

- **RBNZ raises interest rates but higher rates are necessary to quell inflation**
- **Household spending slowed in the March quarter, while weak consumer confidence and falling house prices suggest the outlook has become more challenging**
- **The global outlook has deteriorated as the Russia-Ukraine conflict and COVID-19 restrictions in China further disrupt global supply chains**

Inflation continues to be front of mind both domestically and internationally, as tight labour markets and supply chain disruptions drive inflation to decade-highs. Central banks are responding by raising interest rates. The Reserve Bank of New Zealand lifted its policy rate to 2.0% this week and noted that further increases are needed to meet its inflation and employment objectives. At the same time, the global growth outlook has weakened as the war in Ukraine and COVID-19 restrictions in China disrupt supply chains and add to inflation.

The RBNZ further tightens monetary policy...

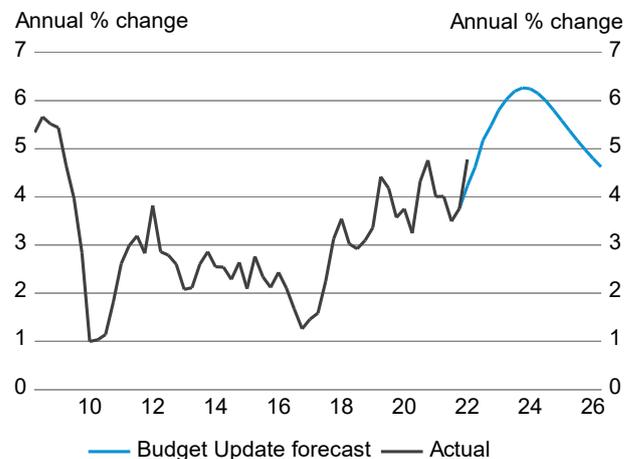
Citing the need to constrain economic activity to better match New Zealand's productive capacity, the RBNZ further increased the official cash rate (OCR) to 2.0%, a 50 basis-point (bp) increase. The Bank projected the OCR would need to rise to 4.0% to return inflation to its 1% to 3% target range and to reduce employment to its maximum sustainable level.

The May MPS projects rates to rise faster and to be higher than assumed in the Treasury's Budget Economic and Fiscal Update 2022 (Budget Update). This raises the risk that unemployment lifts earlier and by more than the Treasury forecasts but reduces the risk that inflation remains above target for as long as forecast.

...as the labour market remains tight...

The hike in rates follows March quarter labour market data that showed the unemployment rate remained at a record-low 3.2%. Labour market tightness has seen wage growth pick up to 3.0% on the labour cost index measure while the average hourly earnings measure increased 4.8% over the year to \$36.18. In the Budget Update, ongoing tightness in the labour market is expected to drive annual wage growth to over 6.0% in 2023 (Figure 1).

Figure 1: Average ordinary time hourly earnings



Sources: Stats NZ, the Treasury

Hours worked fell modestly in the March quarter, down 0.2% compared to the previous quarter, reflecting Omicron disruptions, although these weren't as large as expected.

...but economic headwinds remain...

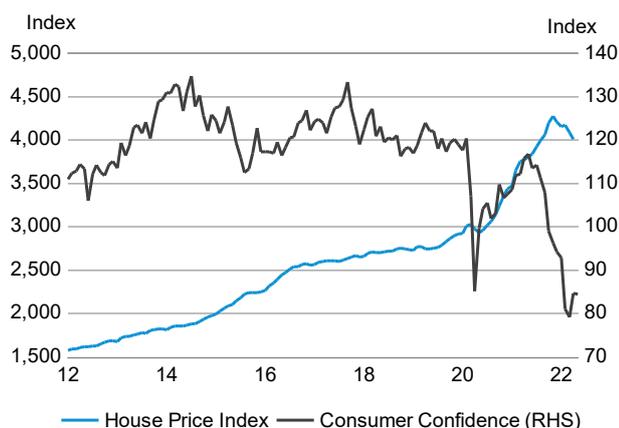
The Omicron outbreak also weighed on household spending in the quarter. The March quarter Retail Trade Survey showed sales volumes fell 0.5%, while values rose 0.5%. This followed an 8.5% rebound in retail volumes in the December quarter, as spending recovered from pandemic-related restrictions, so some pull back in spending was a risk in this volatile environment. Driving the decline in retail sales volumes was the unwind in spending in hardware, building, and garden supplies stores (down 5.5%) and motor vehicle and parts sellers (down 4.0%), following very strong growth in the previous quarter.

Overall, the small decline in retail sales is consistent with the Budget Update forecast of a small fall in household consumption in the quarter. However, a larger fall remains a risk. Spending on services, which is not well-covered by this survey, has been considerably more sensitive to COVID-19 developments. In addition, consumer confidence has been remarkably weak since February (figure 2).

...as house prices fall

House prices fell 1.1% in April, to be 6.2% lower than their November peak (figure 2). The fall in house prices has been steeper than projected in the Budget Update and prices are likely to fall further as interest rates rise.

Figure 2: House prices and consumer confidence



Sources: REINZ, ANZ Roy Morgan

Meanwhile, broader housing market activity also looks to be softening. Total house sales in the three months to April were down 33% compared to the same period in 2021.

Building consents rise...

The number of new building consents issued reached a fresh monthly and annual high with 5,303 new homes were consented in March, taking annual consents to 50,858. Consents for multi-unit dwellings – townhouses, flats, units, apartments, and retirement village units – were the key driver of the annual increase, up 40% on the year ended March 2021.

In the Budget Update, residential investment is forecast to experience strong growth over the coming year as the large pipeline of consents flows through. However, there is a risk that supply constraints push some activity into subsequent years.

The construction sector will likely continue driving non-tradable inflation over the coming months. Off the back of material and labour shortages, the cost of building a house was up 18% in the year ended March 2022 according to the recent CPI inflation release. With demand for building a house continuing to support the construction sector and overall economic activity, it is fair to expect continued cost pressures.

...and the goods trade deficit narrowed

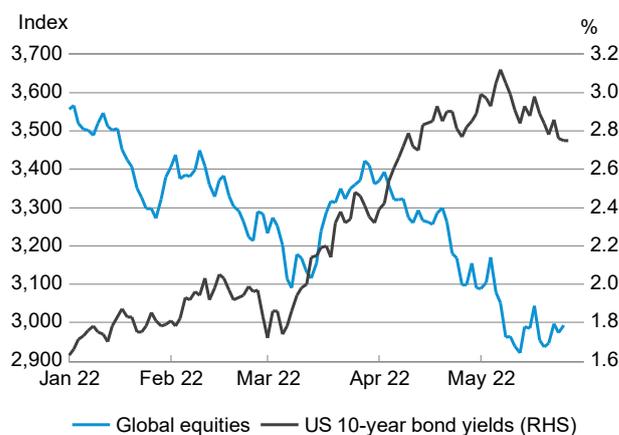
The monthly goods trade deficit narrowed in April to \$507 million as exports rose 2.3% and imports declined by 7.6%. The main driver of the fall in imports was a 58.7% monthly fall in fuel imports as refining of crude oil at Marsden Point ceased. The annual trade deficit narrowed slightly from its record level in March, to \$9.1 billion. Exports to China fell 1.8% in April compared to the previous year, the only top ten destination to observe a fall, reflecting the impact of COVID-19 lockdowns in the country.

Looking forward, the Treasury expect import demand to ease in line with slower economic growth. High commodity prices are expected to continue supporting export revenue in the near term, though slowing growth in China presents a downside risk to export prices.

The global outlook has deteriorated...

Incoming data shows the global growth outlook has deteriorated: activity in April fell sharply in China and indicators of activity in advanced economies in May also point to slower growth. At the same time, inflation remains strong in many advanced economies and labour markets are very tight leading central banks to tighten policy. The weaker growth outlook has weighed on investor sentiment, leading to volatility in financial markets (figure 3).

Figure 3: Global financial markets



Sources: Haver

Over the year ahead, the process of reopening economies, improved resilience to COVID-19 and faster wage growth is expected to offset the impact of tighter monetary policy on activity, and forecasters expect global growth of around 3.5% this year, a bit above its pre-pandemic average.

...driven by the Russia-Ukraine crisis...

The Russia-Ukraine conflict is continuing to exert a significant drag on the global economy, particularly in Europe, through higher energy and food prices. In addition, the potential for large-scale disruptions in Russian gas flows to Europe remains a key downside risk to the outlook.

Meanwhile, the US government has let lapse a licence that allows Russia to make interest and maturity payments on its sovereign debt to US persons. With the waiver gone, there is no way for bondholders to be paid, which suggests it is inevitable that Russia will default on at least some of its \$40 billion in international bonds. However, with Russia already under heavy sanctions, the immediate consequences of a default will probably not be large.

...which has added to inflation...

Inflation rose further in many economies in April (Table 1), but the pace of increase has slowed, except in the UK, and attention is shifting to the growth implications of central bank rate hikes to return inflation to their targets. UK inflation reached 9.2% in April, boosted by a near 50% jump in home energy prices as regulator Ofgem lifted its price cap. Euro area headline inflation reached 7.4% in April, with food overtaking energy as the key driver of the monthly price increase, which slowed to 0.1% from an average of 1.2% over the previous three months. Inflation in Canada rose to 6.8%, driven by food prices (up 9.7%) and home heating costs (up 7.4%). US CPI inflation dipped to 8.3% in April from 8.5% in March, driven by lower fuel prices.

In China, food and energy prices drove the April consumer price increase of 0.9% from the previous month, and 2.1% compared to April 2021. The outlook for inflation is mixed, with lockdowns expected to weigh on consumer demand but to aggravate supply constraints. Overall, analysts expect inflation to rise to around 3% this year. Inflation in Japan rose to 2.5% in April, but measures of core inflation were little changed and inflation expectations are still low, leading the Bank of Japan to continue with its highly accommodative policy stance.

Table 1: Inflation in selected countries

	Annual % change		2022, year average**
	Mar 2022	Apr 2022	
Euro area	7.4	7.4	7.7
US	8.5	8.3	5.3
UK	7.0	9.0	7.4
Canada	5.8	6.8	5.6
Australia*	5.1		3.9
NZ*	6.9		5.9
Japan	0.9	2.5	1.0
China	1.1	2.1	2.1

*March quarter, **IMF WEO April 2022

...but inflation pressures are broad based

Labour markets are tight across many developed economies and are adding to inflationary pressures in the form of wage growth. In the UK, unemployment declined to 3.5% in March, taking the quarter average to 3.7%, the lowest since 1974. Annual wage growth picked up to 7.0% on the official average weekly wage measure, while wage settlement data rose to 4.0% in April, up from 2.0% at the start of the year.

In the euro area, March's unemployment rate moved down to 6.8% - a further record low since the founding of the euro area. This was accompanied by a sharp move higher in wage settlements to 2.8% from 1.6% in the previous quarter, reinforcing the ECB's intentions to begin raising rates in the months ahead.

Covid-19 disruptions in China are also weighing on growth...

Activity in China fell sharply in April and pandemic-related restrictions have continued to restrain activity in May. These restrictions are spilling-over into the global economy via a rapid slowing in China's demand and through supply chain disruptions, although reports suggest the latter are having a lesser effect than might have been anticipated earlier in the pandemic. Turning to the details, compared to the previous month, industrial production fell 7.0% and retail sales fell 9.9%. Fixed asset investment was 1.8% higher than the same month a year ago, down from 6.7% in March, with the residential sector posting a 10.1% decline.

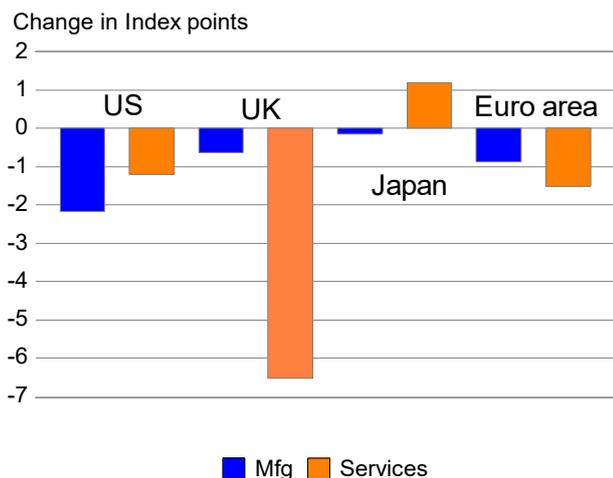
China has ramped up macro policy support in recent weeks. These measures include fiscal, credit, and industry supports to boost investment and consumption, and stabilise the labour market. However, it is not clear how effective these measures will be if increased mobility is accompanied by a resurgence in covid cases and further lockdown measures.

Elsewhere in Asia, March quarter GDP reports showed domestic demand remained firm, but the outlook is at risk as growth in China slows.

...and spilling into advanced economies...

May's Purchasing Managers Indexes (PMIs) are showing the effects of surging inflation and weaker activity in China. Preliminary or 'flash' reports show weaker manufacturing activity in all the major developed economies and, with the exception of Japan, weaker services activity too (figure 4).

Figure 4: May PMIs



Sources: Haver

The decline in manufacturing activity was not a surprise given the headwinds weighing on goods production, but services momentum was expected to hold up as economies continued to reopen following pandemic restrictions. That said, the PMI levels are not outright weak – they are around their pre-pandemic averages – but following falls in April, they do signal a significant slowing in momentum. In more encouraging news, indicators of bottleneck pressures improved across many of the developed markets in May. Next week’s release of PMIs for Asia will be closely watched for signs of spill-over from the sharp fall in China.

Other US data has been mixed, April retail sales and manufacturing output recorded solid gains, up 0.9% in nominal terms, and 0.8% in volumes respectively on the previous month. However, rising mortgage rates are dragging on house sales (down 30% since January) and homebuilder sentiment.

Australia elects new Government

In Australia, a new Government has been sworn in following the weekend’s federal election. At this stage, the new policies proposed by the incoming government have not altered analysts’ views of the economic outlook. The consensus view is that GDP will grow around 4% this year and unemployment will fall to around 3.5% this year from 3.9% in April. Inflation is expected to peak around 6% later this year and to decline to 3.0%, the top of the central bank’s 2%-3% target, by the end of 2023.

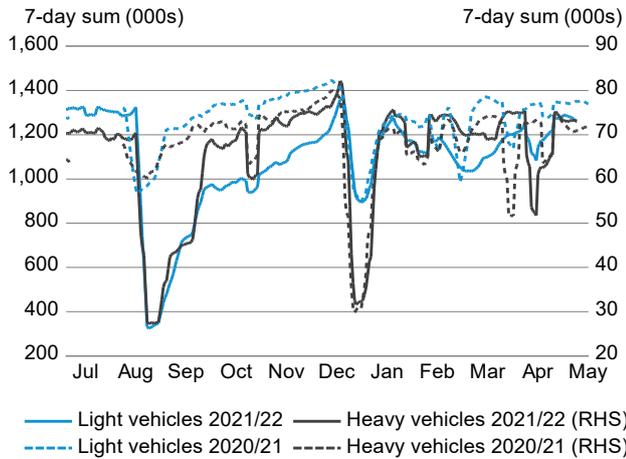
Wage pressures in Australia remain well below those being experienced in some other economies. The Wage Price Index (WPI), which is comparable to New Zealand’s Labour Cost Index, was up 2.4% in the March quarter from the same quarter a year ago and is expected to rise to around 3.75% by the end of 2024. This compares to an expected peak of 4.6% in NZ’s LCI in 2023. This implies that monetary policy does not need to lean as strongly against inflation or wage growth as in New Zealand, and analysts expect a slower pace of interest rate hikes in Australia.

Coming Up:

Date	Release
31 May	Building Consents (Apr), ANZ Business Outlook
2 June	Terms of trade (Q1)
3 June	Building Activity (Q1)
10 June	Manufacturing Activity (Q1)

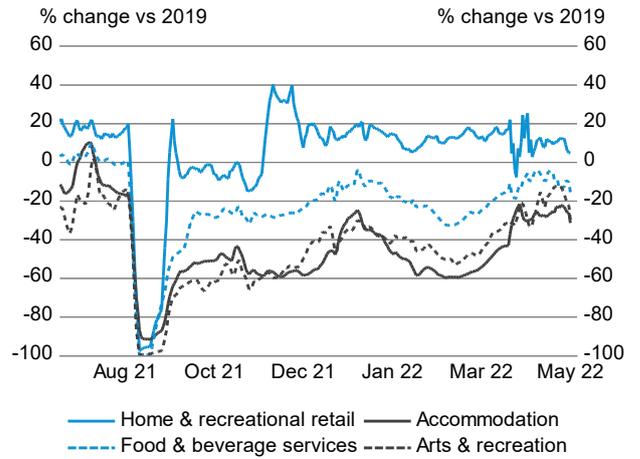
High-Frequency Indicators

Traffic and Freight Movement



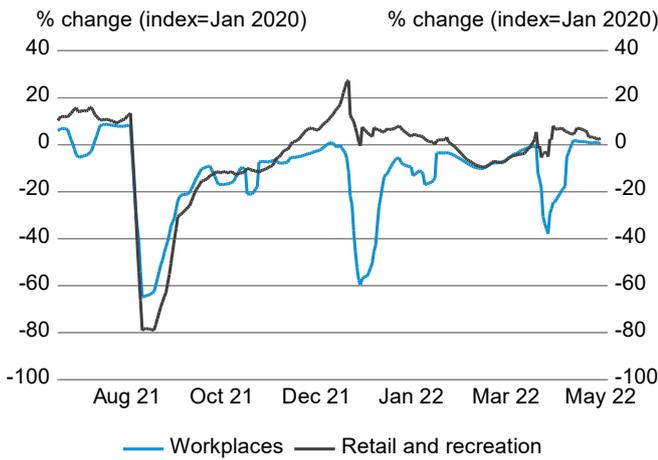
Source: Waka Kotahi NZ Transport Agency

Card Spending



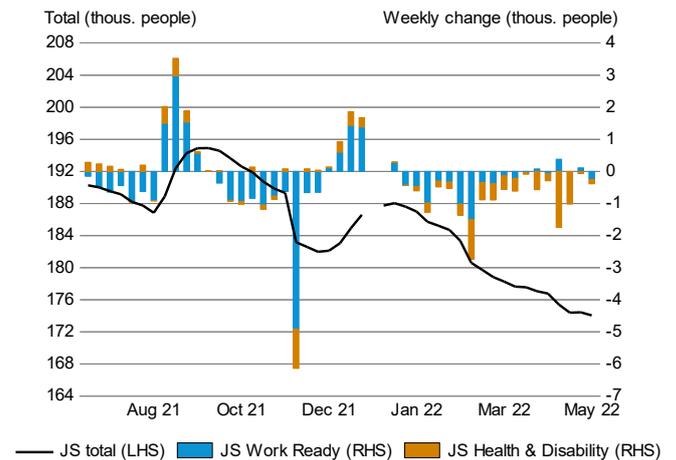
Source: Marketview data via MBIE

People Movements at Selected Locations



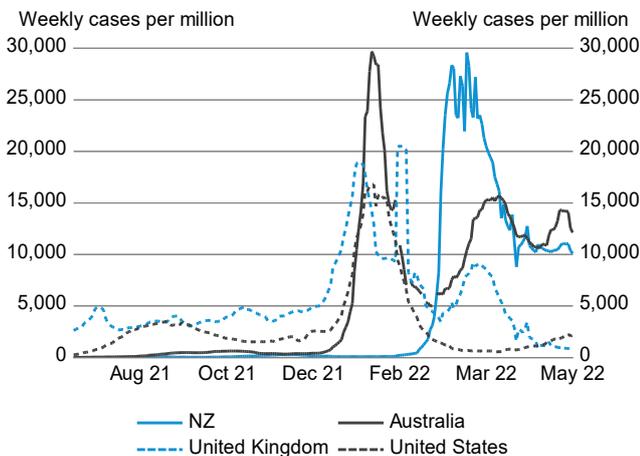
Source: Google/Haver

Jobseeker (JS) and Income Support Recipients



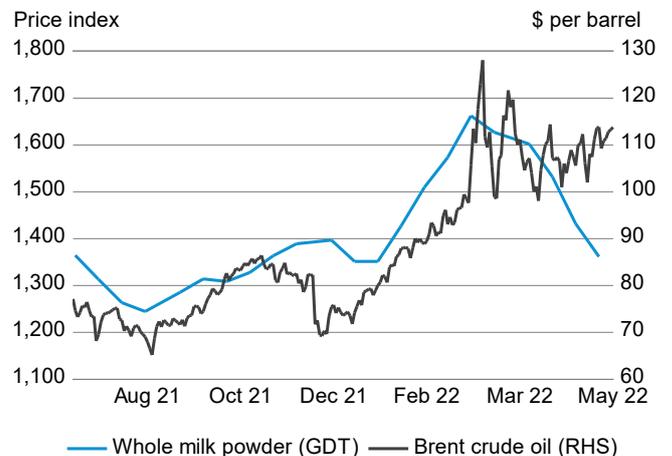
Source: MSD

COVID-19 Cases Per Million People



Source: Johns Hopkins University/Haver

World Commodity Prices



Source: Haver

Quarterly Indicators		2020Q4	2021Q1	2021Q2	2021Q3	2021Q4
Real Production GDP (1)	qpc	-0.3	1.3	2.5	-3.6	3.0
	aapc	-2.1	-1.4	5.2	4.8	5.6
Current account balance (annual)	%GDP	-0.8	-2.5	-3.3	-4.6	-5.8
Merchandise terms of trade	apc	-1.6	-0.9	-0.1	5.2	2.6
CPI inflation	qpc	0.5	0.8	1.3	2.2	1.4
	apc	1.4	1.5	3.3	4.9	5.9
Employment (HLFS) (1)	qpc	0.5	0.7	0.9	1.8	0.0
Unemployment rate (1)	%	4.9	4.6	4.0	3.3	3.2
Participation rate (1)	%	70.2	70.4	70.5	71.2	71.1
LCI salary & wage rates - total (2)	apc	1.6	1.6	2.1	2.4	2.6
QES average hourly earnings - total (2)	apc	4.3	4.0	4.0	3.5	3.8
Core retail sales volume	apc	4.4	5.3	30.0	-3.2	5.1
Total retail sales volume	apc	4.7	6.6	33.1	-5.1	4.4
WMM - consumer confidence (3)	Index	106.0	105.2	107.1	102.7	99.1
QSBO - general business situation (1,4)	net%	-12.5	-6.3	6.9	-11.6	-35.0
QSBO - own activity outlook (1,4)	net%	10.5	7.3	26.6	8.6	8.0

Monthly Indicators		Nov 21	Dec 21	Jan 22	Feb 22	Mar 22
Merchandise trade balance (12 month)	NZ\$m	-6,239.7	-7304.9	-7765.4	-8681.6	-9303.2
Dwelling consents - residential	apc	20.8	10.1	-6.3	34.1	25.7
House sales - dwellings	apc	-15.4	-25.8	-26.4	-30.9	-32.2
REINZ - house price index	apc	27.0	22.5	19.7	14.2	9.0
Estimated net migration (12 month total)	people	-8,838.0	-9125.0	-9496.0	-9547.0	-7255.0
ANZ NZ commodity price index	apc	22.9	27.8	26.5	29.2	20.9
ANZ world commodity price index	apc	26.1	23.5	19.7	20.4	18.0
ANZBO - business confidence	net%	-16.4	-23.2	...	-51.8	-41.9
ANZBO - activity outlook	net%	15.0	11.8	...	-2.2	3.3
ANZ-Roy Morgan - consumer confidence	net%	96.6	98.3	97.7	81.7	77.9
NZAC	apc	1.8	1.9	...	...	...

Daily Indicators		Fri	Mon	Tue	Wed	Thu
		20/5/22	23/5/22	24/5/22	25/5/22	26/5/22

NZ exchange and interest rates (5)

NZD/USD	\$	0.6379	0.6450	0.6433	0.6475	0.6471
NZD/AUD	\$	0.9077	0.9105	0.9090	0.9122	0.9141
Trade weighted index (TWI)	index	71.41	71.92	71.62	71.97	72.12
Official cash rate (OCR)	%	1.50	1.50	1.50	2.00	2.00
90 day bank bill rate	%	2.23	2.28	2.31	2.33	2.40
10 year govt bond rate	%	3.56	3.50	3.53	3.47	3.56

Share markets (6)

Dow Jones	index	31,262	31880	31929	32120	32637
S&P 500	index	3,901	3974	3941	3979	4058
VIX volatility index	index	29.4	28.5	29.5	28.4	27.5
AU all ords	index	7,391	7399	7373	7392	7339
NZX 50	index	11,267	11316	11247	11173	11103

US interest rates

3 month OIS	%	0.83	0.83	0.83	0.83	...
3 month Libor	%	1.51	1.52	1.53	1.55	...
10 year govt bond rate	%	2.78	2.86	2.76	2.75	2.75

Commodity prices (6)

WTI oil	US\$/barrel	112.63	110.32	112.55	110.33	114.09
Gold	US\$/ounce	1,834.20	1856.20	1867.10	1847.20	...
CRB Futures	index	631.55	632.89	630.88	631.29	...

(1) Seasonally adjusted
(2) Ordinary time, all sectors
(3) Westpac McDermott Miller

(4) Quarterly Survey of Business Opinion
(5) Reserve Bank (11am)
(6) Daily close

Data in italic font are provisional
... Not available

Country	Indicator		Oct 21	Nov 21	Dec 21	2021Q4	Jan 22	Feb 22	Mar 22	2022Q1	Apr 22	May 22
United States	GDP (1)	qpc				1.7				-0.4		
	Industrial production (1)	mpc	1.4	0.7	-0.3		0.8	1.0	0.9		1.1	...
	CPI	apc	6.2	6.8	7.0		7.5	7.9	8.5		8.3	...
	Unemployment rate (1)	%	4.6	4.2	3.9		4.0	3.8	3.6		3.6	...
	Employment change (1)	000s	677.0	647.0	588.0		504.0	714.0	428.0		428.0	...
	Retail sales value	apc	16.5	18.6	16.8		13.7	17.7	7.3		8.2	...
	House prices (2)	apc	18.5	18.3	18.5		18.9	20.2	...		...	...
	PMI manufacturing (1)	index	60.8	60.6	58.8		57.6	58.6	57.1		55.4	...
Consumer confidence (1)(3)	index	111.6	111.9	115.2		111.1	105.7	107.6		107.3	...	
Japan	GDP (1)	qpc				0.9				-0.2		
	Industrial production (1)	mpc	2.1	5.0	0.2		-2.4	2.0	0.3		...	...
	CPI	apc	0.1	0.6	0.8		0.5	0.9	1.2		2.5	...
	Unemployment rate (1)	%	2.7	2.8	2.7		2.8	2.7	2.6		...	...
	Retail sales value	apc	0.9	1.9	1.2		1.1	-0.9	0.7		...	...
	PMI manufacturing (1)	index	53.2	54.5	54.3		55.4	52.7	54.1		53.5	...
	Consumer confidence (1)(4)	index	39.2	39.2	38.8		36.6	35.1	32.5		32.0	...
Euro area	GDP (1)	qpc				0.3				0.3		
	Industrial production (1)	mpc	-1.5	2.5	1.7		-0.8	0.5	-1.8		...	...
	CPI	apc	4.1	4.9	5.0		5.1	5.9	7.4		7.4	...
	Unemployment rate (1)	%	7.2	7.1	7.0		6.9	6.9	6.8		...	...
	Retail sales volume	apc	1.6	8.5	2.4		8.5	5.2	0.8		...	...
	PMI manufacturing (1)	index	58.3	58.4	58.0		58.7	58.2	56.5		55.5	...
Consumer confidence (5)	index	-5.4	-8.2	-9.3		-9.7	-9.5	-21.6		-22.0	-21.1	
United Kingdom	GDP (1)	qpc				1.3				0.8		
	Industrial production (1)	mpc	-0.7	1.0	0.3		0.9	-0.3	-0.2		...	...
	CPI	apc	3.8	4.6	4.8		4.9	5.5	6.2		7.8	...
	Unemployment rate (1)	%	4.2	4.1	4.1		3.9	3.8	3.7		...	...
	Retail sales volume	apc	-1.1	3.7	-1.4		9.9	7.4	1.3		-4.9	...
	House prices (6)	apc	9.9	10.0	10.4		11.2	12.6	14.3		12.1	...
	PMI manufacturing (1)	index	57.8	58.1	57.9		57.3	58.0	55.2		55.8	...
Consumer confidence (1)(5)	net %	-17.0	-14.0	-15.0		-19.0	-26.0	-31.0		-38.0	-40.0	
Australia	GDP (1)	qpc				3.4				...		
	CPI	apc				3.5				5.1		
	Unemployment rate (1)	%	5.2	4.6	4.2		4.2	4.0	3.9		3.9	...
	Retail sales value	apc	4.5	6.2	5.0		5.8	9.1	8.2		...	...
	House Prices (7)	apc				27.5					...	...
	PMI manufacturing (1)	index	50.4	54.8	48.4		48.4	53.2	55.7		58.5	...
Consumer confidence (8)	index	104.6	105.3	104.3		102.2	100.8	96.6		95.8	90.4	
China	GDP	apc				4.0				4.8		
	Industrial production	apc	3.5	3.8	4.3		7.5	7.5	5.0		-2.9	...
	CPI	apc	1.5	2.3	1.5		0.9	0.9	1.5		2.1	...
	PMI manufacturing (1)	index	49.2	50.1	50.3		50.1	50.2	49.5		47.4	...
South Korea	GDP (1)	qpc				1.2				0.7		
	Industrial production (1)	mpc	0.4	1.6	3.4		0.4	0.3	1.3		...	...
	CPI	apc	3.2	3.8	3.7		3.6	3.7	4.1		4.8	...

(1) Seasonally adjusted

(2) Case-Shiller Home Price Index 20 city

(3) The Conference Board Consumer Confidence Index

(4) Cabinet Office Japan

(5) European Commission

(6) Nationwide House Price Index

(7) Australian Bureau of Statistics

(8) Melbourne/Westpac Consumer Sentiment Index