

- **Reserve Bank raises cash rate to 5.5% and signals hiking cycle has ended**
- **Employment indicators show continued growth, while outlook for spending bleak**
- **Services activity is supporting global growth and core inflation**

The Reserve Bank hiked its policy interest rate 25bps to 5.5% as expected by the market and left its projections for the peak unchanged at 5.5%. With the impact of past rate hikes yet to be fully felt, and with evidence that policy was restricting activity, the Bank's forecasts assume that if held at 5.5% until late 2024, settings will be tight enough to bring inflation back to target. Business sentiment improves slightly as jobs are filled but uncertainty prevails over future plans for investment. Likewise, consumers cite few plans for large purchases in the future. Weaker building consents last year start to show in slower residential activity. 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.

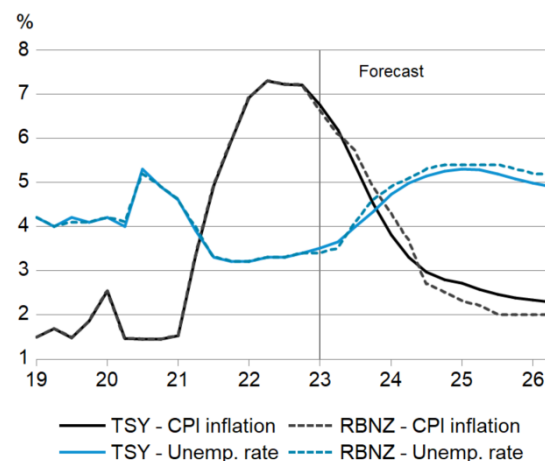
Reserve Bank signals end of rate hikes

The Reserve Bank (RBNZ) raised the Official Cash Rate (OCR) 25 basis points (bps) to 5.5% at its projected peak. The RBNZ's Monetary Policy Committee (MPC) expressed confidence that interest rates are curbing economic activity, and with the full effects still taking effect, a rate of 5.5% held for about 18 months would be sufficient to return inflation back to its 1-3% target band within the next two years. A vote was required for the first time since the MPC was formed due to a split of 5:2 to hike 25bps versus no change.

The RBNZ forecasts GDP contracting 0.1% in the year to June 2024. This compares to modest growth of 1.0% in the Treasury's Budget forecasts with most of the difference attributable to projected falls in residential investment in response to different interest rate tracks. Despite the weaker demand picture, the RBNZ see higher employment growth than the Treasury, and also higher labour force growth, as both migration and participation are stronger – reflecting recent data, but also judgements around how persistent these trends will be and how they will affect the balance between demand and supply and, ultimately, inflation. Overall, greater economic slack opens up in the

RBNZ forecasts, which is reflected in comparatively higher unemployment and lower inflation projections (Figure 1).

Figure 1: Unemployment and inflation



Source: Reserve Bank, the Treasury

Headline CPI inflation is below 3% from the second half of 2024 in both Treasury and RBNZ forecasts, but thereafter is a little lower in the RBNZ forecast. Tradables inflation drives much of this difference, slowing to near-0% in the RBNZ forecast – similar to the average over the previous decade – compared to a little less than 2% in the Treasury forecast.

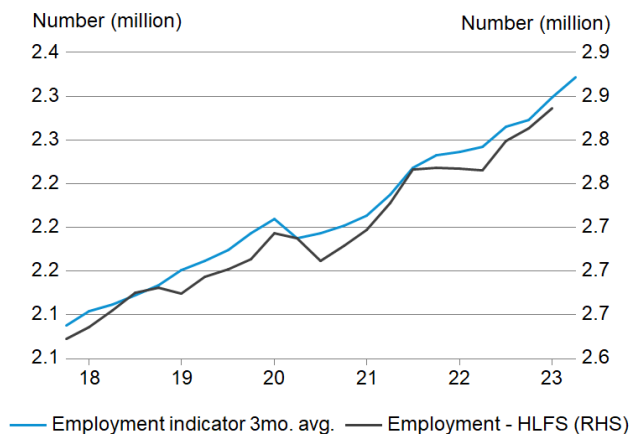
Analysts' attention was focused on the reaction of the MPC to the increased fiscal spending revealed in the Budget. The Monetary Policy Statement assessed fiscal policy would initially be inflationary, followed by a dampening effect as government spending declines as a share of GDP. Further, government spending would be less inflationary than recent years as COVID support measures are phased out. Markets had priced in the 25bps hike but were not expecting the RBNZ's position that policy was sufficiently tight despite fiscal spending and higher net migration. The NZD fell 1.5 cents against the USD and by 2.1% on the TWI, and fell further over the following week.

Employment growth across most industries...

Despite slower demand forecast this year, employment is expected to grow slowly relative to population growth. This was confirmed by ongoing growth in Stats NZ's Monthly

Employment Indicators which showed filled jobs increased 0.6% in April (Figure 2). Employment filled has continued in part from high net migration, with 65,000 new arrivals in the past year. On an adjusted basis, filled jobs in the Primary industries increased 0.2%, the Goods-producing industries increased 0.7%, and Services industries increased 0.5%.

Figure 2: Employment indicator and HLFS

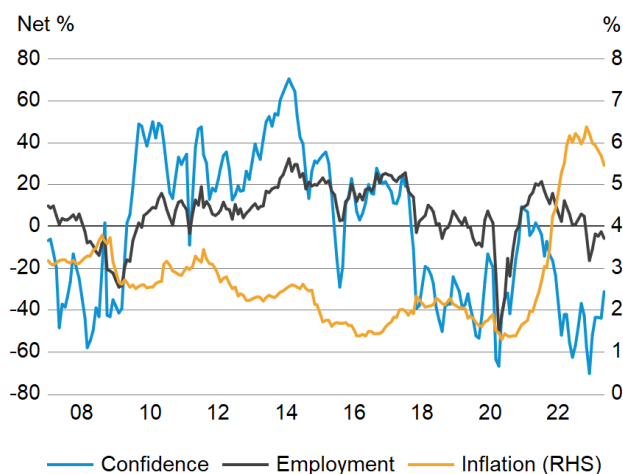


Source: Stats NZ

... as businesses less constrained by labour...

Overall business confidence improved in May lifting 13 points from -43.8 to -31.1, its highest reading since December 2021 (Figure 3). The expected own activity also rose, while employment intentions dropped from -2.4 to -5.7. Rather than businesses intending to reduce employment, this may reflect some optimism with vacancies finally being filled. Businesses' expectations for annual inflation slowed for the six consecutive month, from a peak of 6.4% in November to 5.5% in May. Business sentiment was also influenced by economic uncertainty, with little appetite for investment. The ANZ Business outlook investment intentions subcomponent stayed at -6.8 for the third month, and has been below zero for ten of the last 12 months.

Figure 3: ANZ Business Outlook



Source: ANZ

... while consumers slow down spending

Similarly, the ANZ-Roy Morgan Consumer survey revealed consumers' uncertainty about the future, and a lack of appetite for large purchases. The purchase plans subcomponent fell from -31 to -34 in May. While overall consumer confidence was flat, sentiment around current conditions improved, but future conditions deteriorated.

March quarter retail sales volumes, down -1.4%, much weaker than the 0.2% gain analysts expected, which adds to the risk that Q1 GDP growth is weaker than the Treasury's Budget forecast of 0.2%. With GDP having fallen in Q4, a fall in Q1 would signal a technical recession.

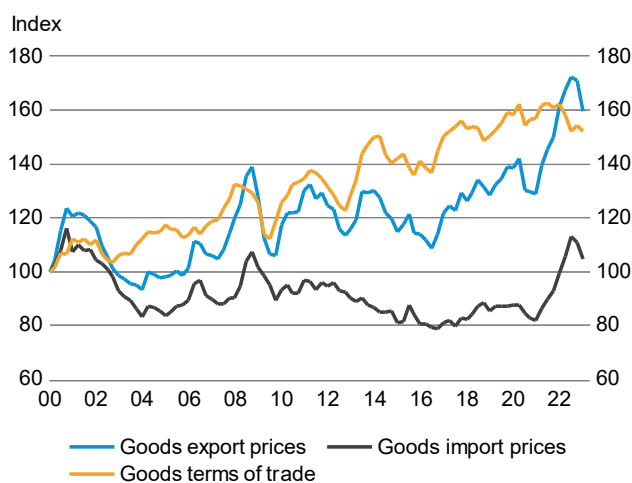
... amid slowing residential building ...

Consistent with trends in consent issuance over the past year, the volume of residential building work fell in the March quarter by 0.8%, following a 1.6% fall in December. Growth of 3.6% in non-residential building offset the fall, resulting in total growth of 0.6%. In value terms, building was up 4.4% in the March 2023 year, compared with the December 2022 year, reflecting in part rising residential and commercial construction costs over the same period. Going forward, residential building is expected to weaken further, after consents fell 2.6% in April across all major dwelling types, to be 9.3% lower than the year to April 2022. Stats NZ only identified a few alterations that mentioned weather-related repair work in April's data, however some emergency repairs do not require a building consent.

Dairy and meat prices impact terms of trade

The merchandise terms of trade fell 1.5% in March quarter as export and import prices saw significant falls of 6.9% and 5.4% respectively. Import volumes grew 6.7%, their highest rate of growth since June 2021, suggesting demand for imports remains more robust than expected. Service exports continue to recover strongly, driven by a 42.3% increase in travel service exports and underpinned by a 1.3% rise in the services terms of trade.

Figure 4: Merchandise terms of trade



Source: Stats NZ

Services support global activity

The pickup in growth evident in the March quarter continued into May with Purchasing Managers Indexes (PMIs) in the major advanced economies firming slightly compared to April. Notably, the divergence between weakness in the manufacturing sector and expanding services sector widened further, casting doubt on whether monetary policy is restrictive enough to lower sticky services inflation. In contrast, China's PMIs eased, adding to concerns about the sustainability of the recovery and to calls for more policy stimulus.

Slower momentum in China has contributed to lower oil prices and a weaker NZD. At the end of May, Brent crude oil prices were US\$73bbl, down from US\$81bbl at the end of April, while NZ's TWI ended the month at 69.9, its lowest since November last year. OPEC+ members are meeting on July 4 and despite prices being lower than in April when their announcement of production cuts surprised traders, no further supply cuts are anticipated.

US sentiment improves as debt deal struck...

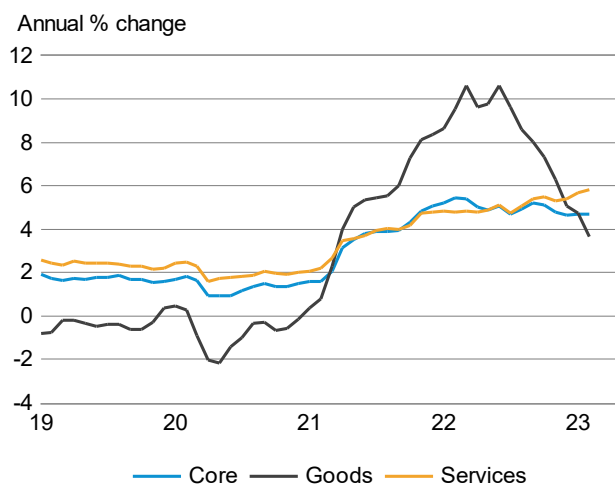
Concerns about a US debt default eased as a deal on the debt ceiling was negotiated and the date when the Treasury would run out of funds was revised to 5 June, allowing both houses of Congress time to vote. The deal suspends the debt ceiling until January 2025 and caps non-defence federal spending for two years near 2022/23 levels. The Congressional Budget Office's assessment is that the deal would lower Federal spending by 0.2%-to-0.3% of GDP per year compared to the current baseline. The deal has several other provisions, but these are seen to have limited macroeconomic impacts.

...and activity remains solid

Turning to US data, private consumption expenditure (PCE) rose 0.8% in April, and a sizeable 0.5% in real terms, while job openings rose following three months of declines. This followed earlier reports of solid retail spending and jobs growth in April and has pushed aside near-term recession concerns – the Atlanta Fed GDPNow indicator is estimating annualised growth of 1.9% for the June quarter.

Meanwhile, core PCE inflation, the Federal Reserve's preferred inflation measure, rose 0.4% in April to be 4.7% higher than a year ago, underscoring the stickiness of underlying inflation (Figure 5). The Fed's March dot plots showed core PCE inflation was expected to slow to around 3.6% by the end of the year. Financial market participants anticipate the Fed will have to raise rates again by July to ensure inflation is consistent with this projection.

Figure 5: US PCE inflation



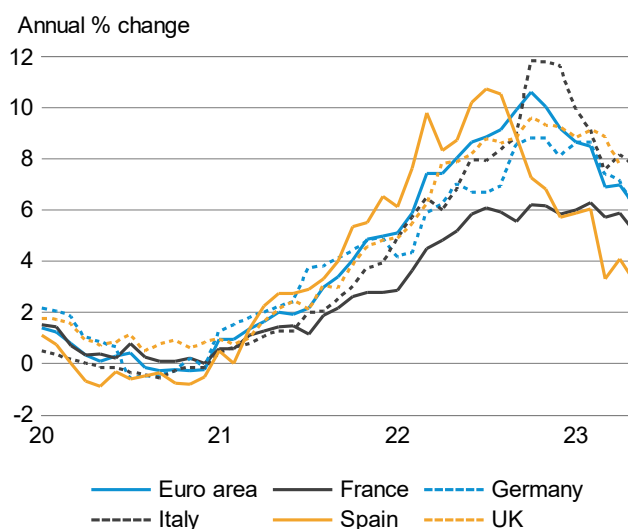
Source: Haver

Inflation slows in Europe

Euro area inflation eased to 6.1% in May from 7.0% in April, a larger fall than markets had anticipated, as the four major economies all experienced large declines (Figure 6). Base effects from lower energy prices drove the fall in euro area headline measure, but the drivers were broad-based and included lower services inflation. As a result, core inflation slowed to 5.3% from 5.6% in April, also a bigger fall than had been expected. Meanwhile, revised data showed that Germany has been in recession, with GDP now down 0.3% in Q1 after contracting 0.5% in Q4. Despite signs of easing core inflation, the European Central Bank is widely expected to raise its policy rate in coming meetings.

In the UK, April data showed annual headline inflation slowed to 8.7% but core inflation picked up to 6.8% from 6.2% in March. The CPI data surprised analysts with its strength, adding to the risk that the Bank of England takes rates higher than the 5.0% markets had expected.

Figure 6: European inflation

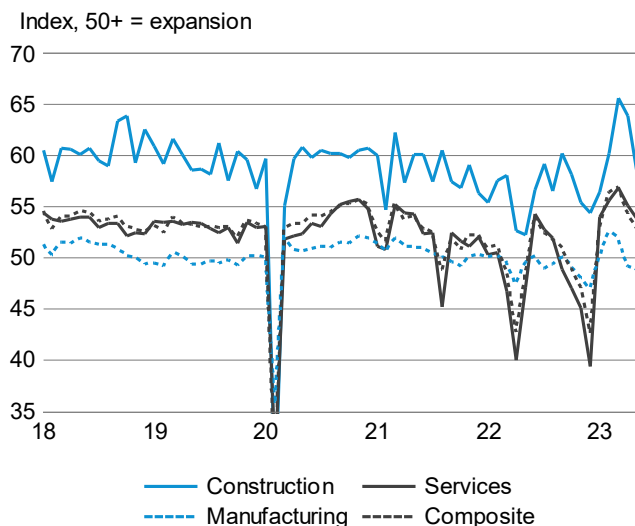


Source: Haver

China's recovery continued in May

China's official PMIs suggest that the economic recovery was still ongoing in May, albeit at a slower pace. Manufacturing is struggling and fiscal support for construction waning. But the service sector is still seeing decent gains, and the composite CPI, while easing further, remains around its 5-year average (Figure 7). Overall, the PMIs are consistent with quarterly growth of around 2%. However, analysts had been anticipating stronger outcomes and this data has added to growing concerns around the outlook for China.

Figure 7: China's PMIs



Source: Haver

Earlier this year, analysts warned that the China's recovery from its zero-covid policy could spur global demand and complicate central banks' fight against inflation. This view is being reassessed as China's economic momentum fades, inflation remains soft, the labour market faces structural challenges and trade tensions with the US continue to weigh on investor sentiment. China's CSI 300 equity price index fell nearly 6% in May and is 10% below its peak at the end of January 2023.

Concerns about a covid reinfection wave have also emerged in China, but mobility indicators and offline activities are holding up well so far. Commentators do not think policymakers will resort to zero-covid again, and the infection wave could be much smaller compared to the peak wave, but the risk of some mild disruptions could be real.

Japan's CPI inflation continued to firm in April, with the annual headline rate up 2-tenths to 3.5%, and core inflation up 3-tenths to 3.4%. It remains unclear how persistent this strength will be, with markets seeing the rise as likely to be transitory, similar to the debate in other economies that took place in 2021. Large wage hikes in recent months support the view that inflation will persist at rates consistent with the 2% inflation target.

India's GDP rose 6.1% in March compared to the same quarter a year ago, up from 4.5% in the previous quarter, and rose 7.2% in the year ended March compared to the previous year. Stronger export growth drove the March quarter rise, partly reflecting China's reopening. Analysts expect slower global growth and restrictive monetary policy will reduce GDP growth to around 5.5% in the year ahead.

Australian inflation rises

Australia house prices rose 1.2% in May compared to the previous, the third consecutive monthly rise.

Australia's monthly CPI rose 0.8% in April, lifting the annual rate to 6.8% from 6.3% in March, a larger rise than had been anticipated, keeping alive the prospect of further hikes from the Reserve Bank of Australia. The next RBA cash rate announcement is on 6 June and financial markets are pricing a 30% chance of a rise.

Later in the week, March quarter GDP statistics are expected to show the economy expanded by 0.2%-0.3%, with support from business investment and household spending more than offsetting drags from residential investment and net exports.

Coming up:

Date	Release
12 Jun	Electronic card spending (May)
13 Jun	Net migration and travel (Apr)
14 Jun	Food and rent price indexes (May)
14 Jun	Balance of payments (Q1)
15 Jun	GDP (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	-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		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	-25.9
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	Fri	Mon	Tue	Wed	Thu
		25/5/23	26/5/23	29/5/23	30/5/23	31/5/23	1/6/23
NZ exchange and interest rates (5)							
NZD/USD	\$	0.6090	0.6075	0.6060	0.6056	0.6018	0.6016
NZD/AUD	\$	0.9323	0.9336	0.9270	0.9244	0.9253	0.9247
Trade weighted index (TWI)	index	70.55	70.48	70.26	70.14	69.90	69.81
Official cash rate (OCR)	%	5.50	5.50	5.50	5.50	5.50	5.50
90 day bank bill rate	%	5.69	5.69	5.70	5.71	5.69	5.68
10 year govt bond rate	%	4.40	4.42	4.41	4.33	4.27	4.28
Share markets (6)							
Dow Jones	index	32,765	33093	...	33043	32908	33062
S&P 500	index	4,151	4205	...	4206	4180	4221
VIX volatility index	index	19.1	18.0	...	17.5	17.9	15.7
AU all ords	index	7,317	7335	7395	7387	7274	7291
NZX 50	index	11,960	11830	11936	11879	11813	11916
US interest rates							
3 month OIS	%	5.08	5.08	5.08	5.08	5.08	...
3 month Libor	%	5.46	5.48	...	5.50	5.52	...
10 year govt bond rate	%	3.83	3.80	...	3.69	3.64	3.61
Commodity prices (6)							
WTI oil	US\$/barrel	71.83	72.35	...	69.45	68.09	70.10
Gold	US\$/ounce	1,948.25	1947.90	...	1952.45	1964.40	1974.35
CRB Futures	index	536.37	540.49	...	540.37	541.45	...

(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	-1.1		...	...
	PMI manufacturing (1)	index	50.0	49.0	48.4		47.4	47.7	46.3		47.1	46.9
Consumer confidence (1)(3)	index	102.2	101.4	109.0		106.0	103.4	104.0		103.7	102.3	
Japan	GDP (1)	qpc				-0.0				0.4		
	Industrial production (1)	mpc	-3.2	0.2	0.3		-5.3	4.6	1.1		-0.4	...
	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		2.6	...
	Retail sales value	apc	4.4	2.5	3.8		5.0	7.3	6.9		5.1	...
	PMI manufacturing (1)	index	50.7	49.0	48.9		48.9	47.7	49.2		49.5	50.6
	Consumer confidence (1)(4)	index	30.8	29.6	30.9		31.0	30.9	34.0		35.0	36.2
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	6.6		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	44.8
Consumer confidence (5)	index	-27.4	-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	0.4	0.0	0.2		-0.3	-0.1	0.8		...	...
	CPI	apc	9.6	9.3	9.2		8.8	9.2	8.9		7.8	...
	Unemployment rate (1)	%	3.7	3.7	3.7		3.7	3.8	3.9		...	...
	Retail sales volume	apc	-5.4	-6.0	-6.7		-5.2	-3.5	-3.9		-3.1	...
	House prices (6)	apc	7.2	4.4	2.8		1.1	-1.1	-3.1		-2.7	-3.4
	PMI manufacturing (1)	index	46.2	46.5	45.3		47.0	49.3	47.9		47.8	47.1
	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		3.3	...
	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	48.8
South Korea	GDP (1)	qpc				-0.3				0.3		
	Industrial production (1)	mpc	-3.7	-0.4	-3.1		1.9	-2.9	5.3		-1.2	...
	CPI	apc	5.7	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