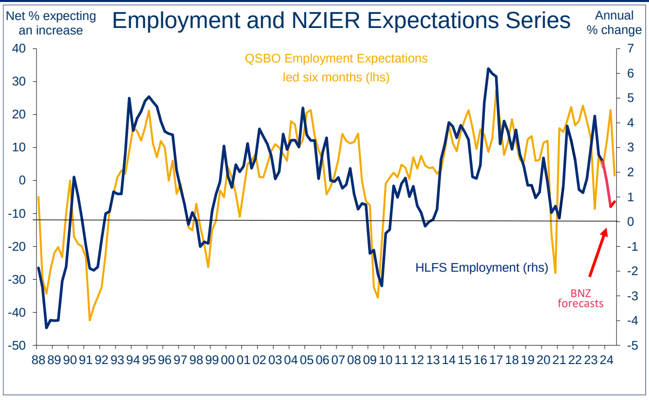
Bear in mind, the QSBO does not directly survey the state sector so may overstate overall employment at the current juncture, given current job reductions in the government sector.

QSBO employment expectations have dropped markedly too (+2 from +21). But they do remain positive and consistent with some employment growth ahead perhaps even a touch stronger than we have pencilled in. So, with risk on both sides to our (and we think the RBNZ's) near term employment forecast, we stick with our current forecast of minimal employment growth over coming quarters. Combined with rapid expansion of the labour force, we remain of the view that the unemployment rate is set to rise further.

Downside risk here

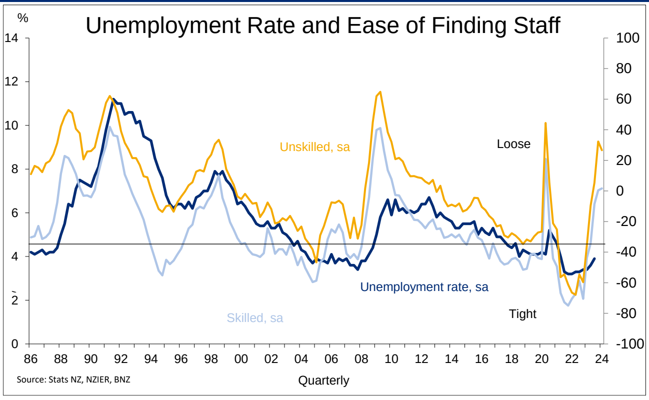


But some upside here



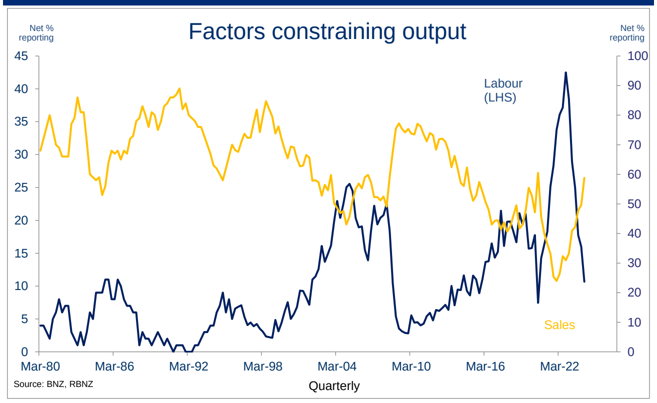
Labour market tightness indicators continue to indicate slack. Firms continue to report staff – both skilled and unskilled – as easy to find, on net. With minimal change from the previous quarter, these indicators continue to suggest a material rise in the unemployment rate lies ahead. They are consistent with annual wage inflation easing this year and next.

Unemployment rate set to rise further



In a similar fashion, labour as the major constraint on output growth continues to plummet. This quarter, 11% of firms saw labour as the major constraint to lifting output. Meanwhile, the percentage of firms seeing sales the major constraint to lifting output continues to ramp higher, hitting 59% this quarter. It all points to a rapid rebalancing of supply and demand – one that promises more disinflation ahead.

Business constraints changing rapidly

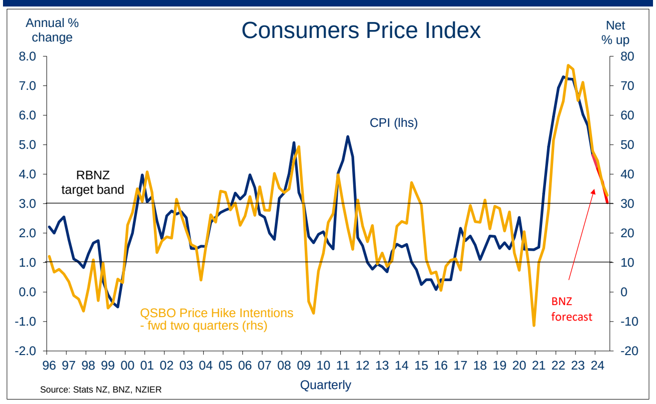


The labour constraint indicator has been highlighted by the RBNZ as one of the better indicators of inflation. It is certainly highly correlated with core inflation, so its ongoing decline is notable.

The inflation gauges themselves generally eased, indicating further progress is being made on the inflation fighting front. For selling prices, a net 35% of firms reported a lift, a touch fewer than the net 37% reporting a lift in the prior quarter. The equivalent for selling price intentions eased to 33% from 37%. Those indicators are not yet at levels that would be consistent with annual CPI inflation inside the RBNZ's target band – but some are getting close. At 33%, selling pricing intentions point to annual CPI inflation will be close to 3% in Q3 this year. That is broadly in line with our forecasts.

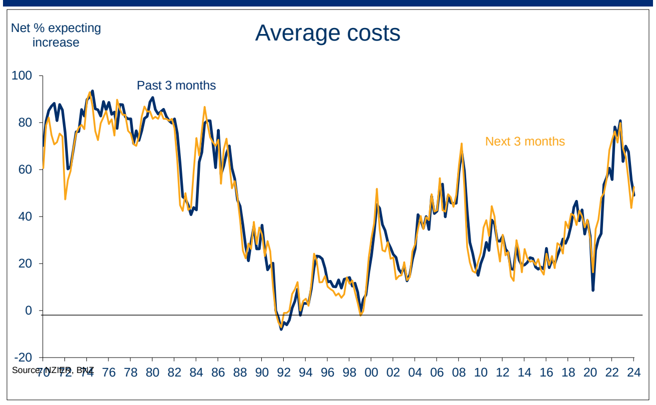
The selling price indicator suggests annual CPI inflation is still heading in the right direction, which will be welcomed by the RBNZ. However, the indicator suggests annual CPI might be a touch higher that the RBNZ forecasts (as are our current near-term forecasts) which might niggle a bit and there is still a way to go to the middle of the target band.

Getting there



Cost indicators remain elevated and their movements this quarter were mixed. The net number of firms reporting cost increases continued to trend sharply downward, but the net number expecting cost increases rose.

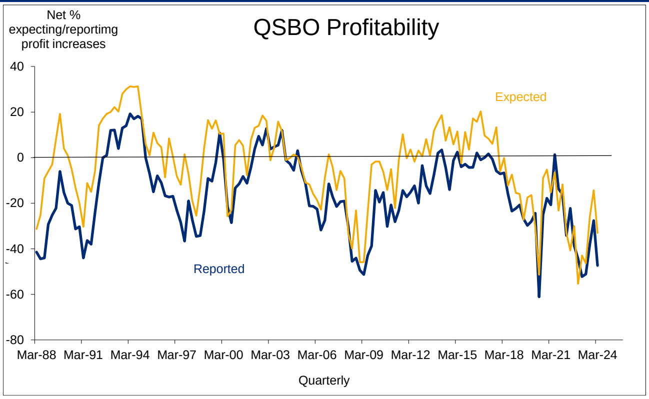
Niggly



One particular concern for business is that when demand was previously robust cost increases had more chance of being passed on. But now with demand weak, cost increases are more likely to mean downward pressure on margins and profitability.

Profitability is under significant duress, with firms reported and expected profitability indicators falling this quarter. Both are heavily negative and below long-term norms.

Profitability under duress



No surprise then to see the likes of a pullback in firms' investment intentions. Just like the activity indicators discussed above, none of that is positive for economic growth or such things as the government's tax take. Whether that is a surprise or not depends on one's prior expectations.

The overall backdrop fits with business confidence itself easing back, to -24% on a seasonally adjusted basis from the -10% it had bounced to in the previous quarter.

doug_steel@bnz.co.nz

Contact Details

BNZ Research

Stephen Toplis
Head of Research

Doug Steel
Senior Economist

Jason Wong
Senior Markets Strategist

Stuart Ritson
Senior Interest Rate Strategist

Mike Jones
BNZ Chief Economist

Main Offices

Wellington
Level 2, BNZ Place
1 Whitmore St
Private Bag 39806
Wellington Mail Centre
Lower Hutt 5045
New Zealand
Toll Free: 0800 283 269

Auckland
80 Queen Street
Private Bag 92208
Auckland 1142
New Zealand
Toll Free: 0800 283 269

Christchurch
111 Cashel Street
Christchurch 8011
New Zealand
Toll Free: 0800 854 854

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