Fortnightly Economic Update

19 May 2023

- **Budget 2023 reprioritises spending and invests in resilient infrastructure**
- **Labour market remains tight, with some signs of easing through net migration**
- **House prices stabilise but low sales volumes and consents point to weakness going forward**
- **Global central banks hike rates as activity shows resilience, but China's recovery stalls**

On 18 May the Government unveiled Budget 2023, which centred on easing cost of living pressures and investing in infrastructure. The Treasury's Economic and Fiscal Update (*Budget Update*) presented to parliament forecasts a moderate economic slowdown this year, with inflation falling to 3% and unemployment peaking at 5.3% by the end of 2024. The labour market is yet to show convincing signs of easing with the unemployment rate holding steady, together with wage and employment growth, due in part to strong net migration. House prices halted their decline, however fewer sales and lower consents point to weakness from higher interest rates. Globally, central banks continue to tighten policy as activity and labour markets show resilience and core inflation persists at elevated levels, but the end of the tightening cycle appears to be near. Financial markets are focusing on the implications of banking sector stress, tighter credit conditions and the US debt ceiling, while weaker data in China raises questions about the sustainability of its post-pandemic recovery.

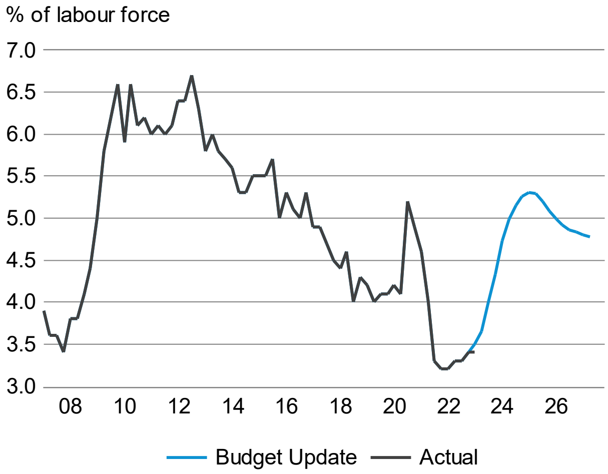
Budget 2023 focuses on support for today and building for tomorrow

Budget 2023 targets spending on early childhood education, health, and public transport through a reprioritisation and savings process that lowers net new spending from $5.9 billion last year to $4.8 billion. Low public debt, which is expected to peak at 22% of GDP in 2023/24, allows for $10.7 billion in capital investment of which $6 billion is used to create a National Resilience Plan to respond to severe weather events. The operating balance is also forecast to return to a small surplus in 2025/26. The *Budget Update* forecasts economic growth to slow to 1% in the June 2024 year, avoiding a recession due to demand from strong tourism, net migration, rebuild activity in response to severe weather events, and less contractionary fiscal policy. While inflation expectations have retreated, persistence in non-tradable inflation is expected keep interest rates higher for longer than expected at the Half-Year Update 2022.

Labour market still relatively tight...

The unemployment rate stayed near historic lows at 3.4%, close to the *Budget Update* forecast of 3.5% (Figure 1). Employment continued to grow (0.8%) as strong net migration helped increase the working age population by about 22,000 people in the March quarter.

Figure 1: Unemployment rate

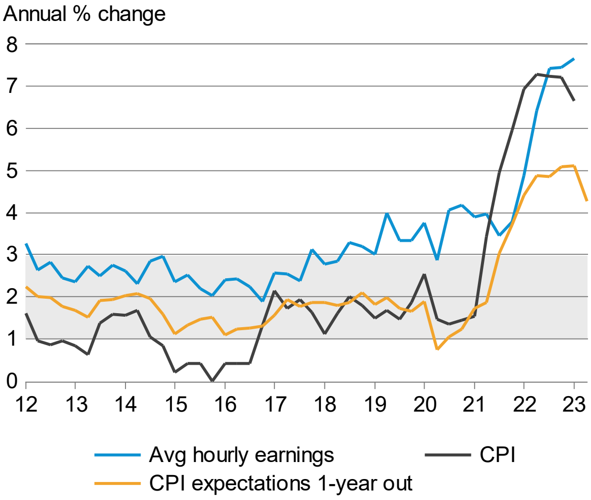


Source: StatsNZ, the Treasury

Wage growth continues to outpace consumer price inflation with average hourly earnings increasing 1.9% in the March quarter to be 7.6% higher than March 2022, the highest annual rate since the series began in 1989 (Figure 2). Meanwhile, inflation expectations two years out fell for the second consecutive quarter, according to the Reserve Bank's (RBNZ) survey of expectations. The fall from 3.3% in the March quarter to 2.8% in the June quarter signals the first time this measure has fallen within the RBNZ's target band between 1 to 3% since the December 2021 quarter. Expected inflation one-year ahead fell from 5.1% to 4.3%, the first substantial fall since the June 2020 quarter (Figure 2).

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

Figure 2: Earnings, actual and expected CPI inflation



Source: Stats NZ, RBNZ

…while production and sales activity weaken

Business sentiment in the manufacturing and services sector was generally negative in April, with the exception of an easing in labour constraints. While the BNZ-BusinessNZ Performance of Manufacturing index (PMI) increased from 48.1 to 49.1 in April, it has been below the breakeven level of 50 for five of the past seven months. The production subcomponent has been below 50 for all but one month over the same period. The services sector had been fairly resilient, but dropped below 50 in April for the first time since February 2022. The Performance of Services Index (PSI) dropped from 53.8 to 49.8 and the activity/sales subcomponent plummeted 10.8 points to 45.1.

Food and rent pressures linger…

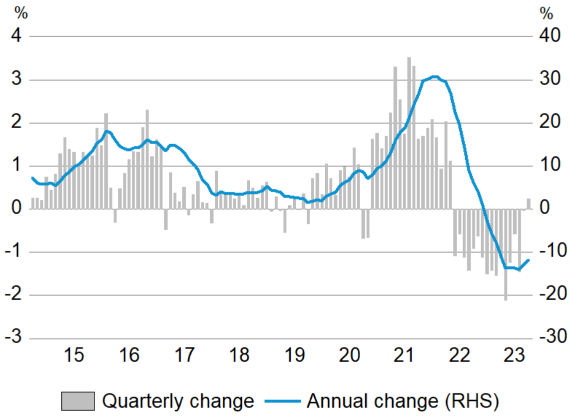
In April spending on consumables, including items such as groceries, were up 2.3% increasing total card spending by 1%. The higher spending on consumables will be at least partly inflation-related given card spending data is measured in nominal terms.

The annual rate of food price inflation reached a 36-year high of 12.5% in April. Annual increases were spread across the five subgroups, with grocery food prices up 14% compared with April 2022, and fruit and vegetable prices up 22.5%. Rents for new tenancies (the flow measure) increased 0.9% lifting the annual rate from 2.7% to 2.8%. In Auckland rents were up 1.7% in April raising the annual rate from 4.9% to 5.4%. While the annual rate of rents nationwide across all tenancies (the stock measure) fell from 3.9% to 3.8%, it remains above its 10-year average of 3.3%.'

… as housing market softens

House prices were relatively flat again in April with the REINZ house price index increasing 0.2%, after no change in the March month (Figure 3). Compared with April 2022, the index was 12% lower, a slight improvement on the March year (down 13%). The index is now 16.4% lower than its peak in November 2021. Higher net migration presents an upside risk to house prices with Stats NZ data released earlier this month revealing 12.5% of property transfers in the March quarter were to buyers on resident visas, compared with 7.5% in March 2019. Sellers on a resident visa have mainly fluctuated between 4% and 5% over the same period, currently 4.3% compared with 4.1% in March 2019.

Figure 3: House price inflation



Source: REINZ

The number of total house sales reached record lows (since 1992) at the national level and in several regions, including Taranaki and Wellington. Seven other regions had the lowest number of sales in over a decade, including Waikato, Canterbury, and Otago.

This is consistent with ongoing weakness in building consents. All but three regions consented fewer new homes in the year to March 2023. Nationwide, the number of new homes consented fell 7.9% compared with the year to March 2022. Of these, the number of stand-alone houses consented was down 23% over the same period. Growth in the number of multi-unit houses, including townhouses and retirement village units, continues to slow.

Migration arrivals hit record high…

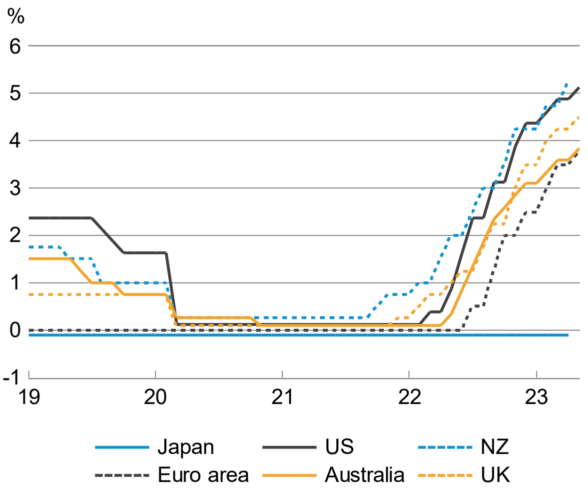
Stronger than expected net migration presents an upside risk to the economic outlook. Net migration over the year to March 2023 increased to 65,440 from 52,902 in February 2023 as migrant arrivals hit their highest level for any month (21,400), exceeding the previous record set in February 2020. However, there are signs the recent surge is starting to normalise, with those arriving on work visas down 3% in April 2023 compared with April 2019.

In addition to net migration, the RBNZ's proposal to relax loan-to-value restrictions from 1 June presents a small upside risk to house prices. The proposed changes are relatively minor, and the RBNZ's Financial Stability Report (FSR) released earlier this month revealed New Zealand Banks carry little interest rate risk. The FSR highlighted much of this risk is borne by borrowers. They expect higher interest rates and mortgage refixing will raise the share of interest servicing costs from 9.5% of disposable income in the September 2021 quarter to 21.3% by the end of this year.

Global central banks continued to raise rates

Central banks in the US, Australia and Europe raised rates but the end of the tightening cycle is approaching as inflation eases and banking stresses weigh on credit availability. Improved global conditions, especially from lower energy prices and China's reopening, are being reflected across March quarter GDP outturns. Global Purchasing Managers Indexes (PMIs) firmed in April, pointing to solid growth momentum in the current quarter, although their sustainability is being questioned by the slower pace of recovery in China and by concerns around credit tightening and the US debt ceiling.

Figure 4 – Central bank policy rates



Source: Haver

US markets focus on credit and debt…

The focus of US market attention is on the twin threats of banking system stress and the looming concern that the government debt ceiling will be reached, potentially leading to a debt default in a worse-case scenario. April's Senior Loan Officers Opinion Survey (SLOOS) showed weaker demand for loans and further tightening in borrowing standards, although movements from the previous survey were not as large as analysts feared. The net percentage of banks tightening lending standards was similar to levels during the early 1990s and early 2000s, but still well below GFC and pandemic levels. Loan demand weakened to historically low levels for residential investment and for commercial and industrial loans to small business. Separately, the Fed's twice-yearly financial stability report warned that despite decisive actions by regulators and officials, credit growth could contract further. A credit crunch was among the risks identified but not the Fed's most likely scenario.

Treasury Secretary Yellen reiterated her warning that 'X-date', when the government would not be able to meet all of its cash commitments, could be as soon as 1 June. This followed data showing the year-to-date federal deficit continuing to widen compared to the same period a year ago. Highlighting the urgency, President Biden cut short his planned trip to Papua New Guinea and Australia to continue talks with Republicans, saying he was confident a deal could be reached.

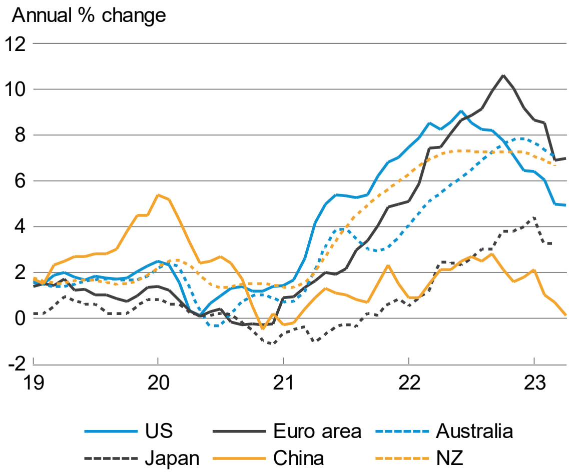
Financial markets are assuming that the debt ceiling will get raised in time, but market volatility will rise as the deadline approaches. If the ceiling is not raised, Fed transcripts from a meeting during a similar crisis in 2011 show officials had agreed to give priority to making payments on Treasury interest and principal, delaying other payments, such as for Social Security and veteran's benefits, as necessary.

…as tightening cycle nears end and inflation slows

The Fed raised its policy target range 25bps to 5-5.25% at its May meeting and stated future decisions would be based on incoming data.

April CPI data for the US showed headline inflation fell to 4.9%, and the core rate, which excludes volatile prices, eased to 5.5% (Figure 5). This followed April's non-farm payroll report, which showed the pace of employment growth eased to an average of 222K over the past three months, down from 333k at the start of the year. The US unemployment rate fell to 3.4%, matching January's 50-year low, while annual hourly wage growth rose to 4.5%. Activity indicators began the quarter on a sound footing, with industrial production and retail sales posting decent gains. Overall, these reports have reinforced financial market pricing for the Fed to be on hold in June and for its next move to be a cut.

Figure 5 – Global inflation



Source: Haver

Modest GDP growth in Europe…

Euro area GDP increased 0.1% in the March quarter, according to the flash estimate. This was a little below expectations, with analysts pointing to a sharp drop in Ireland (-2.7%) as the source of surprise. Ex-Ireland, GDP rose 0.2%. Meanwhile, euro area inflation rose to 7.0% in

April from 6.9% in March, but core inflation eased, while unemployment fell to a record low 6.5%.

The European Central Bank (ECB) also increased policy rates 25bps, bringing the deposit rate to 3.25% and the main refinancing rate to 3.75%. ECB President Lagarde considered incoming data warranted a future hike but was non-committal on how far the cycle would extend – financial markets are pricing in two further hikes. Earlier, the ECB's Bank Lending Survey said credit standards had 'tightened further substantially' in Q1.

Similarly, UK GDP rose 0.1% in the first quarter, avoiding a technical recession in the near-term, while the Bank of England hiked 25bp and upgraded its growth outlook, pointing to further hikes there as well.

…but firmer growth in Japan

Preliminary GDP estimates showed Japan GDP grew 0.4% in the March quarter compared to the previous quarter. Domestic demand and the return of overseas tourists drove the rise, more than offsetting weak external demand for goods.

Earlier, the Bank of Japan (BoJ) maintained its ultra-easy policy settings while removing its forward guidance on rates, which will allow more flexibility in future policy decisions. The BoJ also announced a formal long-term review of monetary policy will take place over the next 12-18 months, dampening market expectations for a quick normalisation in policy.

Slower growth in China

Activity data for April showed the pace of the reopening recovery in China had slowed markedly. The gains in annual retail sales and industrial production shown in Table 1 are flattered by base effects – in April 2022 stringent lockdown measures were in place in Shanghai – and monthly growth contracted sharply on some measures. Growth in fixed asset investment slowed, especially for real estate. Overall, the weak data led some analysts to downgrade their expectations for Q2 growth, and for 2023 overall. Reflecting the uneven recovery, the differential between youth and older-age unemployment widened as the headline rate dipped 0.1%-point to 5.2% but hit a new record high of 20.4% for 16–24-year-olds.

Table 1 – Monthly activity indicators

Monthly indicators (apc)*	Jan/Feb-23	Mar-23	Apr-23
Fixed asset investment (ytd)*	5.5	5.1	4.7
- Infrastructure (ex utilities)	9.0	8.8	8.5
- Real estate	-5.7	-5.8	-6.2
Retail Sales	3.5	10.6	18.4
Industrial production	2.4	3.9	5.6

*apc = annual % change, ytd = year-to-date

The weaker activity data reinforced concerns about the sustainability of the recovery, which first emerged following April's inflation data. Prices in the CPI fell 0.1% in the month and annual inflation slowed to just 0.1%, while producer price deflation deepened to -3.6%, indicative of weak demand and increasing spare capacity.

Earlier, officials at the year's first economic Politburo meeting noted that although demand and supply conditions were normalising, the underlying drivers of growth remained weak. The meeting confirmed growth remains the priority, although the central bank kept its key policy rates unchanged following the release of its March quarter monetary policy report.

Australian Budget posts a surplus

The Federal Budget projected a AU$4.2 billion surplus (0.2% of GDP) for the year ending June 2023, the first in 15 years. Strong employment and high commodity prices boosted tax revenues (Table 2). Thereafter, the budget is expected to return to deficit as high inflation and rising interest rates weigh on growth, and commodity prices revert to average. Nonetheless, the improved starting point for the Budget saw net debt revised to 24% of GDP in 2025/26 from 28.5% in October. On the spending side, the budget focused on alleviating cost-of-living pressures including through energy subsides to households. The energy subsidies are estimated to directly reduce inflation by 0.8%-pts in 2023/24, although commentators had mixed views on whether the budget overall adds to inflation.

Table 2 - Key Budget aggregates

	Actual	Forecasts				
June Years (% GDP)	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27
Economic Outlook						
Real GDP	3.7	3 1/4	1 1/2	2 1/4	2 3/4	2 3/4
Unemployment rate*	3.8	3.5	4 1/4	4 1/2	4 1/2	4 1/4
CPI inflation*	6.1	6	3 1/4	2 3/4	2 1/2	2 1/2
Fiscal Outlook						
Underlying cash balance	-1.4	0.2	-0.5	-1.3	-1.3	-1.0
Gross debt	38.8	34.9	35.8	36.3	36.5	36.5
Net debt	22.3	21.6	22.3	23.5	24.0	24.1

*change from June qtr a year ago

Source: Australian Treasury

The RBA hiked 25bps to 3.85%. This followed last meeting's pause, which markets, and analysts had anticipated would be extended in May, although it was consistent with the RBA's tightening bias.

The Australia unemployment rate rose to 3.7% in April from 3.5% in March as employment growth stalled. Wages rose 0.8% in the March quarter, a little below analyst expectations, taking annual growth to a decade high 3.7%. Overall, it appears that monetary policy is gaining traction, with markets and analysts seeing a 50/50 chance that the policy rate will be on hold at 3.85% versus one final hike.

Coming up:

Date	Release
24 May	Retail sales (Q1)
24 May	RBNZ MPS
2 Jun	Building work put in place (Q1)
2 Jun	Terms of trade (Q1)

Tables

Quarterly Indicators		**2021Q4**	2022Q1	2022Q2	2022Q3	2022Q4	2023Q1
Real Production GDP (1)	qpc	3.5	-0.5	1.6	1.7	-0.6	...
	aapc	6.0	5.2	1.1	2.7	2.4	...
Current account balance (annual)	%GDP	-6.0	-6.8	-8.0	-8.5	-8.9	...
Merchandise terms of trade	apc	2.8	3.3	-2.2	-6.4	-3.9	...
CPI inflation	qpc	1.4	1.8	1.7	2.2	1.4	1.2
	apc	5.9	6.9	7.3	7.2	7.2	6.7
Employment (HLFS) (1)	qpc	0.1	-0.0	-0.1	1.2	0.5	0.8
Unemployment rate (1)	%	3.2	3.2	3.3	3.3	3.4	3.4
Participation rate (1)	%	71.0	70.9	71.0	71.6	71.7	72.0
LCI salary & wage rates - total (2)	apc	2.6	3.0	3.4	3.7	4.1	4.3
QES average hourly earnings - total (2)	apc	3.8	4.8	6.4	7.4	7.2	7.6
Core retail sales volume	apc	5.1	3.2	-1.8	5.0	-3.7	...
Total retail sales volume	apc	4.4	2.3	-3.7	4.9	-4.0	...
WMM - consumer confidence (3)	Index	99.1	92.1	78.7	87.6	...	...
QSBO - general business situation (1,4)	net%	-33.1	-34.6	-64.7	-42.7	-73.8	-61.3
QSBO - own activity outlook (1,4)	net%	10.5	6.3	-15.5	-15.8	-32.7	-7.7

Monthly Indicators		**Nov 22**	Dec 22	Jan 23	Feb 23	Mar 23	Apr 23
Merchandise trade balance (12 month)	NZ$m	-14,988.7	-14649.0	-15637.5	-15769.6	-16761.6	-16803.7
Dwelling consents - residential	apc	-0.9	-16.3	-2.0	-29.2	-25.1	...
House sales - dwellings	apc	-33.8	-36.6	-24.4	-28.2	-13.5	-15.3
REINZ - house price index	apc	-13.7	-13.9	-13.9	-14.2	-13.0	-12.0
Estimated net migration (12 month total)	people	12,410.0	25783.0	36960.0	52901.0	65439.0	...
ANZ NZ commodity price index	apc	-0.5	-7.1	-10.1	-11.7	-9.8	-10.4
ANZ world commodity price index	apc	-11.5	-11.4	-13.3	-15.3	-17.4	-17.3
ANZBO - business confidence	net%	-57.1	-70.2	-52.0	-43.3	-43.4	-43.8
ANZBO - activity outlook	net%	-13.7	-25.6	-15.8	-9.2	-8.5	-7.6
ANZ-Roy Morgan - consumer confidence	net%	80.7	73.8	83.4	79.8	77.7	79.3
NZAC	apc	...	...	...	...	...	...

Daily Indicators		**Thu 11/5/23**	Fri 12/5/23	Mon 15/5/23	Tue 16/5/23	Wed 17/5/23	Thu 18/5/23
NZ exchange and interest rates (5)							
NZD/USD	$	0.6374	0.6280	0.6203	0.6249	0.6244	0.6247
NZD/AUD	$	0.9403	0.9375	0.9307	0.9335	0.9380	0.9402
Trade weighted index (TWI)	index	72.39	71.67	71.00	71.45	71.63	71.74
Official cash rate (OCR)	%	5.25	5.25	5.25	5.25	5.25	5.25
90 day bank bill rate	%	5.61	5.60	5.58	5.64	5.65	5.70
10 year govt bond rate	%	4.12	4.08	4.05	4.12	4.16	4.26
Share markets (6)							
Dow Jones	index	33,310	33301	33349	33012	33421	33536
S&P 500	index	4,131	4124	4136	4110	4159	4198
VIX volatility index	index	16.9	17.0	17.1	18.0	16.9	16.1
AU all ords	index	7,450	7453	7461	7424	7389	7427
NZX 50	index	11,888	11939	11938	11946	11952	11976
US interest rates							
3 month OIS	%	5.08	5.08	5.08	5.08	5.08	...
3 month Libor	%	5.32	5.32	5.33	5.35	5.37	...
10 year govt bond rate	%	3.39	3.46	3.50	3.54	3.57	3.65
Commodity prices (6)							
WTI oil	US$/barrel	70.87	70.02	71.07	70.85	72.83	71.86
Gold	US$/ounce	2,015.95	2019.90	2019.90	2007.45	1974.40	1960.30
CRB Futures	index	544.79	542.42	544.85	543.88	545.86	543.95

(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 22	Nov 22	Dec 22	2022Q4	Jan 23	Feb 23	Mar 23	2023Q1	Apr 23	May 23
United States	GDP (1)	qpc				0.6				0.3		
	Industrial production (1)	mpc	-0.1	-0.3	-1.5		1.0	0.0	0.0		0.5	...
	CPI	apc	7.7	7.1	6.5		6.4	6.0	5.0		4.9	...
	Unemployment rate (1)	%	3.7	3.6	3.5		3.4	3.6	3.5		3.4	...
	Employment change (1)	000s	324.0	290.0	239.0		472.0	248.0	165.0		253.0	...
	Retail sales value	apc	8.8	6.1	6.0		7.4	5.3	2.4		1.6	...
	House prices (2)	apc	8.6	6.8	4.6		2.6	0.4	...		...	...
	PMI manufacturing (1)	index	50.0	49.0	48.4		47.4	47.7	46.3		47.1	...
	Consumer confidence (1)(3)	index	102.2	101.4	109.0		106.0	103.4	104.0		101.3	...
Japan	GDP (1)	qpc				-0.0				0.4		
	Industrial production (1)	mpc	-3.2	0.2	0.3		-5.3	4.6	1.1		...	...
	CPI	apc	3.8	3.8	4.0		4.4	3.3	3.2		3.4	...
	Unemployment rate (1)	%	2.6	2.5	2.5		2.4	2.6	2.8		...	...
	Retail sales value	apc	4.4	2.5	3.8		5.0	7.3	6.9		...	...
	PMI manufacturing (1)	index	50.7	49.0	48.9		48.9	47.7	49.2		49.5	...
	Consumer confidence (1)(4)	index	30.8	29.6	30.9		31.0	30.9	34.0		35.0	...
Euro area	GDP (1)	qpc				-0.0				0.1		
	Industrial production (1)	mpc	-2.0	1.1	-1.0		0.6	1.5	-4.1		...	...
	CPI	apc	10.6	10.1	9.2		8.7	8.5	6.9		7.0	...
	Unemployment rate (1)	%	6.7	6.7	6.7		6.6	6.6	6.5		...	...
	Retail sales volume	apc	-2.6	-2.5	-2.8		-1.8	-2.4	-3.8		...	...
	PMI manufacturing (1)	index	46.4	47.1	47.8		48.8	48.5	47.3		45.8	...
	Consumer confidence (5)	index	-27.4	-23.7	-22.0		-20.6	-19.0	-19.1		-17.5	...
United Kingdom	GDP (1)	qpc				0.1				0.1		
	Industrial production (1)	mpc	0.4	0.0	0.2		-0.3	-0.1	0.8		...	...
	CPI	apc	9.6	9.3	9.2		8.8	9.2	8.9		...	...
	Unemployment rate (1)	%	3.7	3.7	3.7		3.7	3.8	3.9		...	...
	Retail sales volume	apc	-5.4	-5.8	-6.4		-5.0	-3.3	-3.1		...	...
	House prices (6)	apc	7.2	4.4	2.8		1.1	-1.1	-3.1		-2.7	...
	PMI manufacturing (1)	index	46.2	46.5	45.3		47.0	49.3	47.9		47.8	...
	Consumer confidence (1)(5)	net %	-47.0	-44.0	-42.0		-45.0	-38.0	-36.0		-30.0	-27.0
Australia	GDP (1)	qpc				0.5				...		
	CPI	apc				7.8				7.0		
	Unemployment rate (1)	%	3.4	3.5	3.5		3.7	3.6	3.5		3.7	...
	Retail sales value	apc	12.0	7.7	7.9		7.7	6.5	5.6		...	...
	House Prices (7)	apc				...				...		
	PMI manufacturing (1)	index	2.2	-7.1	-17.1		-17.1	-6.4	5.6		-20.2	...
	Consumer confidence (8)	index	83.7	78.0	80.3		84.3	78.5	78.5		85.8	79.0
China	GDP	apc				2.9				4.5		
	Industrial production	apc	5.0	2.2	1.3		2.4	2.4	3.9		5.6	...
	CPI	apc	2.1	1.6	1.8		2.1	1.0	0.7		0.1	...
	PMI manufacturing (1)	index	49.2	48.0	47.0		50.1	52.6	51.9		49.2	...
South Korea	GDP (1)	qpc				-0.4				0.3		
	Industrial production (1)	mpc	-3.7	-0.4	-3.1		1.9	-2.7	5.1		...	...
	CPI	apc	5.7	5.0	5.0		5.2	4.8	4.2		3.7	...

(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