

- **Domestic demand easing as rising interest rates and higher consumer prices bite**
- **Annual consumer price inflation expected to remain above 7% in the December quarter**
- **The global outlook remains challenging but China’s reopening will provide a boost**

Since our last fortnightly economic update in December, domestic data is revealing a slowdown in economic activity. Despite a record low unemployment rate and strong GDP outturn for the September 2022 quarter, business sentiment has worsened and consumers are beginning to ease off on spending after rapidly rising interest rates. Inflationary pressure lingers at elevated rates and we expect annual headline inflation for the December quarter to remain above 7.0%. Globally, a challenging year lies ahead. China’s reopening and its implications for global growth and inflation could pass through to domestic inflation.

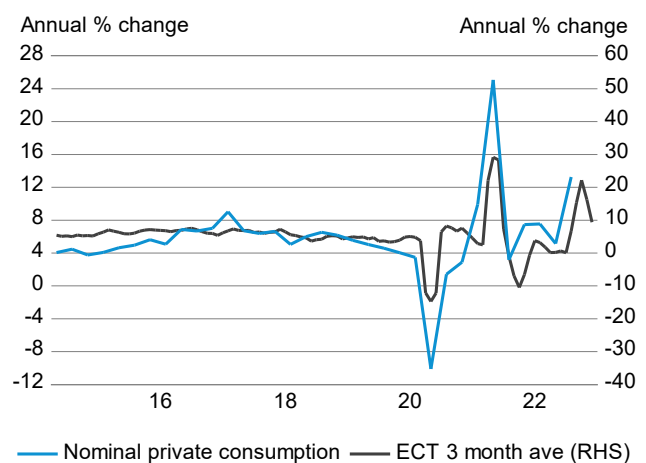
### **Domestic demand responds to higher prices and higher interest rates...**

Higher costs of living and lower house prices are starting to show in consumer activity. The national house price index fell for the 13th consecutive month in December according to the Real Estate Institute of New Zealand (REINZ). While the declines have moderated, with a fall of 1.3% in the December month, house prices are down 15% since their peak in November 2021. Houses are taking longer to sell and fewer are selling, meaning further weakness is expected after mortgage rates rose nearly 40 basis points in December alone with further increases expected this year.

### **...putting more pressure on consumers...**

Meanwhile, consumer confidence fell to an 18-year low in December of 73.8 according to the ANZ-Roy Morgan Index. This unease about the future is reflected in lower electronic card spending (ECT) in the December quarter (Figure 1). Declines in spending were spread across all types, including durables (down 1.5%) and fuel (down 9.8%), with the exception of consumables (up 2.1%) which include spending on food and beverages. Weaker consumption in the quarter will in turn weigh heavily on the GDP outturn for the December 2022 quarter.

**Figure 1: Private consumption and ECT**

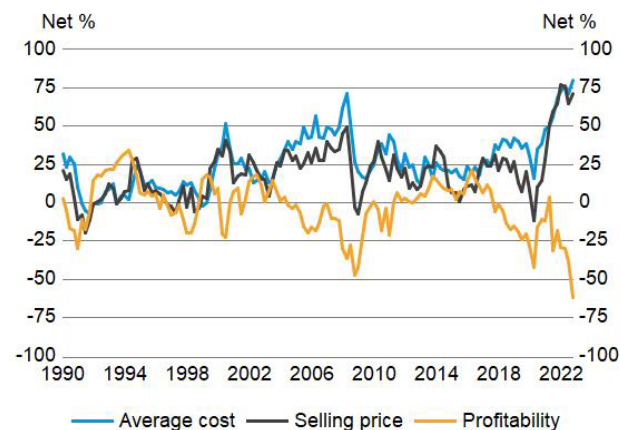


Source: Stats NZ

### **...and businesses face higher costs and labour shortages across sectors ...**

Business sentiment worsened considerably in December according to both the ANZ Business Outlook and the NZIER’s Quarterly Survey of Business Opinion (QSBO). The ANZ survey revealed respondents’ pessimism at levels last seen during the Global Financial Crisis in 2008. The QSBO however revealed its worst outlook in its 40-year history. Businesses already struggling with supply chain disruptions and labour scarcity, face higher input costs including wages, putting pressure on profit margins. Businesses across almost all sectors indicate a reluctance to keep increasing prices for consumers already facing higher interest rates and cost of living (Figure 2).

**Figure 2: QSBO Economy-Wide for Next Three Months**



Source: NZIER QSBO

**...with construction being one to watch**

Despite weak sentiment reported from the construction sector, some data points to signs of activity. Building consents bounced back in November after a sharp drop in October. Overall, demand is holding up for both multi-unit and stand-alone dwellings despite weaker house prices and selling activity. Consents for multi-unit dwellings in Auckland now make up one-third of all building consents over the last year.

**Good news for net migration and tourism...**

Labour market shortages may start to ease with annual net migration in November 2022 becoming positive for the first time since March 2021 as a backlog in visa applications get processed to address key labour shortages. Tourism continues to look positive and edges closer to pre-COVID-19 levels, with visitor arrivals up 231,300 in the month and 1.07 million in the year.

**....while dairy prices tread water**

The *GlobalDairyTrade* Price Index declined slightly at the 17 January auction down 0.1%, following large declines at the previous two auctions, to be nearly 33% down from their March 2022 peak. Buyers largely took a wait-and-see approach to China’s reopening, as upside risk to demand later in the year is tempered by the possibility of near-term COVID-19 disruption. Global supply remains tight but has improved in recent months, following wet weather in New Zealand and solid production in US and Europe, taking some upward pressure off prices.

**Inflation is expected to remain elevated at 7.1%**

The Consumer Price Index (CPI) for the December quarter (released on Wednesday 25 January) is expected to rise 1.5% in the December quarter compared to the previous quarter. That would see annual inflation remain above 7.0%.

**Table 1 – Forecast CPI Inflation December 2022**

Consumer Price Index	Quarterly % change	Annual % change
HYEFU 2022 forecast	1.5	7.1
Reserve Bank (November 2022 MPS)	1.7	7.5
Market average	1.4	7.2
Market range *	1.1 - 1.6	6.9 – 7.4
Previous quarter	2.2	7.2

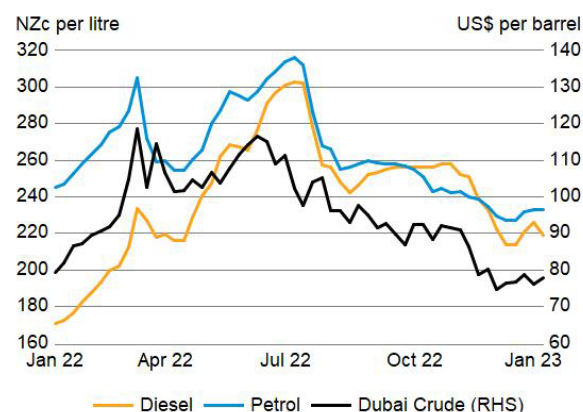
\* Bloomberg Poll (n=3, 20 January 2023).

Source: Bloomberg, the Treasury

The food and housing groups are expected to be the main contributors based largely on partial indicators released during the last quarter of 2022. Stats NZ reported its Food Price Index lifted 4% in the December quarter on a seasonally adjusted basis, taking the annual increase in food prices to 11.3%, the largest in 32 years. Meanwhile, households continue to face increasing costs relating to home ownership, maintenance, and materials.

The outlook for the transport group is mixed, but may ease slightly as lower fuel prices offset higher domestic and international airfares. The price of crude oil returning to levels of a year ago saw petrol prices fall 12.5% in the quarter and diesel prices down 9.1% (Figure 3).

**Figure 3: Crude Oil, Domestic petrol and diesel prices**



Source: MBIE

We expect the other components to experience similar growth to recent quarters, reflecting the broad-based nature of the inflation impulse and limited signs of substantive easing domestically or internationally.

**A challenging year ahead for the global economy**

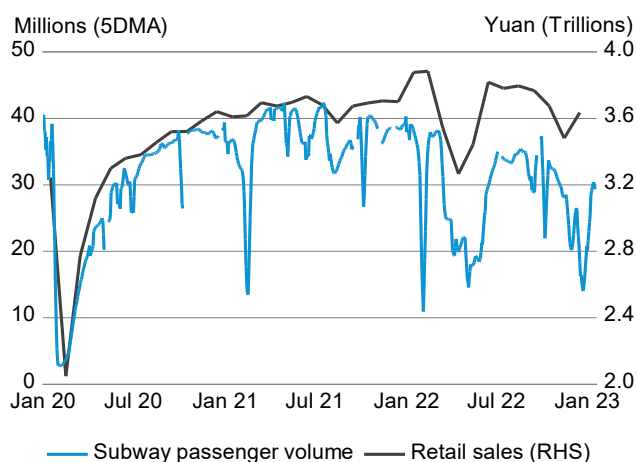
While 2023 is expected to see an easing of global inflation, the continuation of monetary tightening across many economies will cause a significant slowdown. The World Bank’s latest forecasts show global growth slowing to 1.7% in 2023 – the third slowest rate in nearly three decades – and a 1.3%-age point downgrade from their June 2022 forecast. Recent activity data, however, point to ongoing resilience in demand, albeit as supply constraints persist, and the IMF has signalled that it will upgrade its 2.7% forecast in its forthcoming January update.

## COVID-19 spreads in China

China's economy was stagnant in the December quarter, but well ahead of market consensus of a 0.8% contraction. Indicators for the month of December released at the same time highlighted activity holding up much better than expected. Retail sales declined 1.8% from a year previous, against expectations of a 9.0% fall, despite the surge in COVID-19 cases weighing heavily on customer-facing services. Industrial production also exceeded expectation in December, rising 1.3% on a year ago against consensus of 0.1% lift, and spurring optimism that COVID-19-related supply-chain disruptions are manageable. On a less positive note, December's monthly indicators continued to show the property sector in a deep slump, with no clear evidence of a rebound, and analysts expect additional policy stimulus to support the sector in coming months.

While December outturns exceeded market expectations, they highlight the toll of the current COVID-19 outbreak sweeping the country. The removal of most COVID-19 restrictions will improve mobility and support a rebound in economic activity, although case data limitations make it difficult to ascertain whether the outbreak has peaked. High-frequency indicators suggest mobility has continued to recover into January (Figure 4). Activity is nonetheless expected to remain constrained in the March quarter, while weakening external demand adds additional headwinds to growth.

**Figure 4: China retail sales and mobility**



Source: Haver. Note: Subway passenger volume is an aggregate measure of ridership in 7 major cities

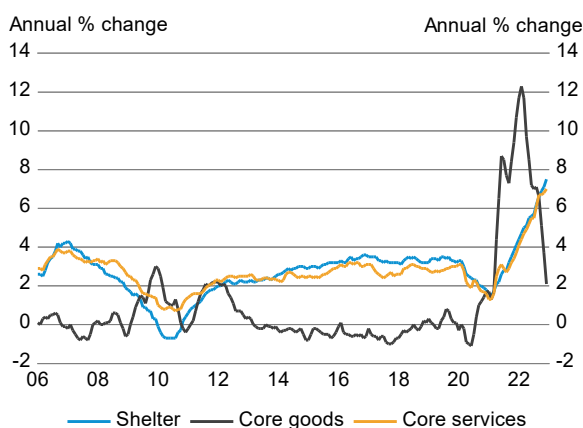
The reopening of the world's second largest economy will have widespread implications for global economy, as strengthening demand risks adding to inflation pressures. The stronger-than-expected end to 2022 and the earlier-than-expected unwind of COVID-19 restrictions has led analyst to revise up their expectations of 2023 growth to between 5.0% and 5.5% from around 4.5% previously. However, the ailing property sector and COVID-19 remain sources of downside risk.

In addition, the demographic transition underway may add further constraints to growth moving forward. China's population fell in 2022 for the first time since 1961, by 850,000 to 1.412 billion, and may signal the beginning of the end of China's labour abundance that has been a disinflationary force in the global economy in recent decades.

## US inflation eases, and further signs of a slowing emerge

December's CPI report highlighted the continuation of easing inflation in the US, with the headline measure declining 0.1% in the month, reducing the annual rate to 6.5%, the smallest since October 2021. Falling energy prices was the largest driver, although the report highlighted continued goods disinflation while core services and shelter inflation pushed higher (Figure 5). The core measure of inflation rose 0.3% in the month, reinforcing the need for further policy tightening by the Federal Reserve (Fed).

**Figure 5: US CPI components**



Source: Haver

While December CPI came in slightly higher than market expectations, the market continues to expect the Federal Open Market Committee (FOMC) to step down to a 25-bps hike at its February meeting. The sustained deceleration in consumer prices, and further evidence of moderating wage growth according to the Atlanta Wage Growth Tracker will be welcome signs of easing inflationary pressures for the Fed. The stickiness of the core inflation measure, however, reinforces the need for further tightening, and analysts expect to see the Fed update its terminal rate guidance to over 5.0%, with 25-bps hikes to continue through to May.

There were further signs of softening demand in the US in December as retail sales declined 1.1% for the second month in a row. US manufacturing output also declined 1.3% in December, and November's figures were revised down further to a 1.1% decline, the weakest quarter since the start of the pandemic.



## Euro area outlook improves as gas prices fall...

In Europe, the major development over the past month has been a collapse in gas prices back to pre-invasion levels, as milder-than-usual winter weather and efforts to reduce demand have boosted inventories. Combined with government fiscal measures, some positive data surprises and the positive impulse from faster growth in China this year, the outlook for the euro area no longer appears as bleak as earlier, although a recession still appears likely.

### ...and inflation pressures recede...

Meanwhile, annual eurozone inflation fell further in December from 10.1% to 9.2%, down from October's peak of 10.6%. However, core and services inflation rose further, to 5.2% and 4.4% respectively. The outlook is for core inflation to remain above 5% over 2023Q1, keeping the ECB in tightening mode, before easing over the rest of the year.

UK inflation also eased to 10.5% in December, down from a peak of 11.1% in October, but core inflation rose to 6.3%, adding to the likelihood that the Bank of England hikes rates by 50bps next month. Continuing the theme of lower headline inflation, Canada's CPI and core measures fell to 6.3% and 5.6% respectively. The Bank of Canada meets next week with a 25bps hike to 4.5% expected to be the last in this cycle.

### ...but energy deflation may be short lived

China's oil demand fell in 2022 for the first time in 32 years, as economic growth slowed, and its reopening could lift global oil prices over the year ahead, particularly as recent EU sanctions on Russian oil constrain global supply. The International Energy Agency's January update forecast global demand to rise to a record high in 2023 while sanctions on Russia are expected to reduce world oil supply. Benchmark Brent crude has been trading around the US\$86 mark over the past week or so, and the futures market suggests prices will remain around this level over the next 6 months or so.

With lower energy prices accounting for much of the current decline in global inflation, a stabilisation in oil prices will increase the focus on slower demand growth to bring down inflation. It is unclear whether emerging demand from China's reopening fuels more inflation in Europe and the US or if it arrives at a time to support faltering demand in advanced economies.

## Bank of Japan maintains policy settings as inflation rises

The Bank of Japan defied expectation by maintaining current policy settings at its January meeting, despite annual inflation reaching 40-year highs in November, and widely expected to reach 4.0% in December. Following a surprising policy pivot in December to widen the target range for long term yields, markets were watching the meeting closely for signals of an unwind of ultra-loose monetary policy settings that have been in place for more than a decade. The Bank of Japan, however, expects current inflation to be temporary.

## Australia's labour market remains tight

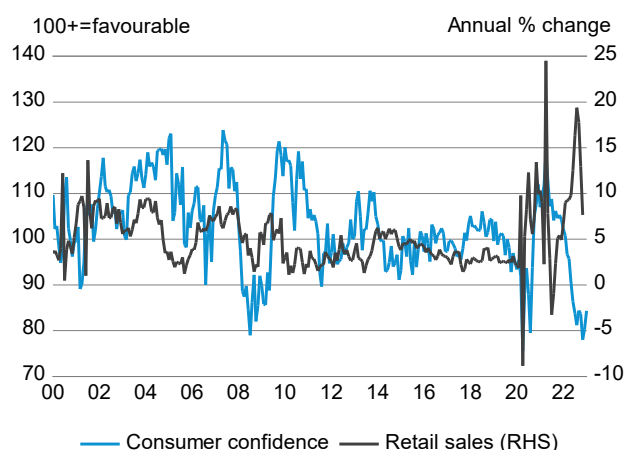
A key uncertainty for the 2023 Australian outlook is the extent of the slowdown in household spending induced by higher interest rates and declining real income from high inflation. There are few signs so far that monetary policy tightening is materially weighing on spending, likely reflecting ongoing labour market tightness. Financial markets expect the Reserve Bank of Australia to raise its policy rate 25 bps to 3.25% at its meeting on 7 February.

Employment declined by 15k in December 2022, following a strong 58k gain in November. The unemployment rate was flat at a revised 3.5%, with the participation rate down two-tenths to 66.6%. Despite the softer tone of the report, it hasn't shifted the overall picture of a tight labour market.

Annual inflation rose 7.3% in November, back to a 32-year high, and reversing a surprise drop to 6.9% in October. December quarter inflation data, to be released on 25 January, is expected to be around 7.5%.

Retail sales increased strongly in November, up 1.4% from October, while October's figures were also revised up. The strength in retail sales contrasts strongly with consumer sentiment, which remains near record lows despite consecutive rises in January and December (Figure 6).

Figure 6: Retail spending and consumer confidence



Source: Haver

## Coming Up:

Date	Release
25 Jan	Consumer Price Index (Q4)
30 Jan	Overseas Merchandise Trade (Dec)
1 Feb	Labour Market Statistics (Q4)
2 Feb	Building Consents (Dec)

## Tables

<b>Quarterly Indicators</b>		<b>2021Q3</b>	2021Q4	2022Q1	2022Q2	2022Q3	2022Q4
Real Production GDP (1)	qpc	-3.9	2.9	-0.4	1.9	2.0	...
	aapc	5.4	6.1	5.2	1.1	2.7	...
Current account balance (annual)	%GDP	-4.7	-6.0	-6.8	-7.7	-7.9	...
Merchandise terms of trade	apc	5.2	2.8	3.3	-2.2	-5.9	...
CPI inflation	qpc	2.2	1.4	1.8	1.7	2.2	...
	apc	4.9	5.9	6.9	7.3	7.2	...
Employment (HLFS) (1)	qpc	1.5	-0.0	0.0	-0.0	1.3	...
Unemployment rate (1)	%	3.3	3.2	3.2	3.3	3.3	...
Participation rate (1)	%	71.1	71.0	70.9	70.9	71.7	...
LCI salary & wage rates - total (2)	apc	2.4	2.6	3.0	3.4	3.7	...
QES average hourly earnings - total (2)	apc	3.5	3.8	4.8	6.4	7.4	...
Core retail sales volume	apc	-3.2	5.1	3.2	-1.8	5.0	...
Total retail sales volume	apc	-5.1	4.4	2.3	-3.7	4.9	...
WMM - consumer confidence (3)	Index	102.7	99.1	92.1	78.7	87.6	...
QSBO - general business situation (1,4)	net%	-11.6	-32.4	-35.4	-64.7	-42.6	-72.9
QSBO - own activity outlook (1,4)	net%	7.1	10.3	8.3	-15.8	-17.6	-32.9
<b>Monthly Indicators</b>		<b>Jul 22</b>	Aug 22	Sep 22	Oct 22	Nov 22	Dec 22
Merchandise trade balance (12 month)	NZ\$m	-12,002.5	-12504.1	-12839.6	-13854.8	-14632.2	...
Dwelling consents - residential	apc	-2.9	0.9	1.7	-11.9	-0.9	...
House sales - dwellings	apc	-34.7	-15.6	-6.7	-30.5	-34.3	-39.0
REINZ - house price index	apc	-2.8	-5.7	-8.0	-10.9	-13.7	-13.8
Estimated net migration (12 month total)	people	-13,694.0	-10713.0	-7108.0	-4117.0	...	...
ANZ NZ commodity price index	apc	13.6	10.3	14.4	12.8	-0.5	-7.1
ANZ world commodity price index	apc	4.3	2.4	0.2	-5.3	-11.5	-11.4
ANZBO - business confidence	net%	-56.7	-47.8	-36.7	-42.7	-57.1	-70.2
ANZBO - activity outlook	net%	-8.7	-4.0	-1.8	-2.5	-13.7	-25.6
ANZ-Roy Morgan - consumer confidence	net%	81.9	85.4	85.4	85.4	80.7	73.8
NZAC	apc	0.8	6.8	5.2	...	...	...
<b>Daily Indicators</b>		<b>Thu 12/1/23</b>	<b>Fri 13/1/23</b>	<b>Mon 16/1/23</b>	<b>Tue 17/1/23</b>	<b>Wed 18/1/23</b>	<b>Thu 19/1/23</b>
<b>NZ exchange and interest rates (5)</b>							
NZD/USD	\$	0.6369	0.6377	0.6399	0.6395	0.6425	0.6425
NZD/AUD	\$	0.9212	0.9155	0.9158	0.9180	0.9206	0.9300
Trade weighted index (TWI)	index	71.66	71.36	71.35	71.43	71.90	71.98
Official cash rate (OCR)	%	4.25	4.25	4.25	4.25	4.25	4.25
90 day bank bill rate	%	4.78	4.79	4.82	4.82	4.81	4.81
10 year govt bond rate	%	4.13	4.02	4.09	4.07	4.12	3.99
<b>Share markets (6)</b>							
Dow Jones	index	34,190	34303	...	33911	33297	...
S&P 500	index	3,983	3999	...	3991	3929	...
VIX volatility index	index	18.8	18.4	...	19.4	20.3	...
AU all ords	index	7,490	7540	7605	7598	7610	7648
NZX 50	index	11,665	11754	11811	11881	11920	11886
<b>US interest rates</b>							
3 month OIS	%	4.33	4.33	4.33	4.33	...	...
3 month Libor	%	4.83	4.79	4.79	4.80	4.81	...
10 year govt bond rate	%	3.43	3.49	...	3.53	3.37	...
<b>Commodity prices (6)</b>							
WTI oil	US\$/barrel	78.39	79.90	...	80.25	79.53	...
Gold	US\$/ounce	1,882.55	1907.15	1917.00	1913.80	1920.70	...
CRB Futures	index	557.10	559.46	...	558.67	560.01	...

(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		2022Q2	Jul 22	Aug 22	Sep 22	2022Q3	Oct 22	Nov 22	Dec 22	2022Q4	Jan 23
United States	GDP (1)	qpc	-0.1				0.8				...	...
	Industrial production (1)	mpc		0.5	0.0	0.3		0.0	-0.6	-0.7		...
	CPI	apc		8.5	8.3	8.2		7.7	7.1	6.5		...
	Unemployment rate (1)	%		3.5	3.7	3.5		3.7	3.6	3.5		...
	Employment change (1)	000s		537.0	292.0	269.0		263.0	256.0	223.0		...
	Retail sales value	apc		10.0	9.7	8.4		8.0	6.0	6.0		...
	House prices (2)	apc		16.0	13.0	10.4		8.6	...	...		...
	PMI manufacturing (1)	index		52.8	52.8	50.9		50.2	49.0	48.4		...
Consumer confidence (1)(3)	index		95.3	103.6	107.8		102.2	101.4	108.3		...	
Japan	GDP (1)	qpc	1.1				-0.2				...	...
	Industrial production (1)	mpc		0.8	3.4	-1.7		-3.2	0.2	...		...
	CPI	apc		2.6	3.0	2.9		3.8	3.8	...		...
	Unemployment rate (1)	%		2.6	2.5	2.6		2.6	2.5	...		...
	Retail sales value	apc		2.4	4.1	4.8		4.4	2.5	...		...
	PMI manufacturing (1)	index		52.1	51.5	50.8		50.7	49.0	48.9		...
	Consumer confidence (1)(4)	index		30.1	32.0	31.2		30.8	29.6	30.9		...
Euro area	GDP (1)	qpc	0.9				0.3				...	...
	Industrial production (1)	mpc		-2.1	1.7	0.8		-1.9	1.0	...		...
	CPI	apc		8.9	9.1	9.9		10.6	10.1	9.2		...
	Unemployment rate (1)	%		6.6	6.7	6.6		6.5	6.5	...		...
	Retail sales volume	apc		-0.8	-1.4	0.1		-2.6	-2.8	...		...
	PMI manufacturing (1)	index		49.8	49.6	48.4		46.4	47.1	47.8		...
	Consumer confidence (5)	index		-27.0	-24.9	-28.7		-27.5	-23.9	-22.2		...
United Kingdom	GDP (1)	qpc	0.1				-0.3				...	...
	Industrial production (1)	mpc		-0.8	-1.4	-0.1		-0.1	-0.2	...		...
	CPI	apc		8.8	8.6	8.8		9.6	9.3	9.2		...
	Unemployment rate (1)	%		3.6	3.5	3.6		3.7	3.7	...		...
	Retail sales volume	apc		-3.3	-5.2	-6.7		-5.9	-5.8	...		...
	House prices (6)	apc		11.0	10.0	9.5		7.2	4.4	2.8		...
	PMI manufacturing (1)	index		52.1	47.3	48.4		46.2	46.5	45.3		...
	Consumer confidence (1)(5)	net %		-41.0	-44.0	-49.0		-47.0	-44.0	-42.0		...
Australia	GDP (1)	qpc	0.9				0.6				...	...
	CPI	apc	6.1				7.3				...	...
	Unemployment rate (1)	%		3.5	3.5	3.6		3.4	3.5	3.5		...
	Retail sales value	apc		15.8	19.4	18.6		12.0	7.7	...		...
	House Prices (7)	apc	...				...			...		...
	PMI manufacturing (1)	index		52.5	49.3	50.2		49.6	44.7	...		...
	Consumer confidence (8)	index		83.8	81.2	84.4		83.7	78.0	80.3		84.3
China	GDP	apc	0.4				3.9				2.9	...
	Industrial production	apc		3.8	4.2	6.3		5.0	2.2	1.3		...
	CPI	apc		2.7	2.5	2.8		2.1	1.6	1.8		...
	PMI manufacturing (1)	index		49.0	49.4	50.1		49.2	48.0	47.0		...
South Korea	GDP (1)	qpc	0.7				0.3				...	...
	Industrial production (1)	mpc		-1.3	-1.4	-2.0		-3.5	0.4	...		...
	CPI	apc		6.3	5.7	5.6		5.7	5.0	5.0		...

(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