

Fortnightly Economic Update

16 June 2023

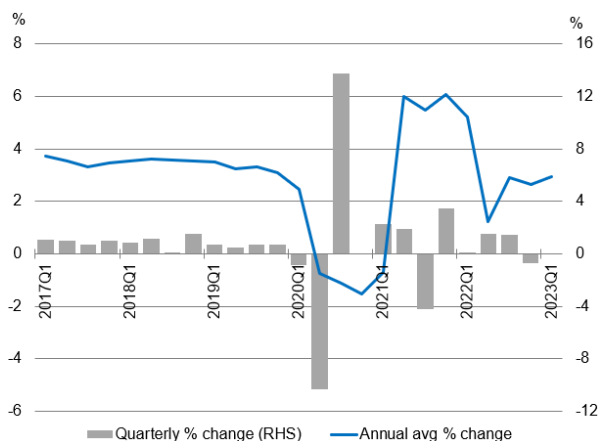
- **GDP contracts as production slows, inventories are run down, and services weaken**
- **Rental and food price inflation eases as house prices stabilise**
- **Global growth slows as central banks tighten policy and China's recovery loses momentum**

GDP contracted in the March quarter after weakness in production spread to services, and businesses drew down on stock. Softer demand is expected to persist as higher interest rates slow retail card spending, and the rate of rent and food price inflation. Meanwhile it is too early to determine if the housing market is recovering as net migration takes a breather. Global inflation is becoming more divergent and central bank actions more varied, reflecting the broad range of challenges countries are facing as the shocks of the past few years unwind. New forecasts from the OECD and World Bank emphasise how weak the economic outlook is, the persistence of inflation and ongoing risks of weaker outcomes.

Economic activity contracts in March quarter

The economy entered a technical recession by the slimmest of margins in the March quarter, contracting by 0.1% after a revised 0.7% decline (from -0.6%) in the December quarter. While the result is slightly weaker than our Budget Update forecast of 0.2%, it suggests in the absence of disruption caused by the adverse weather events in January and February, activity was flat in the quarter and annual average growth picked up slightly to 2.9%, in line with the Budget Update (Figure 1).

Figure 1: Real GDP (production) growth



Source: Stats NZ, the Treasury

Nonetheless it shows that tightening monetary policy and weak global demand is slowing the economy. While the result is slightly weaker than we expected in the Budget Update, it is consistent with our narrative based on partial data and sentiment surveys of weakening manufacturing and construction, starting to spread to the services sectors as higher interest rates impact domestic demand. A series of supply shocks since 2020 – including the Russia invasion of Ukraine – saw sluggish global demand for exports, weighing on domestic production. Since then, restrictive monetary policy has dampened demand to rein in inflation that had accelerated after a long period of low interest rates. More recently, rising interest rates, falling house prices, and cost of living constraints are weakening domestic demand in the services-centric New Zealand economy.

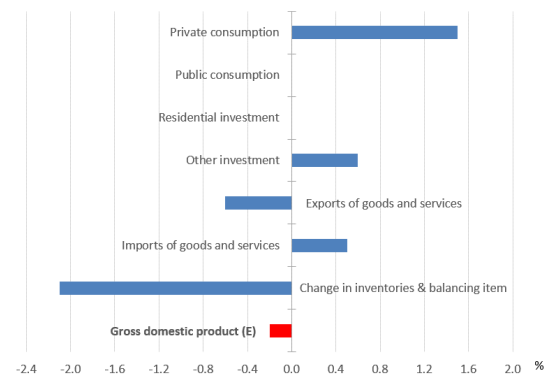
As expected, the primary sectors were weak in the quarter and the manufacturing sector entered its fifth consecutive quarter of decline, consistent with Performance index measures which had been showing contraction in the sector since the end of 2022. We expect this to continue as the rundown in inventories weighed on expenditure GDP (Figure 2) but business surveys show little improvement in indexes measuring new orders.

More recently business sentiment and indexes have shown weakness in the normally resilient services sectors. Services, which together comprise two-thirds of the economy, detracted a sizable 0.3 percentage points from quarterly production GDP growth. In particular, Business services, which had held up consistently throughout COVID fell (-3.5%) in the quarter. Retail trade also fell (-1.1%), consistent with consumer confidence, business financial data, and the March quarter retail sales survey. Part of this may be due to a recent plateau in tourism flows, with declines in the Accommodation services sector (-0.9%), and the Arts and recreation sector (-6.2%) having experienced strong growth since the lifting of COVID lockdowns and restrictions at the end of 2021.

However, some service sectors held up and boosted private consumption (2.4%) in the quarter. Lower spending on durables (-0.9%) and on non-durables (-3.4%) was

offset by an increase in consumer spending on services (2.3%). This was led by increased spending by New Zealanders on international travel, which is consistent with higher overseas billings on New Zealand issued credit cards according to Reserve Bank data. Private consumption contributed 1.5 percentage points to expenditure GDP in the quarter (Figure 2).

Figure 2: Percentage point contributions to quarterly change in GDP (expenditure)



Source: Stats NZ, the Treasury

Market reaction was generally muted with some analysts suggesting in the absence of the adverse weather events, GDP would have expanded. We continue to anticipate that a period of soft demand will be necessary for inflation pressures to ease further, and that rebuild activity will influence the outlook and help support non-residential construction. Data volatility and the -0.06% decline (to two decimal places), is such that future revisions could reverse the recession call.

Card spending eases as food prices stay elevated and budgets stay under pressure...

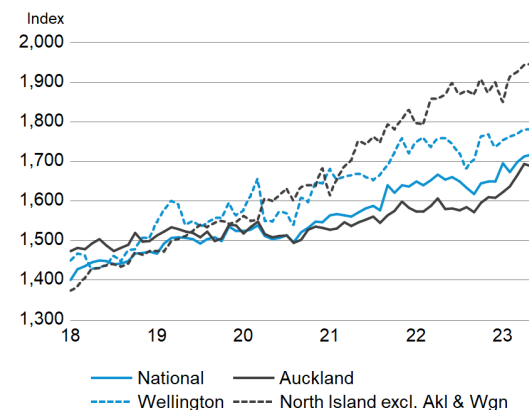
Consumption is likely to ease in the second quarter as interest rates continue to climb as mortgages are refixed. Nominal card spending in core retail sectors fell 1.2% in May, resulting in flat growth over the previous three months. This was led by falls in what is usually considered discretionary spending, such as apparel which fell 3.7% in May after a 1.9% drop in April, and durables which fell 0.8%.

Food prices stayed elevated in May but slowed to 0.4% after April growth of 0.7%. Fruit and vegetable prices fell in May (-2.7%), after a fall in April (-0.6%), while price growth for groceries slowed to 0.2%. Annual growth rates eased but are still high, at 18.4% for fruit and vegetables, 12.7% for groceries, and 11.7% for meat and poultry.

Similarly, the growth in rents for new tenancies slowed in May (0.2%) from April (0.9%). While it is difficult to be certain of the impact of adverse weather events, rents for new tenancies have increased in cyclone-affected areas. Between January and May this year, Auckland rents rose 4.1%, and in the North Island excluding Auckland and Wellington, rents increased 5.1%. This compares to national growth (1.3%) and in Wellington (1.5%) over the same five-month period. The stock index which is less

volatile and measures both new and existing tenancies showed nationwide rents eased slightly in May up 0.3% however, annual growth (3.8%) is currently higher than the long run average since 2011 of 3.3%.

Figure 3: Rent price indexes for new tenancies



Source: Stats NZ

... as the housing market stabilises

House prices lifted for the third consecutive month in May, up 0.2%, after modest gains in both April and March of 0.1%. The annual decline has slowed to -11.2% in May compared with -11.9% in the April year, pointing to tentative signs of a turning point, following sustained double digit annual growth from 2020 to 2022. Market activity is also reflected in an increase in the number of sales in May (11.6%) to 5,600, still down from the 8,000 to 9,000 during 2020 and 2021 but approaching pre-COVID levels.

More New Zealanders head overseas

Monthly net migration in April fell to 5,800, a sharp fall from the record highs of 13,000 in February and March. A net gain of 9,000 non-New Zealanders was partially offset by a net loss of New Zealand citizens of almost 3,300 in the month, the largest net loss since 2013. On an annual basis, net migration remains extremely high by historical standards at 72,000 for the April year. Meanwhile tourism appears to be reaching a plateau, with visitor arrivals in April (446,057) similar to those in February and March.

Current account improvement will rely on exports

The annual current account deficit narrowed to 8.5% of GDP in the March quarter from 9.0% in December. This was led by a smaller primary income deficit as net income outflows to foreign owners of New Zealand assets fell. The goods deficit also narrowed slightly, but the quarterly services deficit stayed flat after service exports unexpectedly fell. The current account deficit is expected to keep reducing as domestic demand slows and spending on imports falls, and as services exports recover. Goods exports are a risk to the outlook with weak world commodity prices, and after recent disappointing results from the *GlobalDairyTrade* auction which saw the Whole Milk Powder index fall 3.0% due to low demand from China and high inventories.

Global growth is slowing as shocks unwind

Monetary policy in the world's largest economies moved in different directions over the past fortnight, with policy tightening in the euro area, loosening in China and no change in the US or Japan. Central banks in Australia and Canada also raised their policy rates. These divergent moves reflect the breadth of challenges facing the global economy as shocks from the past couple of years unwind.

New OECD forecasts showed the global economy expanding 2.7% in 2023 and 2.9% in 2024 (Table 1). Aside from 2020, growth in 2023 would be the slowest since the global financial crisis. The *Economic Outlook* noted that the major risks are still on the downside, including persistent inflation, tighter financial conditions, and Russia's war of aggression against Ukraine and what this means for global food and energy supply.

For New Zealand, the OECD expects tightening macroeconomic policies will slow growth to 1.0% in 2023 and 1.2% in 2024, weaker than the Treasury's Budget forecasts of 1.4% and 1.5% respectively. On the policy front, the OECD advocated a policy focus on digitalisation to improve economic performance.

Table 1: OECD forecasts

Real GDP (year-on-year % change)			
Calendar years	2022 (actual)	2023	2024
World	3.3	2.7	2.9
Euro area	3.5	0.9	1.5
China	3.0	5.4	5.1
United States	2.1	1.6	1.0
Japan	1.0	1.3	1.1
Australia	3.6	1.8	1.4
New Zealand	2.2	1.0	1.2

Source: Economic Outlook, June 2023

The World Bank was more downbeat in its latest *Global Economic Prospects*, warning that global growth would slow to 2.1% this year and remain subdued at 2.4% in 2024, as tight monetary policy and more restrictive credit conditions weigh on growth. In the medium-term, deteriorating prospects for the major drivers of global growth – trade, productivity, labour force and investment growth – is predicted to reduce potential growth to its slowest pace in 30 years.

Adding to the risk of further supply side disruption and inflation, the US Climate Prediction Center confirmed that El Niño conditions were now present and expected to strengthen as summer approaches. The effects of El Niño vary by region, in Australia it tends to raise the risk of droughts, but in the southern US it can lead to wetter conditions and flooding, while in New Zealand it tends to

lead to dryness in the east. El Niño events can create short-run inflationary pressures¹ and may add to climate variability independently of global warming – in 2014-2016 El Niño coincided with record global temperatures and a record number of hurricanes in the Pacific.

Lower US inflation sees Fed on hold, for now...

The US Fed Reserve met market expectations in holding its policy rate at the 4%-4.25% range. Policy rate projections released with the decision showed that most members of the Fed's policy committee expected rates to rise further this year, potentially as high as 4.5%-4.75%. However, financial market pricing suggests investors think it is unlikely to go as high as that (Table 2).

Table 2: Monetary policy expectations

	Current	Expected	
		Sep	Dec
US	5.1	5.3	5.2
Canada	4.8	5.0	5.1
Euro area	3.3	3.6	3.8
UK	4.4	5.4	5.7
Australia	4.1	4.5	4.6
NZ	5.5	5.5	5.5

Source: ANZ, 16 June 2023

The Fed's decision followed the release of CPI data for May that showed annual headline inflation had fallen to 4.0%, while the CPI excluding food and energy eased to 5.3%. Also, in the lead up to the decision were signs the labour market was cooling. Non-farm payrolls remained solid in May, but the unemployment rate rose to 3.7% from 3.4% in April. Annual wage growth over the three months to May slowed to 4.3%, down from 4.6% previously. Meanwhile, weekly jobless claims rose to their highest level in two years.

The Bank of Canada (BoC) surprised markets with its decision to hike rates 25 basis points (bps) to 4.75%, and a further hike is now anticipated (Table 2). The BoC cited strong GDP growth, a pickup in the housing market and only gradual progress in reducing inflation as key drivers of the increase. The BoC had kept rates steady in its two previous reviews.

...more persistent inflation in Europe points to more hikes to come

The European Central Bank (ECB) raised all of its policy rates 25bps in June, taking the deposit rate to 3.5%, up sharply from -0.5% a year ago. ECB President Christine Lagarde observed that a further rise in July was very likely, while financial markets expect another rise after that (Table 2). Forecasts released alongside the decision showed the ECB now views inflation as more persistent, with core

¹ Paul Cashin, Kamiar Mohaddes, Mehdi Raissi, "Fair weather or foul? The macroeconomic effects of El Niño". *Journal of*

International Economics, Volume 106, 2017, Pages 37-54. <https://doi.org/10.1016/j.jinteco.2017.01.010>

inflation revised up by 0.5 percentage points to 5.1% in 2023 and 3.0% in 2024.

Earlier, revised euro area data showed GDP fell 0.1% in the March quarter, matching the fall in December and showing the region was in a technical recession.

Strong labour market data in the UK has pushed shorter-term interest rates higher as markets moved to price in additional monetary tightening. Annual wage growth (ex-bonuses) rose to 7.2% in May, while the unemployment rate for the three months to April eased to 3.8%. Analysts now see a greater risk of a 50bps rise in the policy interest rate on the way from the current 4.5% to peak of 5.75% in late 2023 (Table 2).

Policy eases in China as growth slows

The People's Bank of China cut its 7-day reverse repo rate by 10bps to 1.9%, the first cut since August 2022, and followed up with the same sized cut to its one-year rate. These cuts followed signs that growth in activity was lagging expectations. These signs included a fall of 8.3% in May's exports, building on April's 9.8% fall, and deepening producer price deflation, down 4.6% in May from a year ago. Annual CPI inflation, while higher than in April, remained tepid at 0.2%, as did core inflation of 0.6%.

Subsequently, May's activity data confirmed the loss of momentum with industrial output, investment and retail sales all easing (Table 3). Investment growth slowed across a broad range of activities, with the larger fall in real estate activity highlighting the challenges there including rising risks of developers defaulting and funding challenges for some local governments. In the labour market, the youth unemployment rate continued to post fresh highs, reaching 20.8% in May, well above the 5.2% rate for the labour force overall.

Table 3: China activity summary

Monthly indicators (apc)*	Mar-23	Apr-23	May-23
Fixed asset investment (ytd)*	5.1	4.7	4.0
- Infrastructure (ex utilities)	8.8	8.5	7.5
- Real estate	-5.8	-6.2	-7.2
Retail Sales	10.6	18.4	12.7
Industrial production	3.9	5.6	3.5

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

Source: Haver

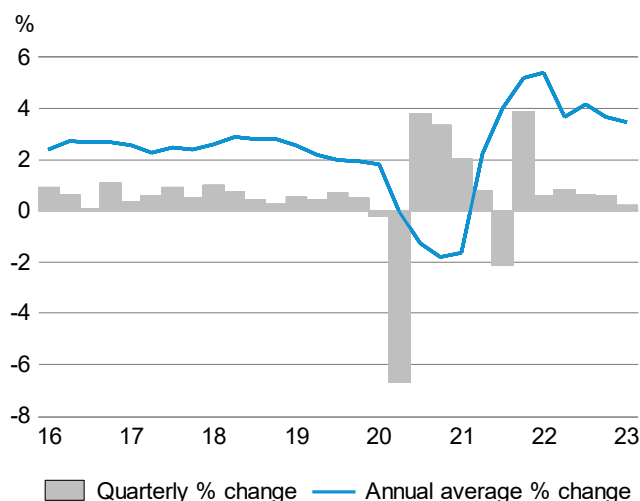
Slow progress in reducing Australian inflation leads to monetary tightening

The Reserve Bank of Australia (RBA) raised its policy rate 25bps to 4.1% at its 6 June meeting. The RBA said that inflation was too high, and policy needed to be tighter to

ensure that inflation would return to target in a reasonable timeframe. This came after CPI data for April showed inflation rose to 6.8% from 6.3% in March, and after the Fair Wage Commission announced a 5.75% increase in minimum and award wages. The RBA's hike surprised many observers, who now see a greater risk of further rate rises and weaker GDP growth over the year ahead (Table 2).

Data released after the RBA decision confirmed that growth had slowed, and that labour market conditions had eased, although they remained very tight. GDP rose 0.2% in the March quarter compared to the quarter prior and was 3.5% higher in the year ended March than in the previous year (Figure 4). Household consumption spending led the slowdown in domestic demand while business investment rose strongly. In the labour market, employment rose 0.5% in May, rebounding from April's fall. This drove the unemployment rate down to 3.6% from 3.7% previously, and reinforced the view that further monetary policy tightening was likely.

Figure 4: Australian GDP



Source: Haver

Coming up:

Date	Release
21 Jun	Westpac consumer sentiment (Q2)
22 Jun	Credit card spending and balances (May)
22 Jun	Merchandise trade (May)
29 Jun	ANZ Business outlook (June)

Tables

Quarterly Indicators		2021Q4	2022Q1	2022Q2	2022Q3	2022Q4	2023Q1
Real Production GDP (1)	qpc	3.5	0.1	1.5	1.4	-0.7	-0.1
	aapc	6.0	5.2	1.2	2.9	2.7	2.9
Current account balance (annual)	%GDP	-6.0	-6.8	-8.0	-8.5	-9.0	-8.5
Merchandise terms of trade	apc	2.8	3.3	-2.2	-6.4	-4.2	-6.2
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	-3.6	-4.0
Total retail sales volume	apc	4.4	2.3	-3.7	4.9	-4.0	-4.1
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		Dec 22	Jan 23	Feb 23	Mar 23	Apr 23	May 23
Merchandise trade balance (12 month)	NZ\$m	-14,649.0	-15637.5	-15769.6	-16761.6	-16803.7	...
Dwelling consents - residential	apc	-16.3	-2.0	-29.2	-25.1	-25.9	...
House sales - dwellings	apc	-36.6	-24.4	-28.2	-12.7	-12.0	-0.4
REINZ - house price index	apc	-13.9	-13.9	-14.2	-12.9	-11.9	-11.2
Estimated net migration (12 month total)	people	24,201.0	35500.0	52114.0	65754.0	72329.0	...
ANZ NZ commodity price index	apc	-7.1	-10.1	-11.7	-9.8	-10.3	-9.9
ANZ world commodity price index	apc	-11.4	-13.3	-15.3	-17.4	-17.3	-13.3
ANZBO - business confidence	net%	-70.2	-52.0	-43.3	-43.4	-43.8	-31.1
ANZBO - activity outlook	net%	-25.6	-15.8	-9.2	-8.5	-7.6	-4.5
ANZ-Roy Morgan - consumer confidence	net%	73.8	83.4	79.8	77.7	79.3	79.2
NZAC	apc	...	...	...	...	...	...

Daily Indicators		Thu	Fri	Mon	Tue	Wed	Thu
		8/6/23	9/6/23	12/6/23	13/6/23	14/6/23	15/6/23
NZ exchange and interest rates (5)							
NZD/USD	\$	0.6046	0.6090	0.6118	0.6119	0.6164	0.6164
NZD/AUD	\$	0.9076	0.9079	0.9079	0.9068	0.9091	0.9085
Trade weighted index (TWI)	index	69.96	70.18	70.57	70.58	70.97	71.08
Official cash rate (OCR)	%	5.50	5.50	5.50	5.50	5.50	5.50
90 day bank bill rate	%	5.69	5.68	5.69	5.69	5.68	5.68
10 year govt bond rate	%	4.55	4.49	4.51	4.51	4.55	4.50
Share markets (6)							
Dow Jones	index	33,834	33877	34066	34212	33979	34408
S&P 500	index	4,294	4299	4339	4369	4373	4426
VIX volatility index	index	13.7	13.8	15.0	14.6	13.9	14.5
AU all ords	index	7,288	7312	...	7329	7354	7370
NZX 50	index	11,716	11690	11616	11653	11679	11687
US interest rates							
3 month OIS	%	5.08	5.08	5.08	5.08	5.08	...
3 month Libor	%	5.54	5.54	5.56	5.55	5.51	...
10 year govt bond rate	%	3.73	3.75	3.73	3.84	3.83	3.72
Commodity prices (6)							
WTI oil	US\$/barrel	71.29	70.16	67.08	69.39	68.27	70.62
Gold	US\$/ounce	1,966.40	1960.30	1952.90	1954.40	1955.80	1952.35
CRB Futures	index	548.23	545.87	546.69	547.41	550.34	552.93

(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		Nov 22	Dec 22	2022Q4	Jan 23	Feb 23	Mar 23	2023Q1	Apr 23	May 23	Jun 23
United States	GDP (1)	qpc			0.6				0.3			
	Industrial production (1)	mpc	-0.3	-1.5		1.0	0.0	0.1		0.5	-0.2	...
	CPI	apc	7.1	6.5		6.4	6.0	5.0		4.9	4.0	...
	Unemployment rate (1)	%	3.6	3.5		3.4	3.6	3.5		3.4	3.7	...
	Employment change (1)	000s	290.0	239.0		472.0	248.0	217.0		294.0	339.0	...
	Retail sales value	apc	6.1	6.0		7.4	5.3	2.2		1.2	1.6	...
	House prices (2)	apc	6.8	4.6		2.6	0.4	-1.1		...	...	...
	PMI manufacturing (1)	index	49.0	48.4		47.4	47.7	46.3		47.1	46.9	...
Consumer confidence (1)(3)	index	101.4	109.0		106.0	103.4	104.0		103.7	102.3	...	
Japan	GDP (1)	qpc			0.1				0.7			
	Industrial production (1)	mpc	0.2	0.3		-5.3	4.6	1.1		-0.4	...	...
	CPI	apc	3.8	4.0		4.4	3.3	3.2		3.4	...	...
	Unemployment rate (1)	%	2.5	2.5		2.4	2.6	2.8		2.6	...	...
	Retail sales value	apc	2.5	3.8		5.0	7.3	6.9		5.1	...	...
	PMI manufacturing (1)	index	49.0	48.9		48.9	47.7	49.2		49.5	50.6	...
	Consumer confidence (1)(4)	index	29.6	30.9		31.0	30.9	34.0		35.0	36.2	...
Euro area	GDP (1)	qpc			-0.1				-0.1			
	Industrial production (1)	mpc	1.3	-1.3		0.6	1.4	-3.8		1.0	...	...
	CPI	apc	10.1	9.2		8.7	8.5	6.9		7.0	...	...
	Unemployment rate (1)	%	6.7	6.7		6.6	6.6	6.6		6.5	...	...
	Retail sales volume	apc	-2.4	-2.8		-1.8	-2.4	-3.3		-2.6	...	...
	PMI manufacturing (1)	index	47.1	47.8		48.8	48.5	47.3		45.8	44.8	...
	Consumer confidence (5)	index	-23.7	-22.0		-20.6	-19.0	-19.1		-17.5	-17.4	...
United Kingdom	GDP (1)	qpc			0.1				0.1			
	Industrial production (1)	mpc	0.0	0.2		-0.3	-0.1	0.8		-0.3	...	...
	CPI	apc	9.3	9.2		8.8	9.2	8.9		7.8	...	...
	Unemployment rate (1)	%	3.7	3.7		3.7	3.8	3.9		3.8	...	...
	Retail sales volume	apc	-6.0	-6.7		-5.2	-3.5	-3.9		-3.1	...	...
	House prices (6)	apc	4.4	2.8		1.1	-1.1	-3.1		-2.7	-3.4	...
	PMI manufacturing (1)	index	46.5	45.3		47.0	49.3	47.9		47.8	47.1	...
	Consumer confidence (1)(5)	net %	-44.0	-42.0		-45.0	-38.0	-36.0		-30.0	-27.0	...
Australia	GDP (1)	qpc			0.6				0.2			
	CPI	apc			7.8				7.0			
	Unemployment rate (1)	%	3.5	3.5		3.7	3.5	3.5		3.7	3.6	...
	Retail sales value	apc	7.7	7.9		7.7	6.5	5.6		3.3	...	...
	House Prices (7)	apc			...					...	...	...
	PMI manufacturing (1)	index	-7.1	-17.1		-17.1	-6.4	5.6		-20.2	-5.1	...
	Consumer confidence (8)	index	78.0	80.3		84.3	78.5	78.5		85.8	79.0	79.2
China	GDP	apc			2.9				4.5			
	Industrial production	apc	2.2	1.3		2.4	2.4	3.9		5.6	3.5	...
	CPI	apc	1.6	1.8		2.1	1.0	0.7		0.1	0.2	...
	PMI manufacturing (1)	index	48.0	47.0		50.1	52.6	51.9		49.2	48.8	...
South Korea	GDP (1)	qpc			-0.3				0.3			
	Industrial production (1)	mpc	-0.4	-3.1		1.9	-2.9	5.3		-1.2	...	...
	CPI	apc	5.0	5.0		5.2	4.8	4.2		3.7	3.3	...

(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