

Fortnightly Economic Update

3 November 2023

- **Unemployment rate increases as economic activity slows down**
- **Construction set to weaken but general business sentiment improves**
- **Global outlook remains subdued as inflation eases amidst heightened geopolitical risk**

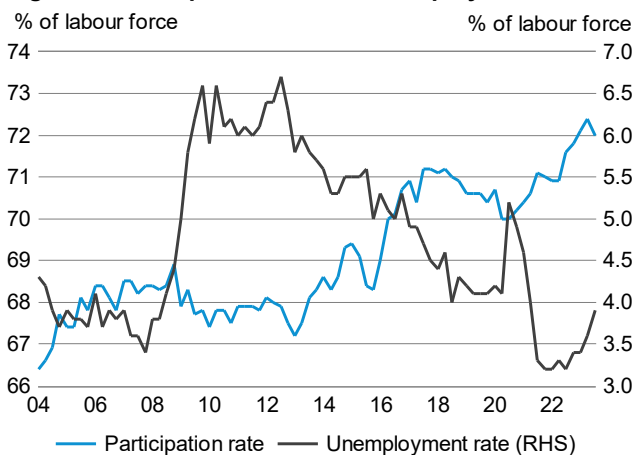
Domestic indicators confirmed an economic slowdown is currently underway with consumer sentiment low but business confidence slowly improving. Lower domestic demand is impacting imports leading to a smaller merchandise trade deficit but global uncertainty could hinder the rate of further improvements.

Events in the Middle East are creating uncertainty about the global outlook, including risks of higher energy prices. Global growth has been subdued over the course of 2023 and is expected to slow further, although September quarter growth in the US and China has exceeded expectations. Global inflation has eased, but inflation remains elevated in many countries. Restrictive monetary policy settings are in place in most advanced economies, and there has been an increase in financial market conviction that interest rates will be held high for longer.

Labour market eases further

The unemployment rate increased to 3.9% in the September 2023 quarter from 3.6% in the June quarter following several years of competitive labour market conditions in which businesses reported chronic shortages. The participation rate also came off its 37-year high falling from 72.4% to 72.0% and after four consecutive quarters of increases (Figure 1). This likely reflects a cyclical response to a slowing economy as economic imbalances are gradually unwinding.

Figure 1: Participation rate and unemployment rate



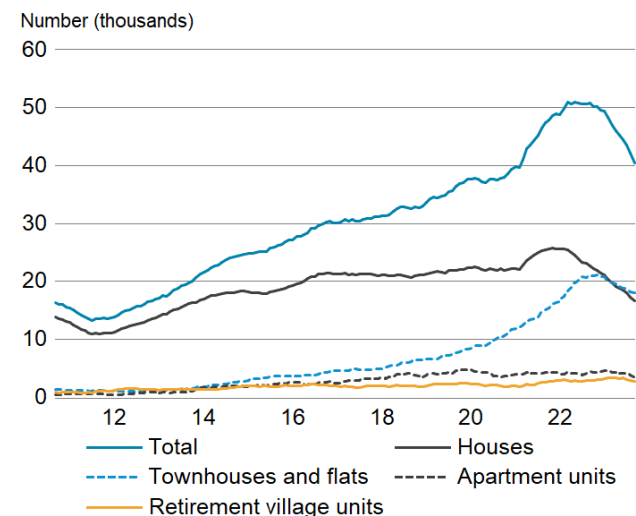
Source: Stats NZ

The employment rate fell to 69.1% from a series high (since 1986) of 69.8% in the June quarter. This was due to a decrease in the number of employed people and an increase in the working age population (0.7%) in the quarter. However, the expansion in the working age population this quarter was not matched with a corresponding increase in the labour force, with an additional 29,000 people being classified as “not in the labour force” consisting mainly of people aged 15-19 years and females. Together with an increase in the underutilisation rate, the labour market is experiencing spare capacity as growing labour supply interacts with waning demand.

Residential construction activity set to slow as consents for new dwellings continue to fall

Consents for new residential dwellings fell 4.7% in September compared with August, and by 10.7% in the September quarter. On an annual basis, consents for new dwelling units are around 2021 levels, with 40,408 new dwellings consented in the September year, down 21% from the 51,000 peak reached for the 12 months to May 2022 (Figure 2).

Figure 2: Residential consents for new dwelling units (12-month moving sum)



Source: Stats NZ

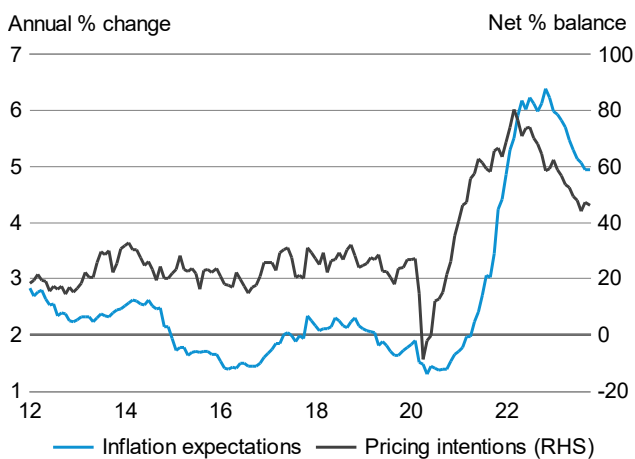
A breakdown by dwelling type reveals annual consents for new stand-alone houses (16,600) are at its lowest number since 2013, but the number of new townhouses and flats consented – which now exceed standalone house consents – are around February 2022 levels, and consents for new apartment units are at 2018 levels. The Reserve Bank’s Financial Stability Report states the drop in consents has been explained in part due to very low pre-sales for residential development units, suggesting there are more existing properties available as house prices are increasing. This is consistent with September quarter property transfer data released by Stats NZ which reveals a further increase in the proportion of property buyers on resident visas from 13.8% in the June quarter to 14.3%. This rate has increased steadily from 10.1% in September 2021, having hovered around 8% between the December 2016 (when the series began) and March 2020 quarters.

Business confidence bounces back

The ANZ Business Outlook saw business confidence jump in October to a net 23.4% of respondents expecting an improvement in general business conditions over the coming year. This was up from a net 1.5% in September which had been the first positive reading in over two years.

Inflation indicators were little changed, including firms’ average estimate of where their own selling prices will be in three months’ time (still just over 2%) and expected costs in three months’ time (just under 4%). Over a longer horizon, inflation expectations for the year ahead are stuck at around 5% (Figure 3).

Figure 3: ANZ Business Outlook Inflation indicators



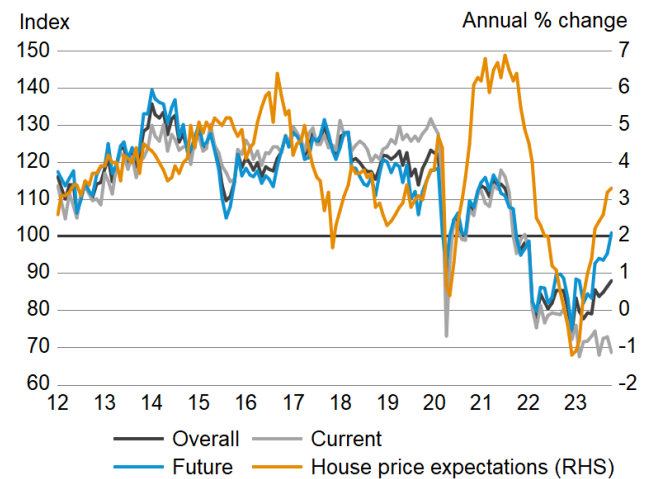
Source: Haver

Consumers optimistic as house prices increase

The ANZ-Roy Morgan consumer confidence index rose 1.7 points to 88.1 driven by a 5.6 point increase in the future conditions subcomponent, which was only partly offset by a 4.2% decline in the current conditions subcomponent. Consumers’ optimism about the future seems to coincide with the stabilisation in house prices earlier this year which is when a divergence between the current and future indexes began occurring (Figure 4). The increase in house prices may have led to an improvement in the net balance of households reporting an expectation of improving family

finances to sit at levels of mid-2021 prior to the rise in interest rates. However, consumers are still pessimistic about current conditions with the three lowest points in the series history (since 2004) of the current conditions index all occurring in 2023. Consumers’ pessimism about their current situation is reflected in a deterioration of their assessment of their current finances, and in their assessment whether now is a good time to purchase a large item. The latter component is at its third lowest point in the series 19-year history having sustained a downward trend since late 2021.

Figure 4: ANZ-Roy Morgan Consumer Confidence



Source: Haver

Merchandise trade deficit continues to narrow slowly

The annual merchandise trade balance narrowed slightly in September to \$15.3 billion from \$15.5 billion in August, an improvement from the historic peak of \$17.1 billion in May. The improvement in the trade deficit is due to downward pressure on import values as domestic demand slows down. While seasonally adjusted imports rose 1.5% in September compared with August, when petroleum products are excluded, imports fell 0.7%. In the September quarter, imports fell 3.4% but the decline was partially offset by higher imports of passenger cars and transport equipment. Meanwhile weak demand from China continues to weigh on export values, which fell 1.7% in the month, and fell by 7.8% in the September quarter. The declines in dairy and meat values reflect lower prices for these commodities in recent months, while a fall in fruit export values was driven by a 30% drop in seasonally adjusted export volumes resulting from the impact of severe weather events this year on apple and kiwifruit harvests. Going forward, the main risks to an improvement in the merchandise trade balance is higher oil prices and weaker global demand for New Zealand exports.

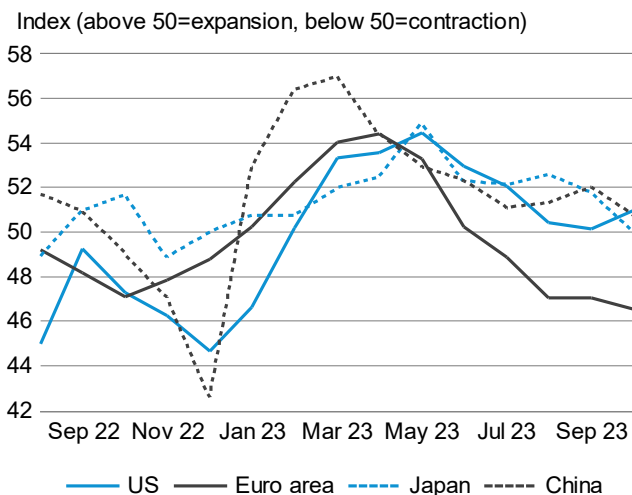
Geopolitical risks continue to add to uncertainty...

The Israel-Gaza crisis continues to create uncertainty about the outlook and could have broader spillovers for markets and economies if it escalates further. In oil markets, fears of supply disruption have eased, and prices have retreated from last month's peaks to be a little above average levels for the year to date (Figure 6).

...as global growth outlook remains subdued...

The US and China have supported global growth in the September quarter, but growth is expected to slow this quarter. The latest round of advanced economy business conditions surveys showed further weakness, signalling that growth has stalled. In the US, October's composite purchasing managers indexes (PMI) showed sentiment improved, with both manufacturing and services picking up, but sentiment fell in Japan from a relatively high level and sank further into contractionary territory in the euro area (Figure 5). Aggregated across advanced economies, JP Morgan's composite PMI declined further into contractionary territory (below 50) down 0.3%-points to 49.4.

Figure 5: Global PMIs



Source: Haver

In China, the official PMIs showed renewed manufacturing weakness as export orders slowed and softer services activity as the property sector continued to weigh on confidence. Elsewhere in Asia, manufacturing PMIs showed continued expansion in the more domestically focused economies of India and Indonesia, although the pace of expansion has been trending down. In contrast, the export oriented economies of Taiwan and Korea showed continued weakness in manufacturing, although conditions appear to have stabilised.

Reflecting the subdued export environment, global trade volumes have fallen nearly 4% this year – the weakest since 2009, excluding the early pandemic disruption.

US economy grew strongly...

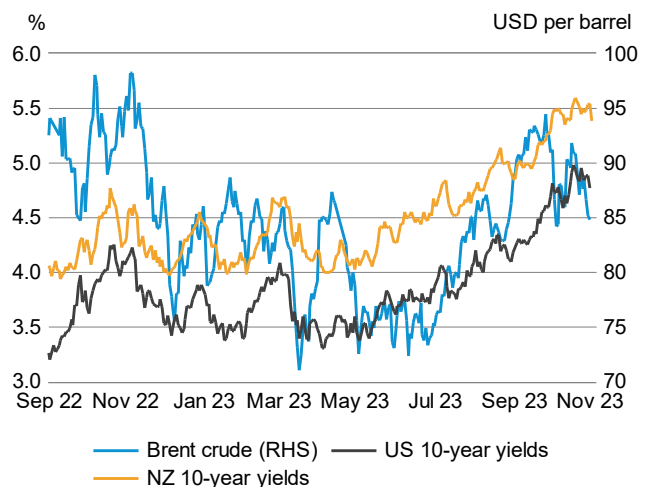
The US economy grew more quickly than analysts expected in the September quarter, as GDP rose at an annual rate of 4.9% (1.2% at a quarterly rate) up from 2.1% in the June quarter. Higher consumer spending was the main driver of September's rise. Activity is expected to slow in the current quarter, but there have been few signs that the slowdown will be abrupt, especially with the labour market remaining buoyant and continuing to provide support for household income and spending.

Inflation continued its descent in September, with the Federal Reserve's preferred measure of underlying inflation, the core PCE deflator, slowing to 3.7%. However, the monthly pace picked up to 0.3%, suggesting that further progress on disinflation may be more gradual.

Following the GDP and inflation reports, the US Federal Reserve held its policy interest rate steady at 5.25%-5.50% for the second time in a row as it continues to assess the evidence that rates are high enough to return inflation to target. Equity markets responded positively as investors grew more confident that there would be no more rate rises.

In bond markets, the run of positive activity and labour market surprises has led investors to expect that the Fed will need to keep interest rates high for longer. Markets have been volatile as they adjust to the changed expectations, with US 10-year treasury yields hitting multi-year highs above 5% in late October before ending the month around 4.85% (Figure 6). Interest rates on New Zealand's 10-year government bonds have followed the US move higher, ending the month at 5.5%, about 25 basis points higher than a month ago. The US dollar continued to strengthen against most other currencies, supported by the move higher in treasury yields and geopolitical uncertainty. The stronger USD saw the NZ trade weighted index fall to 69.0 in late October, its lowest level in a year, before recovering to around 70.0 this week.

Figure 6: Crude oil and 10-year bond rates



Source: Haver

...but euro area growth was weak

Preliminary estimates showed euro area GDP fell 0.1% in the September quarter to be just 0.1% higher than the same quarter a year ago. Compared to the June quarter, all four major economies experienced slower growth, although only Germany recorded a contraction, with GDP down 0.1%. Elsewhere, GDP rose 0.1% in France, 0.3% in Spain and was flat in Italy.

The weakness in output was reflected in lower inflation, which dropped sharply to 2.9% in October. Energy prices played a large role in the decline, core inflation eased more moderately to 4.2%.

Earlier in the month, the European Central Bank left its policy interest rates unchanged but stressed that until inflation falls further it was too early to rule out further hikes. However, the prospect of further hikes faded following October's inflation and activity data. The Bank of England held its policy rate steady at 5.25%.

More policy support in China

The government announced a CNY1 trillion (US\$137bn) of additional spending for disaster-related rebuilding and resilience, around 0.8% of GDP. This funding is unlikely to have much immediate impact but will add to activity in 2024 and could lift expectations of growth in 2024 from 4.5% to around 5.0%.

While the stimulus measures are potentially positive for New Zealand's commodity exports, there are ongoing risks from China's property sector. These concerns are weighing on Chinese equities, and this week the CSI 300 index dropped to its lowest level since 2019.

Further measures to stabilise the economy were announced at the 5-yearly central financial work conference, chaired by President Xi Jinping. The conference resolved to strengthen financial regulation, reduce financial risks and support high quality financial development. The meeting also agreed to keep reducing financing costs, which analysts saw as flowing through to further monetary policy easing over the year ahead.

Firmer inflation expected in Japan

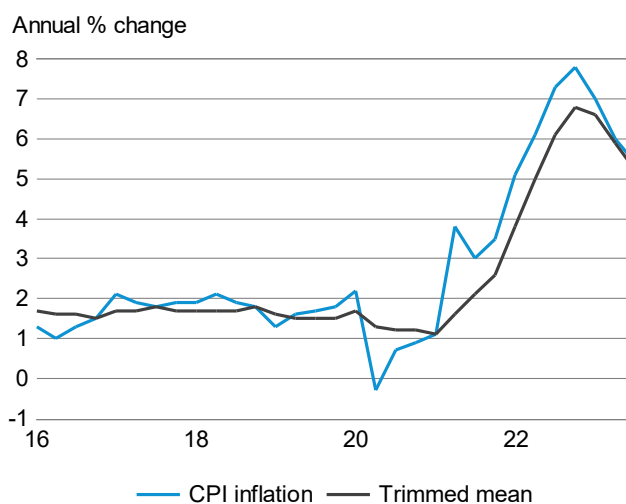
The Bank of Japan (BoJ) left its monetary policy rate unchanged but introduced some further flexibility into its yield curve control operations. The BoJ raised its year-on-year GDP forecasts for 2023/24 to 2.0% from 1.3% previously, reflecting recent strength in net exports. The outlook for CPI inflation was also revised higher, with inflation of around 2.8% forecast for March 2024 and 2025, before slowing to around 1.7% in March 2026. Earlier, Japan's Prime Minister announced proposals for a tax cut and one-off cash distribution to all citizens by the middle of 2024 to address weakness in household income growth

and spending. Some analysts viewed the impact of the package as modest with limited pass through to spending.

Inflation eases gradually in Australia

September quarter CPI data were firmer than markets had expected, leading to heightened expectations that the central bank will tighten policy when its board meets on 7 November. Headline inflation rose 1.2% in the September quarter, taking the annual rate to 5.4% from 6.0% in the previous quarter (Figure 7). Core inflation firmed on a quarterly basis, with the trimmed mean rising 1.2% from 1.0% in June, but the annual rate slowed to 5.2%.

Figure 7: Australia CPI inflation



Source: Haver

Following its annual economic assessment, the IMF warned that the gradual pace of decline in Australia's inflation rate could lead to an increase in inflation expectations and add to the challenges of returning inflation to target. The IMF also warned that the pace of public infrastructure investment was adding to inflation pressure and should be slowed, and recommended further monetary policy tightening to address the inflation risks. Financial markets are pricing a 65% chance of a 25 basis point increase in the policy rate to 4.35% at the November meeting.

Coming up:

Date	Release
8 Nov	GlobalDairyTrade auction; RBNZ inflation expectations survey (Q4)
10 Nov	BusinessNZ manufacturing PMI (Oct)
12 Nov	BusinessNZ services PMI (Oct)
14 Nov	Stats NZ Food, Rental price indexes (Oct)
15 Nov	Stats NZ Electronic Card Transactions (Oct)

Tables

Quarterly Indicators		2022Q2	2022Q3	2022Q4	2023Q1	2023Q2	2023Q3
Real Production GDP (1)	qpc	1.3	1.5	-0.5	-0.0	0.9	...
	aapc	1.2	2.9	2.7	2.9	3.2	...
Current account balance (annual)	%GDP	-7.9	-8.3	-8.8	-8.2	-7.5	...
Merchandise terms of trade	apc	-2.2	-6.4	-4.2	-6.2	-3.6	...
CPI inflation	qpc	1.7	2.2	1.4	1.2	1.1	1.8
	apc	7.3	7.2	7.2	6.7	6.0	5.6
Employment (HLFS) (1)	qpc	-0.2	1.4	0.6	1.0	1.0	-0.2
Unemployment rate (1)	%	3.3	3.2	3.4	3.4	3.6	3.9
Participation rate (1)	%	70.9	71.6	71.8	72.1	72.4	72.0
LCI salary & wage rates - total (2)	apc	3.4	3.7	4.1	4.3	4.3	4.2
QES average hourly earnings - total (2)	apc	6.4	7.4	7.2	7.6	6.9	6.7
Core retail sales volume	apc	-1.8	5.0	-3.6	-4.0	-5.1	...
Total retail sales volume	apc	-3.7	4.9	-4.0	-4.1	-3.5	...
WMM - consumer confidence (3)	Index	78.7	87.6	...	...	...	...
QSBO - general business situation (1,4)	net%	-62.9	-41.9	-74.8	-63.4	-60.3	-52.7
QSBO - own activity outlook (1,4)	net%	-13.8	-16.7	-33.5	-7.7	-16.6	-14.2

Monthly Indicators		May 23	Jun 23	Jul 23	Aug 23	Sep 23	Oct 23
Merchandise trade balance (12 month)	NZ\$m	-17,133.7	-16115.6	-15884.4	-15523.6	-15333.2	...
Dwelling consents - residential	apc	-17.7	-15.7	-25.4	-30.3	-37.0	...
House sales - dwellings	apc	2.2	19.2	5.0	11.6	5.1	...
REINZ - house price index	apc	-11.0	-8.8	-6.8	-4.6	-3.3	...
Estimated net migration (12 month total)	people	87,482.0	97380.0	103288.0	110245.0	...	...
ANZ NZ commodity price index	apc	-10.3	-11.0	-13.8	-9.2	-11.1	...
ANZ world commodity price index	apc	-13.2	-14.3	-14.7	-14.3	-12.6	...
ANZBO - business confidence	net%	-31.1	-18.0	-13.1	-3.7	1.5	23.4
ANZBO - activity outlook	net%	-4.5	2.7	0.8	11.2	10.9	23.1
ANZ-Roy Morgan - consumer confidence	net%	79.2	85.5	83.7	85.0	86.4	88.1
NZAC	apc	...	...	...	...	...	...

Daily Indicators		Fri 27/10/23	Mon 30/10/23	Tue 31/10/23	Wed 1/11/23	Thu 2/11/23	Fri 3/11/23
NZ exchange and interest rates (5)							
NZD/USD	\$	0.5825	0.5817	0.5838	0.5800	0.5891	...
NZD/AUD	\$	0.9194	0.9169	0.9166	0.9166	0.9159	...
Trade weighted index (TWI)	index	69.41	69.27	69.38	69.14	69.93	...
Official cash rate (OCR)	%	5.50	5.50	5.50	5.50	5.50	...
90 day bank bill rate	%	5.64	5.64	5.64	5.64	5.64	...
10 year govt bond rate	%	5.46	5.48	5.53	5.54	5.38	...
Share markets (6)							
Dow Jones	index	32,418	32929	33053	33275	33839	...
S&P 500	index	4,117	4167	4194	4238	4318	...
VIX volatility index	index	21.3	19.8	18.1	16.9	15.7	...
AU all ords	index	7,014	6960	6967	7025	7095	...
NZX 50	index	10,767	10742	10758	10851	11044	...
US interest rates							
3 month OIS	%	5.33	5.33	5.33	5.33	...	...
3 month Libor	%	5.64	5.64	5.64	5.65	...	...
10 year govt bond rate	%	4.84	4.88	4.88	4.77	4.67	...
Commodity prices (6)							
WTI oil	US\$/barrel	86.04	83.03	81.64	80.44	...	...
Gold	US\$/ounce	1,982.90	1997.60	1996.90	1986.35	...	...
CRB Futures	index	541.23	541.34	539.51	537.31	...	...

(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		2023Q1	Apr 23	May 23	Jun 23	2023Q2	Jul 23	Aug 23	Sep 23	2023Q3	Oct 23
United States	GDP (1)	qpc	0.6				0.5				1.2	
	Industrial production (1)	mpc		0.5	-0.3	-0.5		1.0	0.0	0.3		...
	CPI	apc		4.9	4.0	3.0		3.2	3.7	3.7		...
	Unemployment rate (1)	%		3.4	3.7	3.6		3.5	3.8	3.8		...
	Employment change (1)	000s		217.0	281.0	105.0		236.0	227.0	336.0		...
	Retail sales value	apc		1.3	2.1	1.5		2.8	2.9	3.8		...
	House prices (2)	apc		-1.6	-1.7	-1.2		0.2	2.2	...		...
	PMI manufacturing (1)	index		47.1	46.9	46.0		46.4	47.6	49.0		46.7
Consumer confidence (1)(3)	index		103.7	102.5	110.1		114.0	108.7	104.3		102.6	
Japan	GDP (1)	qpc	0.8				1.2				...	
	Industrial production (1)	mpc		0.7	-2.2	2.4		-1.8	-0.7	0.2		...
	CPI	apc		3.4	3.2	3.2		3.2	3.1	3.0		...
	Unemployment rate (1)	%		2.6	2.6	2.5		2.7	2.7	2.6		...
	Retail sales value	apc		5.1	5.8	5.6		6.9	7.0	5.8		...
	PMI manufacturing (1)	index		49.5	50.6	49.8		49.6	49.6	48.5		48.7
	Consumer confidence (1)(4)	index		35.0	36.2	36.8		37.1	36.1	35.6		35.9
Euro area	GDP (1)	qpc	0.0				0.2				-0.1	
	Industrial production (1)	mpc		1.2	0.0	0.1		-1.3	0.6	...		...
	CPI	apc		7.0	6.1	5.5		5.3	5.2	4.3		...
	Unemployment rate (1)	%		6.5	6.5	6.4		6.5	6.4	...		...
	Retail sales volume	apc		-2.8	-2.1	-0.8		-1.0	-2.1	...		...
	PMI manufacturing (1)	index		45.8	44.8	43.4		42.7	43.5	43.4		43.1
	Consumer confidence (5)	index		-17.5	-17.4	-16.1		-15.1	-16.0	-17.8		-17.9
United Kingdom	GDP (1)	qpc	0.3				0.2				...	
	Industrial production (1)	mpc		0.2	-0.5	2.5		-1.1	-0.7	...		...
	CPI	apc		7.8	7.9	7.3		6.4	6.3	6.3		...
	Unemployment rate (1)	%		3.8	4.0	4.2		4.3	...	...		...
	Retail sales volume	apc		-3.7	-2.7	-1.8		-3.3	-1.3	-0.9		...
	House prices (6)	apc		-2.7	-3.4	-3.5		-3.8	-5.3	-5.3		-3.3
	PMI manufacturing (1)	index		47.8	47.1	46.5		45.3	43.0	44.3		44.8
	Consumer confidence (1)(5)	net %		-30.0	-27.0	-24.0		-30.0	-25.0	-21.0		-30.0
Australia	GDP (1)	qpc	0.4				0.4				...	
	CPI	apc	7.0				6.0				5.4	
	Unemployment rate (1)	%		3.7	3.6	3.5		3.7	3.7	3.6		...
	Retail sales value	apc		3.3	4.3	3.0		1.4	2.0	2.1		...
	House Prices (7)	apc	...				...					...
	PMI manufacturing (1)	index		-20.2	-5.1	-19.8		-25.6	-19.8	-12.8		-20.9
	Consumer confidence (8)	index		85.8	79.0	79.2		81.3	81.0	79.7		82.0
China	GDP	apc	4.5				6.3				4.9	
	Industrial production	apc		5.6	3.5	4.4		3.7	4.5	4.5		...
	CPI	apc		0.1	0.2	0.0		-0.3	0.1	0.0		...
	PMI manufacturing (1)	index		49.2	48.8	49.0		49.3	49.7	50.2		49.5
South Korea	GDP (1)	qpc	0.3				0.6				0.6	
	Industrial production (1)	mpc		-0.7	3.1	-1.6		-2.0	5.2	1.8		...
	CPI	apc		3.7	3.3	2.7		2.3	3.4	3.7		3.8

(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