

Fortnightly Economic Update

18 August 2023

- **No change to Reserve Bank’s monetary policy stance**
- **Net immigration is supporting the housing market, but spending is subdued**
- **Dairy prices weaken further**
- **Growth in advanced economies holds up but challenges mount in China**

Economic activity is slowing, broadly as anticipated in the Budget Update. Indicators of activity in July point to a sluggish start to the third quarter with household spending under pressure from rising mortgage interest rates and high inflation, and lower commodity prices weighing on the rural sector. Net migration inflows are providing support, especially in the housing market, where prices of existing homes are now rising, and rental prices have picked up. Near-term fears of recession in advanced economies have receded with GDP growth exceeding expectations in Japan and Europe, while US growth momentum has continued, and inflation has eased. In contrast, China’s economy slowed further, although policy support is increasing.

Reserve Bank reiterates on hold guidance

The Reserve Bank’s Monetary Policy Committee (MPC) kept the OCR at 5.5% at its August review, as widely expected. The MPC cited slower spending growth, easing labour shortages and progress in reducing inflation as providing confidence that interest rates were sufficiently restrictive to return inflation to target. However, the MPC assessed the OCR to be less restrictive than previously assumed and considered that it would need to remain around 5.5% until the end of 2024 before declining, one to two quarters later than previously expected. The OCR projection was also a little higher than previously forecast and although Governor Orr downplayed the significance of the change, analysts saw it as signalling a greater risk of a further OCR hike.

The MPC noted that the economy was evolving largely as expected and saw risks to that view as balanced. On the one hand, inflation and activity might not slow as expected, while on the other hand, the weaker outlook for China and commodity prices could have a more negative effect.

As in their May forecasts, past monetary tightening is expected to drive a modest contraction in GDP over the second half of 2023. Thereafter, the outlook is a little more positive, mainly owing to higher net immigration (Table 1).

The unemployment rate is now projected to increase more slowly over the second half of 2023, and to be around 5.0% in June 2026, two-tenths lower than previously.

The short-term outlook for inflation was also revised up, to 3.9% in June 2024 from 3.7% previously, but was little changed thereafter.

Table 1: RBNZ forecasts (August)

	June			
	2023	2024	2025	2026
GDP*	3.0	0.0	1.7	3.1
prev	3.2	-0.1	1.6	2.7
Unemployment**	3.6	5.1	5.3	5.0
CPI Inflation***	6.0	3.9	2.2	2.0
OCR**	5.3	5.6	5.1	3.8

*annual average % change, **June quarter, ***annual % change

Source: RBNZ

The MPC noted that inflation expectations had continued to trend down in the RBNZ’s September Survey of Expectations, reinforcing the signal from other business surveys of easing inflation pressures (Table 2).

Table 2: Business inflation expectations

Horizon	Sept	June
1-year ahead	4.2	4.3
2-years ahead	2.8	2.8
5-years ahead	2.3	2.4
10-years ahead	2.2	2.3

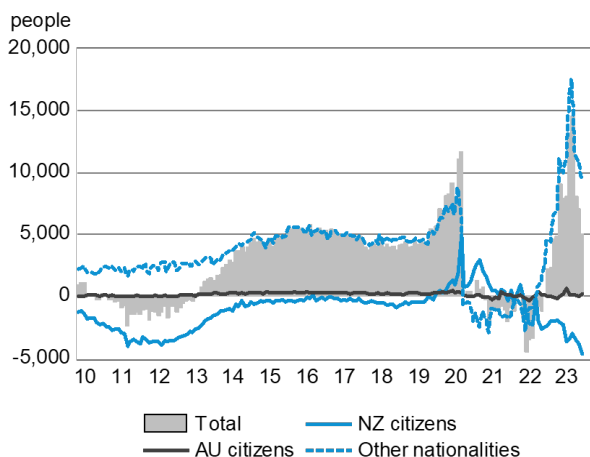
Source: RBNZ

Net migration inflows boosted the population...

Monthly net migration inflows slowed to just over 5,000 in June, well down from the levels earlier this year (Figure 1). Inflows of non-NZ citizens drove the monthly gain, consistent with the record number of work visas issued over the past 12 months, while NZ citizens drove the outflows.

June’s net inflow lifted the 12-month gain to 86,700 and took NZ’s population past 5.2 million - 2.1% higher than 12 months ago.

Figure 1: Monthly net migration



Source: Stats NZ

...and added to housing demand...

As well as adding to the economy's labour force and boosting output, net immigration is also adding to demand in the housing market, but the impact on spending appears to be muted.

In the market for existing housing, the Real Estate Institute's price index recorded its fourth consecutive monthly rise in July, climbing 0.7% (seasonally adjusted), which reinforces the view that the cycle has turned. Increased demand from immigration is likely to be supporting prices but high interest rates are providing an offset – this dynamic is likely to persist and mitigate the risk of a sharp price rise.

Housing rental prices are also increasing, up 4.1% in July compared to a year ago and equal to the 14-year highs seen in the second half of 2022.

...but spending remained subdued

Spending fell 0.9% in July according to Stats NZ's electronic cards data, led by a decline in non-retail spending (such as health care and travel). Retail spending on goods was flat as lower spending on fuel was offset by higher spending on consumables (food, liquor, personal items). Excluding spending on fuel and motor vehicles, which was impacted by the return of the full fuel excise on 1 July, retail spending was flat for the second month in a row and around 1.5% lower than in April. The slowdown in spending is consistent with the negative effects of higher mortgage payments and inflation on households real disposable income.

Food price inflation appears to be past its peak with prices easing 0.5% (seas. adj.) in July, the first decline since November 2021, and the annual pace slowing to 9.6% from 12.5% in June. Annual vegetable price inflation slowed sharply, to 7.0% from 26.9% in June, as supply recovered from the severe weather events earlier this year.

...and sentiment has deteriorated

Echoing the weakness in July's consumer spending, the BNZ-BusinessNZ Performance of Services Index (PSI) pointed to a fall in activity in July, dropping 1.6 points

to 48.0. With the index for the manufacturing sector also giving a contractionary reading, the composite index fell to its lowest level since the 2007-08 recession, excluding the pandemic period. The composite employment measure also softened, consistent with July's fall in employment agency SEEK's advertised job vacancies report, the fourth consecutive monthly fall.

Tourism recovery continued...

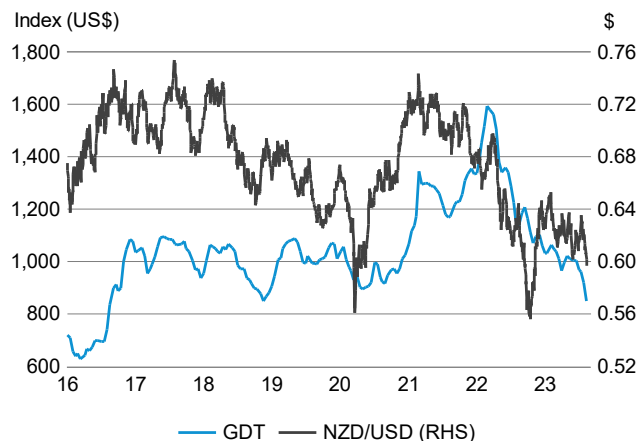
On the positive side, New Zealand tourism continued its steady recovery, with Stats NZ data showing monthly visitor arrivals as a percentage of 2019 rising to 84% in June 2023, compared to an average of around 72% in April and May. This rise in visitor numbers was driven by an increase in Australian holidaymakers and the return of Chinese tourists.

The FIFA Women's World Cup likely lifted tourist spending throughout July and August due to the arrival of higher-spending visitors from countries such as the US. To the extent that it did add to spending, it amplifies the underlying weakness in card spending and the PSI.

...but dairy prices fell

Prices fell 7.4% in the latest Global Dairy Trade auction, driven by higher supply and sluggish demand growth – the latter attributed to the key China market (Figure 2). Subsequently, dairy company Fonterra downgraded its expected 2023/24 season payout to farmers to a midpoint of \$6.75 per kg of milk solids. This compares to an estimated \$8.20kg/MS in 2022/23 and industry estimates of an average farm break-even price of about \$7.50kg/MS.

Figure 2: Dairy prices and the exchange rate



Source: Haver

Analysts estimated the lower milk price could reduce the new season's export revenue by over \$2bn – NZ exported \$21.2bn of dairy products in the 12-months ended June, of which about a third went to China.

The fall in dairy prices has been accompanied by a fall in the NZ/US dollar exchange rate to its lowest level this year, which will moderate some of the negative impacts on export revenue (Figure 2). However, the lower exchange rate will add to import prices, including diesel and petrol, which have increased by 12% and 7.5% respectively over the past four weeks.

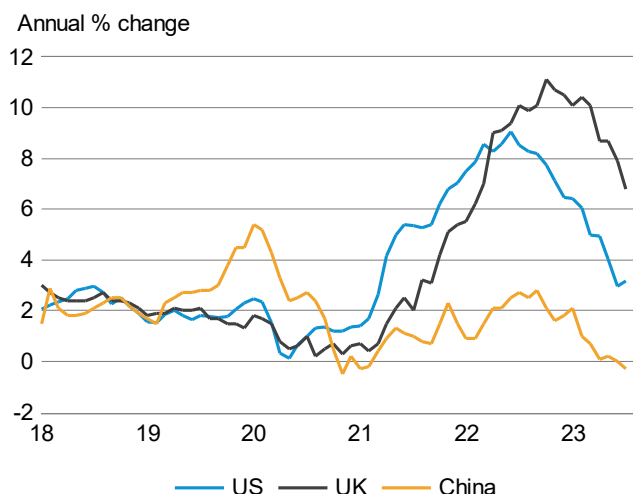
Global growth held up as inflation eased but activity in China slowed further

Global growth likely slowed in the June quarter, but not as much as expected, as GDP growth in Japan and the UK followed the US and euro area with positive surprises. With inflation slowing more quickly than anticipated and labour markets gradually cooling, the prospects of further central bank tightening and synchronised near-term recession have receded. On the other hand, tight labour markets may stall progress on lowering inflation and lead to further rate hikes that cause activity to contract. China's July activity data showed growth continued to slow amidst deepening property market concerns.

US inflation slows as labour market cools

In the US, July's CPI rose 0.2%, matching June's increase and taking the annual rise to 3.2% (Figure 3). Excluding food and energy, the CPI rose 0.2%, also the same as in June, which saw the annual rate ease to 4.7% from 4.8% previously.

Figure 3: CPI inflation



Source: Haver

July's payroll report also met expectations, with jobs up 187k, similar to June's rise but well below the pace of growth earlier in the year. In the labour force survey, the unemployment rate dipped to 3.5% and average hourly earnings rose 0.4% in the month to be 4.4% higher than a year ago. Persistent labour market tightness raises questions about whether the trend of easing inflation will continue, especially for labour-intensive services.

Activity data started the quarter strongly with July reports for industrial production, retail sales and new housing starts all beating expectations. This data saw the Atlanta Fed's GDPNow predictor surge to 5.8% annualised growth in the third quarter. While it will likely drop as new data comes in, it sends a signal of resilient growth.

Past financial stresses continued to weigh on market sentiment with ratings agency Moody's cutting credit ratings for several small to mid-sized US banks. Moody's also warned that it may downgrade some of the nation's biggest lenders, citing funding risks and weaker profitability as the reason. Earlier, Fitch Ratings warned that US banks'

ratings could be cut if conditions deteriorate, and they downgraded the US's long-term credit rating.

GDP beat expectations in Japan and the UK

Japan's June quarter GDP rose 1.5%, well above market expectations of 0.9%, led by strong export growth and a fall in imports. The domestic demand picture was less encouraging – private consumption fell 0.5%, reversing much of March's rise, and business investment was flat. August's Reuters Tankan Survey pointed to a recovery in domestic demand as sentiment improved in both the manufacturing and non-manufacturing sectors.

The UK economy grew by 0.2% in the June quarter, above expectations of zero growth, driven by strong rises in manufacturing (helped by falling raw material prices) and consumer and government spending.

UK headline inflation dropped to 6.8% in July as energy prices fell (Fig 3). However, the ex-food and energy measure was steady at 6.9%, while services inflation picked up two-tenths to 7.4%. Earlier, June quarter labour market data stoked inflation concerns as wage growth rose to a record high 8.2%, although the unemployment rate ticked up to 4.2% from 4.0% previously. Financial markets are pricing a peak monetary policy rate of 6%, 75bps higher than the current rate.

Euro area industrial production expanded 0.5% in June, although the headline figure disguised underlying weakness. Production contracted by around 1% in France, Germany and Spain as manufacturing and construction firms cut investment spending. The contraction in these economies is consistent with the weaker signals from business surveys that point to flat euro area growth over the second half year, following a rise of 0.3% in the June quarter.

The Italian government surprised markets with a proposal for a 40% windfall tax on banks interest income. Sharp falls in bank equity prices saw the government soften the measure through a cap on the levy.

China's challenges mount

China's growth outlook looks to facing multiple headwinds – deflation, property sector credit stress, slowing external demand and weak business and consumer confidence – fuelling concerns that China may be entering a period of much slower growth, akin to Japan's "lost decades".

China's CPI inflation turned negative in July, falling 0.3% from the same month last year, led by lower food prices (Fig 3). Core inflation strengthened to 0.3% on a month ago, the largest gain in three years, which suggests that deflation will be temporary. The annual rate of producer price deflation eased to 4.4% in July from 5.4% in June.

China's July activity report showed activity had slowed across all the major indicators and that the contraction in the real estate had intensified (Table 3). This data prompted the central bank to cut its policy rates for the second time this year.

Table 3: China activity indicators

Monthly indicators (apc)*	May-23	Jun-23	Jul-23
Fixed asset investment (ytd)*	4.0	3.8	3.4
- Infrastructure (ex utilities)	7.5	7.2	6.8
- Real estate	-7.2	-7.9	-8.5
Retail Sales	12.7	3.1	2.5
Industrial production	3.5	4.4	3.7

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

Source: Haver

Adding to concerns, July's credit growth missed expectations by a wide margin as loan demand slowed to its lowest level since 2016. Meanwhile, default fears surrounding Country Garden Holdings (which accounted for ~3% of China's total property sales value in 2022) added further downside risk to the property market as it could significantly weaken confidence.

Downward pressure on growth was also evident in China's exports, which fell 4.0% in July, the fourth consecutive monthly fall, likely reflecting weaker external demand. Imports were down 6.4% following a 4.1% decline in June, consistent with weaker domestic demand. Imports from New Zealand were down 24% on a year ago.

Besides monetary easing, other forms of policy support have stepped up in recent weeks with announcements from various government agencies emphasising stabilising the housing market, promoting consumption, and restoring private sector business confidence. However, analysts note that implementation details remain light and continue to expect further pro-growth measures to be introduced in coming weeks.

Labour market eased in Australia

Australia's July labour force survey revealed a fall in employment (down 15k) alongside a rise in unemployment to 3.7% from 3.5% in June. The employment fall follows strong gains in the previous two months and likely overstates the degree of easing. Nonetheless, it is consistent with the gradual easing in the labour market seen in recent months.

It is also consistent with the Reserve Bank of Australia's (RBA) most recent forecasts, which show unemployment rising to 3.9% in the December quarter and to 4¼% in June 2024 (Table 4). GDP growth is projected to slow to 1% over the year ahead, slightly lower than forecast in May, while CPI inflation is expected to be at the upper bound of the 2-3% inflation target by June 2025.

Table 4: RBA forecasts

	June		
	2023	2024	2025
GDP*	3	1	1 3/4
prev	3 1/4	1 1/4	1 3/4
Unemployment**	3.6	4 1/4	4 1/2
CPI Inflation***	6.0	3 1/2	3

*annual average % change, **June quarter, ***annual % change

Source: RBA

The semi-annual average weekly earnings release showed ordinary-time earnings for full-time adults increased AU\$69 (3.9%) from a year earlier to AU\$1838.

Coming up:

Date	Release
21 Aug	Merchandise trade (Jul)
23 Aug	Retail Trade (Q2)
31 Aug	ANZ Business Outlook
1 Sep	ANZ consumer confidence
4 Sep	Terms of trade indexes (Q2)
6 Sep	Building work put in place (Q2)
7 Sep	Economic Survey of Manufacturing (q2)

Tables

Quarterly Indicators		2022Q1	2022Q2	2022Q3	2022Q4	2023Q1	2023Q2
Real Production GDP (1)	qpc	0.1	1.5	1.4	-0.7	-0.1	...
	aapc	5.2	1.2	2.9	2.7	2.9	...
Current account balance (annual)	%GDP	-6.8	-8.0	-8.5	-9.0	-8.5	...
Merchandise terms of trade	apc	3.3	-2.2	-6.4	-4.2	-6.2	...
CPI inflation	qpc	1.8	1.7	2.2	1.4	1.2	1.1
	apc	6.9	7.3	7.2	7.2	6.7	6.0
Employment (HLFS) (1)	qpc	-0.1	-0.1	1.2	0.7	1.1	1.0
Unemployment rate (1)	%	3.2	3.3	3.3	3.4	3.4	3.6
Participation rate (1)	%	70.9	71.0	71.6	71.8	72.0	72.4
LCI salary & wage rates - total (2)	apc	3.0	3.4	3.7	4.1	4.3	4.3
QES average hourly earnings - total (2)	apc	4.8	6.4	7.4	7.2	7.6	6.9
Core retail sales volume	apc	3.2	-1.8	5.0	-3.6	-4.0	...
Total retail sales volume	apc	2.3	-3.7	4.9	-4.0	-4.1	...
WMM - consumer confidence (3)	Index	92.1	78.7	87.6	...	...	...
QSBO - general business situation (1,4)	net%	-36.1	-61.9	-42.7	-75.2	-63.2	-59.2
QSBO - own activity outlook (1,4)	net%	5.9	-13.8	-16.3	-33.6	-8.0	-16.7

Monthly Indicators		Feb 23	Mar 23	Apr 23	May 23	Jun 23	Jul 23
Merchandise trade balance (12 month)	NZ\$m	-15,769.4	-16,778.4	-17,026.1	-17,122.1	-15,980.4	...
Dwelling consents - residential	apc	-29.2	-25.1	-25.8	-17.7	-15.7	...
House sales - dwellings	apc	-28.2	-12.7	-11.8	2.2	18.2	1.6
REINZ - house price index	apc	-14.2	-12.9	-12.0	-11.0	-8.8	-6.9
Estimated net migration (12 month total)	people	49,432.0	64,519.0	73,454.0	81,706.0	86,773.0	...
ANZ NZ commodity price index	apc	-11.7	-9.8	-10.3	-10.3	-11.0	-13.8
ANZ world commodity price index	apc	-15.3	-17.4	-17.3	-13.2	-14.3	-14.7
ANZBO - business confidence	net%	-43.3	-43.4	-43.8	-31.1	-18.0	-13.1
ANZBO - activity outlook	net%	-9.2	-8.5	-7.6	-4.5	2.7	0.8
ANZ-Roy Morgan - consumer confidence	net%	79.8	77.7	79.3	79.2	85.5	83.7
NZAC	apc	...	...	...	...	...	...

Daily Indicators		Fri	Mon	Tue	Wed	Thu	Fri
		11/8/23	14/8/23	15/8/23	16/8/23	17/8/23	18/8/23
NZ exchange and interest rates (5)							
NZD/USD	\$	0.6015	0.5963	0.5977	0.5956	0.5915	...
NZD/AUD	\$	0.9221	0.9216	0.9216	0.9244	0.9268	...
Trade weighted index (TWI)	index	70.11	69.79	70.03	69.95	69.69	...
Official cash rate (OCR)	%	5.50	5.50	5.50	5.50	5.50	...
90 day bank bill rate	%	5.64	5.64	5.65	5.64	5.64	...
10 year govt bond rate	%	4.83	4.88	4.94	4.95	4.98	...
Share markets (6)							
Dow Jones	index	35,281	35,308	34,946	34,766	34,475	...
S&P 500	index	4,464	4,490	4,438	4,404	4,370	...
VIX volatility index	index	14.8	14.8	16.5	16.8	17.9	...
AU all ords	index	7,554	7,493	7,520	7,412	7,364	...
NZX 50	index	11,837	11,826	11,821	11,763	11,652	...
US interest rates							
3 month OIS	%	5.33	5.33	5.33	5.33	...	...
3 month Libor	%	5.63	5.63	5.64	5.64	...	...
10 year govt bond rate	%	4.16	4.19	4.21	4.28	4.30	...
Commodity prices (6)							
WTI oil	US\$/barrel	83.17	82.50	81.06	79.38	...	...
Gold	US\$/ounce	1,915.80	1,903.75	1,903.85	1,904.20	...	...
CRB Futures	index	554.67	552.23	550.24	550.05	...	...

(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		Jan 23	Feb 23	Mar 23	2023Q1	Apr 23	May 23	Jun 23	2023Q2	Jul 23	Aug 23
United States	GDP (1)	qpc				0.5				0.6		
	Industrial production (1)	mpc	1.0	0.0	0.1		0.5	-0.4	-0.8		1.0	...
	CPI	apc	6.4	6.0	5.0		4.9	4.0	3.0		3.2	...
	Unemployment rate (1)	%	3.4	3.6	3.5		3.4	3.7	3.6		3.5	...
	Employment change (1)	000s	472.0	248.0	217.0		217.0	281.0	185.0		187.0	...
	Retail sales value	apc	7.4	5.3	2.2		1.3	2.1	1.6		3.2	...
	House prices (2)	apc	2.6	0.4	-1.1		-1.7	-1.7	...		...	...
	PMI manufacturing (1)	index	47.4	47.7	46.3		47.1	46.9	46.0		46.4	...
Consumer confidence (1)(3)	index	106.0	103.4	104.0		103.7	102.5	110.1		117.0	...	
Japan	GDP (1)	qpc				0.9				1.5		
	Industrial production (1)	mpc	-3.9	3.7	0.3		0.7	-2.2	2.4		...	...
	CPI	apc	4.4	3.3	3.2		3.4	3.2	3.2		...	...
	Unemployment rate (1)	%	2.4	2.6	2.8		2.6	2.6	2.5		...	...
	Retail sales value	apc	5.0	7.3	6.9		5.1	5.8	5.6		...	...
	PMI manufacturing (1)	index	48.9	47.7	49.2		49.5	50.6	49.8		49.6	...
	Consumer confidence (1)(4)	index	31.0	30.9	34.0		35.0	36.2	36.8		37.1	...
Euro area	GDP (1)	qpc				0.0				0.3		
	Industrial production (1)	mpc	0.5	1.8	-4.4		1.2	0.0	0.5		...	...
	CPI	apc	8.7	8.5	6.9		7.0	6.1	5.5		...	...
	Unemployment rate (1)	%	6.7	6.6	6.5		6.4	6.4	6.4		...	...
	Retail sales volume	apc	-1.8	-2.4	-3.3		-2.8	-2.4	-1.4		...	...
	PMI manufacturing (1)	index	48.8	48.5	47.3		45.8	44.8	43.4		42.7	...
	Consumer confidence (5)	index	-20.6	-19.0	-19.1		-17.5	-17.3	-16.1		-15.1	...
United Kingdom	GDP (1)	qpc				0.1				0.2		
	Industrial production (1)	mpc	-0.2	-0.1	0.8		0.1	-0.7	1.8		...	...
	CPI	apc	8.8	9.2	8.9		7.8	7.9	7.3		6.4	...
	Unemployment rate (1)	%	3.7	3.8	3.9		3.8	4.0	4.2		...	...
	Retail sales volume	apc	-5.1	-3.7	-4.5		-3.4	-2.3	-1.0		...	...
	House prices (6)	apc	1.1	-1.1	-3.1		-2.7	-3.4	-3.5		-3.8	...
	PMI manufacturing (1)	index	47.0	49.3	47.9		47.8	47.1	46.5		45.3	...
	Consumer confidence (1)(5)	net %	-45.0	-38.0	-36.0		-30.0	-27.0	-24.0		-30.0	...
Australia	GDP (1)	qpc				0.2				...		
	CPI	apc				7.0				6.0		
	Unemployment rate (1)	%	3.7	3.6	3.5		3.7	3.6	3.5		3.7	...
	Retail sales value	apc	7.7	6.5	5.6		3.3	4.3	3.0		...	...
	House Prices (7)	apc				...					...	...
	PMI manufacturing (1)	index	-17.1	-6.4	5.6		-20.2	-5.1	-19.8		-25.6	...
	Consumer confidence (8)	index	84.3	78.5	78.5		85.8	79.0	79.2		81.3	81.0
China	GDP	apc				4.5				6.3		
	Industrial production	apc	2.4	2.4	3.9		5.6	3.5	4.4		3.7	...
	CPI	apc	2.1	1.0	0.7		0.1	0.2	0.0		-0.3	...
	PMI manufacturing (1)	index	50.1	52.6	51.9		49.2	48.8	49.0		49.3	...
South Korea	GDP (1)	qpc				0.3				0.6		
	Industrial production (1)	mpc	1.9	-2.7	4.7		-0.7	3.0	-1.0		...	...
	CPI	apc	5.2	4.8	4.2		3.7	3.3	2.7		2.3	...

(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