TE TAI ŌHANGA
THE TREASURY

Fortnightly Economic Update

3 February 2023

- **Inflationary pressures and the labour market show some early signs of easing**
- **Upper North Island flooding has had a major impact on lives and will add to inflation**
- **The global growth outlook has improved as activity holds up in the US and Europe and rebound continues in China**

Data released in the past fortnight point to an easing in domestic demand, following ongoing pessism in business and consumer sentiment. Consumer price inflation showed signs of moderation in the December quarter and employment growth slowed down. The international outlook improved with the IMF upgrading its global growth forecast for 2023 by 0.2 percentage-points to 2.9%, reflecting resilient demand in the US and Europe, improvements in energy markets, and China's reopening. While global inflation has peaked, core rates remain elevated and central banks continue to raise interest rates, although guidance suggests an end to the tightening cycle is near.

Flooding has had a major impact on lives and livelihoods, and will add to inflation in the near term

Recent flooding across the upper North Island has caused a major disruption to people's lives and livelihoods, and the loss of life is tragic. Given reported property damage and the number of insurance claims (around 20,000 in Auckland to date), this is looking likely to be a costly event. To give a sense of scale, the 2019 Timaru hail storms cost $170 million and the 2016 Kaikoura earthquake cost $2.2 billion. While the current event is different in character, it has affected much larger population centres, including Auckland which accounts for a third of New Zealand's population.

The biggest economic costs will take the form of lost capital and lost economic opportunity. New Zealand Inc will spend time and resources on repair and remediation work, diminishing the opportunity to improve the capital stock. While some (but not all) of these losses are insured, over time New Zealand's insurance costs could rise.

GDP is not a measure of economic losses. It is simply a measure of work and production that takes place each quarter. GDP will be diminished by disruptions such as lost crops and lost tourism, but will be boosted by repair and recovery work. The overall impact on GDP could be roughly neutral in the March quarter, and GDP could be boosted in later quarters.

The flooding is likely to affect the supply of certain foods and other products, pushing up prices temporarily. Consequently, inflation may remain higher for longer than previously expected, with consumer price inflation around 0.4 percentage points higher than it would otherwise have been over the first half of 2023. While much of this will prove temporary, lingering supply chain impacts have the potential to boost inflation for a longer period.

Repair and recovery work over time is an additional source of demand in an already capacity-constrained economy. This could be an additional source of inflation pressure and could crowd out other economic activity.

Inflation rate remains elevated…

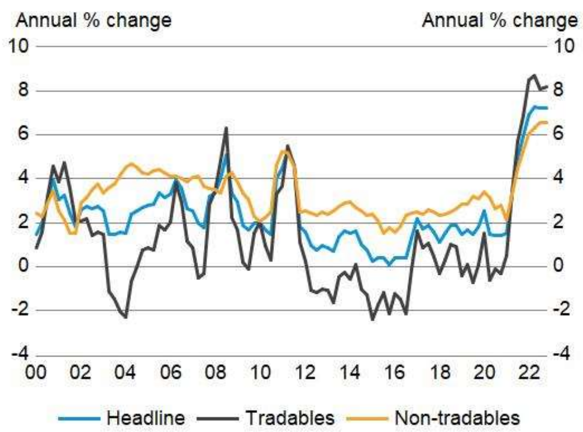
While consumer price inflation eased in the December 2022 quarter, up 1.4% after a 2.2% rise in the September quarter, the strength of domestic demand kept the annual inflation rate elevated at 7.2% (Figure 1). While close to our HYEFU forecast of 7.1%, the rate remains well outside the Reserve Bank's target band of 1 to 3 percent.

An easing in domestic demand was reflected in a flattening of annual non-tradable inflation at 6.6% as the costs for constructing a new house increased 2.1% and rent prices increased 0.9%.

Ongoing strength in the monthly Food Price Index was reflected in the CPI Food group which was up 1.8%, a decades long high for a December quarter. Annual tradable inflation stayed above 8% as rising air fares from returning tourism offset falling petrol prices.

Prepared by the Treasury and released at https://www.treasury.govt.nz/publications/research-and-commentary/fortnightly-economic-updates

Figure 1: Annual Consumer Price Inflation

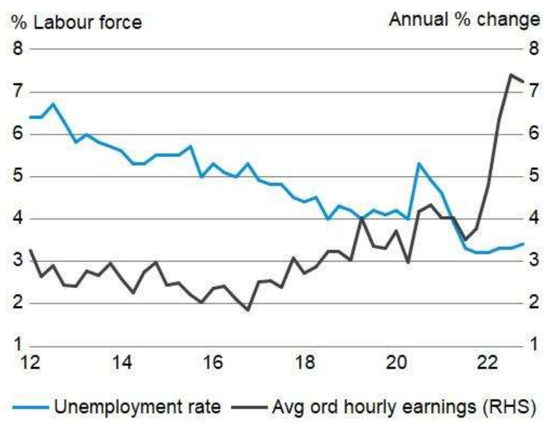


Source: Stats NZ

…while the labour market could be turning a corner

The unemployment rate increased marginally from 3.3% in the September quarter to 3.4% for the December quarter. Conditions remain tight as the number of full-time employees increased 0.6%, the seventh consecutive increase. Employment growth continued for sectors reporting difficulty in securing labour, with the Wholesale Trade, Accommodation and Food Services, and the Construction sectors being the largest contributors. This in turn supported solid growth in hours worked and paid. While growth in average ordinary time earnings slowed in the quarter, increasing 0.9%, wage pressures remain elevated with annual growth at 7.2% (Figure2).

Figure 2: Unemployment and wage growth



Source: Stats NZ

A turning point in the labour market may be starting with an increase in the number of available jobseekers, reflected in an increase in the underutilisation rate from 9.0% to 9.4% in the December quarter. This may also reflect the recovery in recent monthly estimates of net inward migration of non-New Zealand citizens. While this may be positive news for industries reporting difficulty in securing skilled and unskilled labour in business confidence surveys, the increase in the underutilisation rate may show labour is not being directed towards the sectors in dire need, especially the construction sector.

Business and consumer confidence recovers slightly from record lows

Business confidence recovered in January according to the ANZ Business Outlook survey. While the index bounced 18 points to -52.0% from a record low reached in December, pessimism persists around cost pressures, investment intentions, and firms' assessment of their own activity compared with January 2021. A slight reduction in inflation expectations from 6.2% in December to 6.0% in January is too small to conclude a permanent adjustment, and may reflect a recovery from firms' shock at the RBNZ's November MPS.

Similarly, consumer confidence bounced back in January off a record low reported in the ANZ-Roy Morgan Consumer Confidence index. Respondents consider their own current financial situations slightly better, and a net 7% expect to be better off this time next year. Their expectations of inflation one year out increased marginally from 5.2% to 5.3%, which is still reasonably lower than the rates expected by businesses. A net 28% think it is currently a bad time to buy a major household item, which is consistent with an easing in card spending during December, higher interest rates, and an easing in the labour market.

…with construction set to slow…

The construction sector continues to struggle with building consents for new dwellings down 7.2% in December month, and 7.7% in the December quarter. Growth in consents for multi-unit dwellings over the past year has been shown in a decrease in the median floor area of new homes constructed, down 10%. In addition, standalone housing consents were down 8.2% in the quarter and townhouse consents down 8.6%.

The construction sector remains vulnerable as businesses struggle to secure materials and labour, and face increasing pressure to pass on higher costs. Consents are expected to ease in the first half of 2023 as the pipeline clears but the sector faces near-full capacity.

The merchandise trade deficit narrowed slightly

The annual merchandise trade deficit to December narrowed slightly to $14.5 billion but remains at near-record levels. This was mainly due to a drop in export prices being offset by a fall in import prices, with import values down 10.4%. While the significant fall may reflect volatility in the monthly data and the fall in export revenue of 1.6%, import prices are likely driving the decline in import values, and it is therefore too soon to determine whether this reflects an easing in domestic demand

IMF upgrades 2023 global growth outlook…

Incoming GDP reports continue to point to a stronger end to 2022 than was expected while lower energy costs and China's reopening will provide some additional support to growth in 2023. Nonetheless, high inflation and tighter monetary policy will weigh on growth this year.

China's reopening underpinned the IMF's upward revision to global growth in its January *World Economic Outlook (WEO) Update*. The IMF now projects global growth to slow from 3.4% in 2022 to 2.9% in 2023 – 0.2%-points higher in both years – and 3.1% in 2024 (Table 1). The slowdown in 2023 is driven by advanced economies with growth in less developed economies expected to pick up, led by China and Brazil.

Table 1: IMF January 2023 forecasts

	Ann. avg. % change, years ended December (revisions from October WEO 2022)			
	GDP		CPI	
	2023	2024	2023	2024
World	2.9 (0.2)	3.1 (-0.1)	6.6 (0.1)	4.3 (0.2)
US	1.4 (0.4)	1.0 (-0.2)		
Euro area	0.7 (0.2)	1.6 (-0.2)		
China	5.2 (0.8)	4.5 (0.0)		

The IMF consider that global headline inflation peaked in the September 2022 quarter, but that underlying (core) inflation has not yet peaked. Second round effects from earlier price shocks and elevated wage growth are seen as the key contributors to the persistence of core inflation. With inflation having peaked, the outlook is for the combination of slower demand growth, improvements in goods supply and tighter monetary policy to bring inflation back towards central bank targets, although these targets are not achieved until 2025.

In terms of policy, the IMF views disinflation as the priority. They advocate the withdrawal of broad-based fiscal relief measures in favour of measures better targeted to those most affected by high food and energy prices.

China's reopening is a key source of upside risk to the outlook as well as to commodity prices such as oil, which could exacerbate inflationary pressures elsewhere and raise the challenge facing central banks of lowering inflation while avoiding recession.

…as China returns to growth…

Initial indications are that China's economy swung back to growth in January. Both the manufacturing and non-manufacturing NBS Purchasing Managers Indexes returned to expansionary levels. The services sector led the recovery with large increases in transport and COVID-19-sensitive sectors such as retail sales and hospitality. These gains are consistent with improvements in high frequency indicators of mobility, consumption and travel. Meanwhile, COVID-19 infection data shows that the wave of infections following the lifting of key restrictions in early December has subsided, paving the way for a normalisation of production and consumption in the coming months, although Spring Festival travel is still a cause of concern for a resurgence. That said, the level of herd immunity is reported to be high, lowering the risk of a resurgence in the next two to three months. Overall, it appears that China's economy is poised to recover strongly over the first half of the year before settling to a more sustainable pace.

Elsewhere in Asia, the drags from China's zero COVID-19 policy were evident in the 0.4% fall in Korea's real GDP, which was driven by weaker exports and manufacturing activity. Equally, China's reopening suggests a bounce back is likely in the March quarter.

…euro area avoids a contraction…

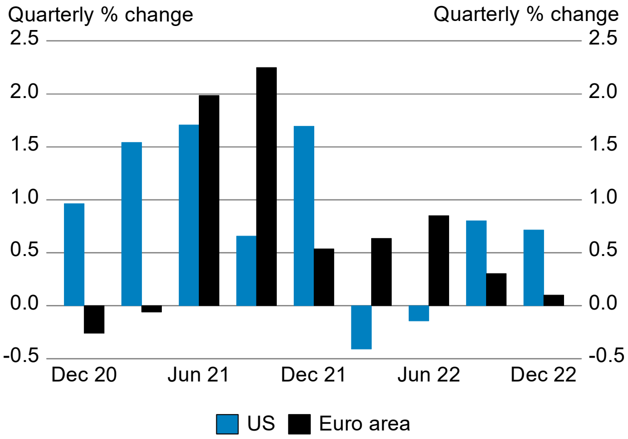
Euro area GDP rose 0.1% in the December quarter, avoiding the onset of recession that had been widely tipped, at least for now (Figure 3). However, strong growth in Ireland (+3.5%) contributed much to the rise, with GDP marginally contracting when excluding Ireland. Across the largest euro area economies, GDP declined in Germany (-0.2%) and Italy (-0.1%) and rose in France (0.2%) and Spain (0.1%). Substantial fiscal policy support helped ensure activity was resilient to the energy shock. Alongside a mild winter and an easing of energy prices, the outlook has become more optimistic in recent weeks.

Continuing the positive news, annual consumer price rises in the euro area slowed to 8.5% in January, down from 9.2% in December, and the lowest since May, as energy prices continued to decline. However, German statistics were unavailable making the data hard to interpret. Core inflation was stable at 5.2%.

…and headline US GDP growth remains solid

In the US, the advance December quarter GDP estimate put growth at 0.7%, a little below the 0.8% increase in the prior quarter. The solid headline result concealed a softening in final private domestic demand as falling residential investment largely offset growth in consumer spending, which slowed only marginally from its September quarter pace. Inventory rebuilding, net exports and government consumption spending accounted for most of the quarterly increase.

Figure 3: Real GDP growth



Source: Haver

Signs of slowing economic momentum were reinforced by weaker manufacturing sentiment in January, a further decline in house prices and construction activity, and weaker consumer confidence.

More monetary policy tightening, but an end to the cycle may be near…

The US Federal Reserve raised its policy rate 25bps to 4.50%-4.75% citing signs of a moderation in inflation and activity as the reason for a slower pace of hikes than occurred in 2022. The Fed signalled that the policy rate will rise further while acknowledging that the disinflationary process was underway. Markets expect a further 25bps rise in March followed by a lengthy pause. Deliberations around whether to raise rates further and how long to hold rates at the higher level will likely centre on how much impact past tightening will have on activity and whether wage and price growth will ease sufficiently without a significant weakening in the labour market.

The European Central Bank (ECB) raised its policy interest rates 50bps, taking its main refinancing rate to 3.0%, and expects to hike by a further 50bps rise in March. Thereafter, decisions will be dependent on the data, but President Lagarde thought it likely rates would need to rise further to reach a level at which they can stay and confidently deliver a return to the 2% target.

The Bank of England raised its policy rate 50bps to 4.0% noting that inflationary pressures had been firmer than expected and the labour market remained tight. But the Bank also saw early signs of loosening in the labour market alongside signs of slower activity owing to the impact of past tightening. The Bank forecast inflation to slow sharply, from 10.5% in December to around 4% towards the end of 2023, alongside a much shallower contraction in output than earlier forecast. The Bank shifted its guidance from further rate hikes to an entirely data dependent approach, but noted risks to the inflation forecast were skewed to the upside.

Inflation rises in Japan and Australia

Going against the grain of lower inflation elsewhere, headline inflation continued to rise in Japan and Australia.

Japan's headline CPI inflation came in at 4.0% in December, and core inflation (stripping out fresh food and energy) came in at 3.0%, the former at a fresh 40-year high. Bank of Japan's Governor Kuroda maintained that these inflationary pressures are transitory, and the Bank's expansionary policy will continue.

Australia's CPI rose 1.9% compared to the previous quarter taking the annual gain to 7.8%, the highest since 1990. Sharply higher domestic travel and accommodation prices accounted for much of the surprise to analysts' expectations of a 1.6% print. On the policy front, the outturn solidified analysts' expectations that the Reserve Bank will raise the cash rate 25bps to 3.35% at its February 7 meeting.

Meanwhile, Australian retail sales fell sharply in December, down 3.9% from November, likely reflecting volatility arising from strong Black Friday/cyber sales in November. Nonetheless, adjusting for price increases, sales volumes likely fell in the quarter. Meanwhile, slower private sector credit growth in December, and further house price falls in January reinforce the view that a slowdown in activity is underway and growth will be below trend in 2023.

IMF completes its annual review of Australia

The IMF's latest assessment of the Australian economy forecast growth to slow to 1.6% this year from 3.6% in 2022; with unemployment expected to rise to 4% because of tighter monetary policy and weaker consumer spending.

The IMF noted that wage growth was lower than in other economies, largely because of the average three-year duration of enterprise agreements, but expected wage growth to pick up. The IMF warned that higher inflation expectations could lock in high wage growth and add to the persistence of inflation.

The IMF's policy recommendations included broadening GST, reducing capital gains tax breaks for the family home, directing windfall revenue gains to budget repair and introducing a contributions based social unemployment insurance programme linked to workers' wages.

Coming Up:

Date	Release
10 Feb	Electronic card transactions (Jan)
14 Feb	Food and Rental Price Indexes (Jan)
14 Feb	RBNZ 2-Year Inflation Expectation (Q1)
16 Feb	Net migration (Dec)
22 Feb	RBNZ Monetary Policy Statement
22 Feb	Merchandise Trade (Jan)

Tables

Quarterly Indicators		**2021Q3**	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	1.4
	apc	4.9	5.9	6.9	7.3	7.2	7.2
Employment (HLFS) (1)	qpc	1.5	0.0	-0.0	-0.1	1.3	0.1
Unemployment rate (1)	%	3.3	3.2	3.2	3.3	3.3	3.4
Participation rate (1)	%	71.1	71.0	70.9	70.9	71.7	71.7
LCI salary & wage rates - total (2)	apc	2.4	2.6	3.0	3.4	3.7	4.1
QES average hourly earnings - total (2)	apc	3.5	3.8	4.8	6.4	7.4	7.2
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

Monthly Indicators		**Jul 22**	Aug 22	Sep 22	Oct 22	Nov 22	Dec 22
Merchandise trade balance (12 month)	NZ$m	-12,002.5	-12504.1	-12857.6	-13884.4	-14978.5	-14463.6
Dwelling consents - residential	apc	-2.9	0.9	1.7	-11.9	-0.9	-16.3
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	-13,217.0	-10057.0	-5682.0	-2180.0	5676.0	...
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	...	...	...

Daily Indicators		**Fri 27/1/23**	**Mon** 30/1/23	**Tue** 31/1/23	**Wed** 1/2/23	**Thu** 2/2/23	**Fri** 3/2/23
NZ exchange and interest rates (5)							
NZD/USD	$	...	...	...	...	...	...
NZD/AUD	$	...	...	...	...	...	...
Trade weighted index (TWI)	index	...	...	...	...	...	...
Official cash rate (OCR)	%	...	...	...	...	...	...
90 day bank bill rate	%	...	...	...	...	...	...
10 year govt bond rate	%	...	...	...	...	...	...
Share markets (6)							
Dow Jones	index	33,978	33717	34086	34093	34054	...
S&P 500	index	4,071	4018	4077	4119	4180	...
VIX volatility index	index	18.5	19.9	19.4	17.9	18.7	...
AU all ords	index	...	...	...	...	...	...
NZX 50	index	...	...	...	...	...	...
US interest rates							
3 month OIS	%	4.33	4.33	4.33	4.33	...	...
3 month Libor	%	4.83	4.81	4.81	4.80	...	...
10 year govt bond rate	%	3.52	3.55	3.52	3.39	3.40	...
Commodity prices (6)							
WTI oil	US$/barrel	79.73	77.97	78.95	76.41	75.88	...
Gold	US$/ounce	1,923.05	1924.10	1923.90	1925.90	...	...
CRB Futures	index	560.06	558.72	557.02	557.35	...	...

(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**				**0.7**	
	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	6.8	...		...
	PMI manufacturing (1)	index		52.7	52.9	51.0		50.0	49.0	48.4		47.4
	Consumer confidence (1)(3)	index		95.3	103.6	107.8		102.2	101.4	109.0		107.1
Japan	GDP (1)	qpc	**1.1**				**-0.2**				**...**	
	Industrial production (1)	mpc		0.8	3.4	-1.7		-3.2	0.2	-0.1		...
	CPI	apc		2.6	3.0	3.0		3.8	3.8	4.0		...
	Unemployment rate (1)	%		2.6	2.5	2.6		2.6	2.5	2.5		...
	Retail sales value	apc		2.4	4.1	4.8		4.4	2.5	3.8		...
	PMI manufacturing (1)	index		52.1	51.5	50.8		50.7	49.0	48.9		48.9
	Consumer confidence (1)(4)	index		30.1	32.0	31.2		30.8	29.6	30.9		31.0
Euro area	GDP (1)	qpc	**0.9**				**0.3**				**0.1**	
	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	6.7		6.6	6.6	6.6		...
	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		48.8
	Consumer confidence (5)	index		-27.2	-25.0	-28.7		-27.5	-23.8	-22.1		-20.9
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		-3.4	-5.4	-6.6		-5.5	-5.7	-5.8		...
	House prices (6)	apc		11.0	10.0	9.5		7.2	4.4	2.8		1.1
	PMI manufacturing (1)	index		52.1	47.3	48.4		46.2	46.5	45.3		47.0
	Consumer confidence (1)(5)	net %		-41.0	-44.0	-49.0		-47.0	-44.0	-42.0		-45.0
Australia	GDP (1)	qpc	**0.9**				**0.6**				**...**	
	CPI	apc	**6.1**				**7.3**				**7.8**	
	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	7.9		...
	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		50.1
South Korea	GDP (1)	qpc	**0.7**				**0.3**				**-0.4**	
	Industrial production (1)	mpc		-1.3	-1.4	-2.0		-3.4	0.6	-2.9		...
	CPI	apc		6.3	5.7	5.6		5.7	5.0	5.0		5.2

(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