Fortnightly Economic Update

28 March 2024

TE TAI ŌHANGA
THE TREASURY

- **GDP data confirmed a shallow recession in the second half of 2023**
- **Activity is expected to remain subdued this year**
- **Global central banks expect to ease policy in mid-2024**

The shocks of the past few years and the unprecedented policy responses have resulted in dramatic shifts in household and business behaviour. Inflation rose to multi-decade highs in 2022/23 and monetary policy tightened sharply to contain it. The impact of tighter monetary policy is apparent in weak GDP growth but, while inflation has eased, core inflation remains high. To ensure inflation returns to the 1-3% inflation target, monetary policy is expected to remain restrictive, although financial markets expect there will be scope for some easing later this year.

Global central banks, most notably the US Federal Reserve, confirmed that they are on track to ease policy by the middle of the year, despite recent firming in inflation. The latest round of activity indicators confirmed a gradual recovery in Europe, but the outlook for China was clouded by mixed activity data.

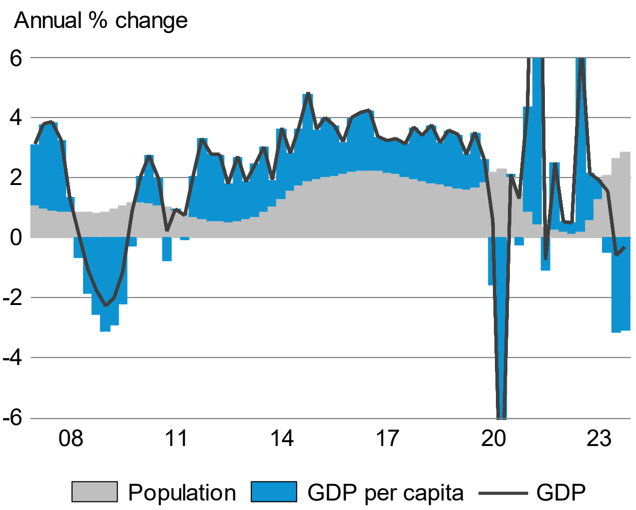
Economic activity weakened in 2023…

Real GDP fell 0.1% in the December quarter, as high interest rates delivered the pull back in demand that is needed to reduce inflation. With the economy also shrinking in the September quarter, the latest outturn confirmed the economy experienced a shallow recession over the second half of 2023. This followed a slightly deeper recession over late 2022/early 2023. As a result, GDP was 0.3% lower than a year ago, and growth in the calendar year slowed to 0.6% from 2.4% last year.

Population growth is supporting headline GDP and contributing to momentum in some parts of the economy, especially in the services sector including rental and real estate markets. With wages also growing strongly, inflation in the services sector is proving to be sticky.

Stripping away the effects of population growth, which reached 2.8% in December on an annual basis, shows that real GDP per person was 3.1% lower than a year ago, a sharper fall than seen in the 2008/09 recession (Figure 1).

Figure 1: Composition of real GDP growth



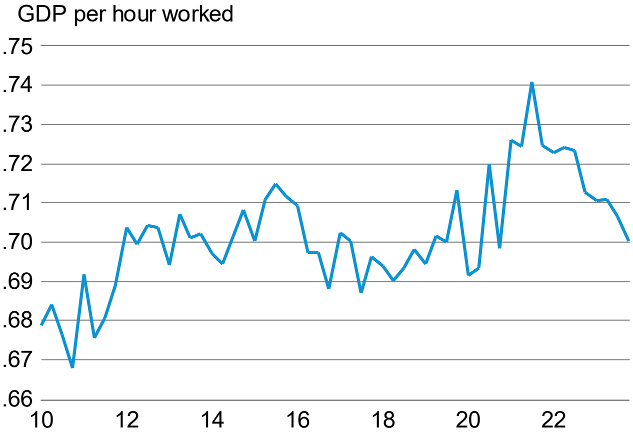
Source: Stats NZ

Population growth is also contributing to increased labour supply, and with output shrinking, labour productivity, or output per hour worked, has also fallen sharply. Hours worked increased 1.5% over the past year, while GDP declined 0.3%, leaving labour productivity 1.8% lower than a year ago (Figure 2).

With little immediate prospect of a turnaround in productivity, and wage growth remaining elevated, the risk is that firms will be under greater pressure to raise prices and cut costs. This could keep inflation high and lead to fewer hours worked and fewer jobs.

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

Figure 2: Labour productivity



Source: Stats NZ, the Treasury

…and is expected to remain subdued in 2024

Although the fall in GDP met our expectations in the scenario accompanying the *Budget Policy Statement* (BPS), the composition of the fall, combined with subdued business and consumer sentiment, increases the risk that growth in 2024 will be lower than in this scenario (Table 1). Spending most sensitive to higher interest rates, including investment and household purchases of discretionary items such as furniture, home appliances and hospitality are likely to be weaker than expected in the BPS.

Table 1: Expenditure on GDP

	Quarterly % change	%age pt contribution	Annual avg % change
Private consumption	0.5	0.3	0.3
Public consumption	0.2	0.0	-1.1
Residential investment	-1.7	-0.1	-4.3
Other fixed assets	0.6	0.1	0.5
Exports of goods and services	3.2	0.8	10.0
Imports of goods and services	-2.9	0.9	-0.3
Change in inventories & bal item	-	-2.0	-
Real GDP (expenditure)	**0.0**	**0.0**	**0.6**

Source: Stats NZ

In terms of investment spending, the 27% decline in dwelling consents in the 12-months ended January suggests further weakness in residential investment is likely this year. Meanwhile, business investment fell 1.9% from the same quarter a year ago, led by a 12.6% decline in spending on capital equipment. With consumer spending expected to remain weak and global growth also subdued, business investment will also likely remain soft. Spending on non-residential building and infrastructure has been providing a partial offset, increasing 6.1% from a year ago.

Overall, the continued decline in labour productivity, combined with weaker momentum in interest sensitive spending areas suggests domestically orientated growth could be weaker over the year ahead compared to the *Budget Policy Statement* (BPS). In addition, the decline in productivity raises the risk that inflation could be slower to fall than forecast.

In contrast to the weakness in domestic demand, exports supported growth rising 3.2% in the quarter, despite a decline in services exports, as growth in inbound tourism stalled. Imports fell sharply, down 2.9%, reflecting weakness in demand for consumer goods and capital equipment. Imports of passenger cars also fell, likely in anticipation of the end of the government scheme providing rebates on electric vehicles. The decline in vehicle imports also likely contributed to the large fall in inventories.

On the nominal side, GDP fell 0.6% in the quarter, led by a near 5% decline in the terms of trade. Export prices fell 2.8%, reflecting weak dairy prices, while import prices rose 2.2%, led by higher oil prices. With commodity export prices rising this year, we expect the terms of trade to improve in the March quarter.

Financial market pricing for future overnight interest rates firmed slightly following the GDP outturn, which was slightly below market expectations of a flat result. Markets are now fully priced for a 25 basis point (bps) cut to the official cash rate in August.

The current account deficit narrowed

In the nation's external accounts, the weakness in domestic demand is flowing through to a lower current account deficit. The annual deficit was 6.9% of GDP in the December quarter, down from 7.4% in September. Growth in services exports was the main driver of the smaller deficit, increasing by $9 billion over the past 12 months. The goods deficit also contributed, narrowing by $1.0 billion over the year as imports fell. A larger investment income deficit, up $0.4 billion, provided a partial offset.

These trends are expected to continue and to reduce the current account deficit to around 5.5% of GDP by the end of the year. Indeed, February's merchandise trade data showed growth in exports had driven the annual trade deficit to $12.0 billion from $13.6 billion in December.

The cumulative impact of past deficits is only partially reflected in higher net external liabilities, with Stats NZ advising that financial liabilities are being under-reported. At the end of 2023 net external liabilities were 51.7% of GDP, only slightly higher than a year earlier. Net government debt drove the increase, up $18 billion over the past year to $53.4 billion.

Global central banks on track to ease mid-year

At central bank meetings in Australia, the US, the UK and Japan over the past two weeks, officials expressed greater confidence that inflation was moving towards their targets and that they were getting closer to adjusting policy settings to more neutral settings. Officials were also more confident that their inflation targets could be achieved without a further slowdown in growth, particularly in the US. Investors responded by increasing their exposure to equities, sending markets to fresh highs in the US, Europe and Japan.

In the US, the Federal Reserve left interest rates unchanged at a 23-year high of 5.25%-5.5%. New quarterly projections showed officials still intend to cut rates 75 basis points (bps) this year, most likely beginning in June, despite higher inflation, stronger growth and lower unemployment. However, expected cuts in 2025 were pared back to 75bps from 100bps. Officials now expect GDP growth of 2.1% in 2024, up from 1.4%, and 2.0% over the following two years, with both years also higher than previously. The Fed's target measure of core inflation in the December 2024 quarter was projected to be 2.6%, two-tenths higher than previously, slowing to 2.2% and 2.0% in the following years, unchanged from earlier. Unemployment was expected to be around 4% over the three-year projection period, a little lower than earlier.

Meanwhile, the Baltimore shipping accident has closed one of the US's busiest ports, disrupting supply chains along the east coast. Potentially, this could slow the decline in shipping costs post Red Sea disruption.

The Bank of Japan (BoJ) raised its policy rate for the first time since 2007 and brought an end to its negative interest rate policy that began in 2016. The BoJ said it would keep its overnight interest rate in the 0.0% to 0.1% range, up from -0.1% previously. This followed news that workers at some of Japan's biggest companies had secured their largest pay rises in over 30 years, which is helping support expectations that recent inflation rates will be sustained. However, the pace of further hikes will likely be gradual, with the BoJ governor noting that inflation expectations were not yet anchored at the 2% target. The BoJ also removed its yield curve control policy but will continue to buy government bonds to prevent a rapid rise in long-term interest rates. Subsequently, CPI inflation rose 2.8% in February, below market expectations.

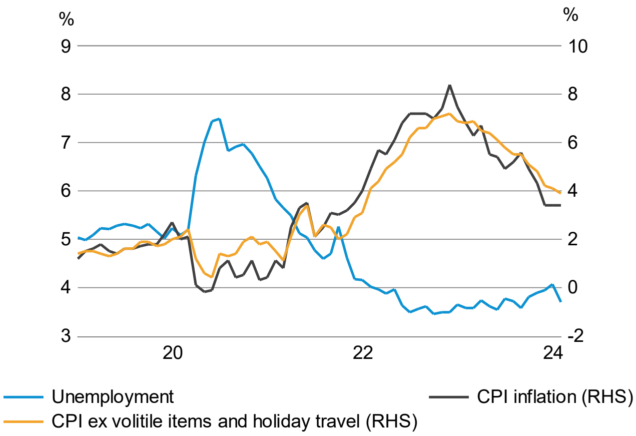
The Bank of England (BoE) held is policy rate at 5.25% and signalled that it is getting closer to lowering it. Earlier in the week, February's CPI report showed inflation fell to 3.5%, the lowest in three years, while the CPI excluding food and energy prices slowed to 4.5% from 5.1%. Markets expect BoE rate cuts to begin in June.

Australia's labour market surprised

The Reserve Bank of Australia (RBA) held its overnight cash rate at 4.35% and adopted a more balanced stance on the risks for the next move in the cash rate. Market pricing indicates cash rate cuts could begin in September.

Following the RBA's decision, February's labour market data showed unemployment had fallen to 3.7% from 4.1% in January, the lowest since September 2023 (Figure 4). Employment was strong, with February's gains more than reversing weak prints in December and January. Monthly reports can be volatile, and while February's report suggests less easing in the labour market than earlier thought, it is also likely to have cooled more than is portrayed by this report. Meanwhile, annual inflation was steady at 3.4% in February, while the core measure dropped to 3.9% from 4.1% in January (Figure 4).

Figure 4: Australian unemployment and inflation



Source: Haver

Mixed data in China…

China's factory output, retail sales and exports beat expectations in the January-February period, marking a solid start for 2024 even as weakness in the property sector remains a drag on the economy and confidence. That said, China's data are presented in year-on-year terms and interpretation is complicated by movements in China's new year holiday period and by last year's reopening from COVID-19, leaving analysts cautious about changing expectations for the 2024 outlook. The consensus among forecasters is for GDP growth of 4.6% in 2024.

...but activity indicators improved elsewhere

March's developed economy preliminary purchasing managers indices (PMIs), an indicator of economic activity, improved for the fifth month in a row, although they still indicate subdued growth. The gains were strongest in manufacturing, with the gauges pointing to an increase in activity for the first time since April 2023. Across countries, the PMI rose to a level consistent with modest growth in the euro area, while the US PMI was slightly lower, as increased manufacturing activity was outweighed by lower services activity. In Japan, the indicators rose strongly, especially for services.

Coming up:

Date	Release
3 Apr	Employment indicators (Feb)
4 Apr	Building consents (Feb)
9 Apr	QSBO
10 Apr	RBNZ Monetary Policy Review
12 Apr	Electronic Card Transaction (Mar) Selected price indexes (Mar)

Tables

Quarterly Indicators		2022Q3	2022Q4	2023Q1	2023Q2	2023Q3	2023Q4
Real Production GDP (1)	qpc	1.8	-0.4	-0.3	0.5	-0.3	-0.1
	aapc	2.5	2.4	2.7	3.0	1.3	0.6
Current account balance (annual)	%GDP	-8.3	-8.8	-8.2	-7.6	-7.4	-6.9
Merchandise terms of trade	apc	-6.4	-4.2	-7.1	-5.0	-1.7	-10.6
CPI inflation	qpc	2.2	1.4	1.2	1.1	1.8	0.5
	apc	7.2	7.2	6.7	6.0	5.6	4.7
Employment (HLFS) (1)	qpc	1.4	0.7	1.1	1.0	-0.1	0.4
Unemployment rate (1)	%	3.3	3.4	3.4	3.6	3.9	4.0
Participation rate (1)	%	71.6	71.8	72.1	72.4	72.0	71.9
LCI salary & wage rates - total (2)	apc	3.7	4.1	4.3	4.3	4.2	4.3
QES average hourly earnings - total (2)	apc	7.4	7.2	7.6	6.9	6.7	6.9
Core retail sales volume	apc	5.0	-3.6	-4.0	-5.1	-3.1	-3.2
Total retail sales volume	apc	4.9	-4.0	-4.1	-3.5	-3.4	-4.1
WMM - consumer confidence (3)	Index	87.6	75.6	77.7	83.1	80.2	88.9
QSBO - general business situation (1,4)	net%	-38.8	-78.7	-65.1	-57.8	-49.0	-10.2
QSBO - own activity outlook (1,4)	net%	-15.0	-35.7	-9.9	-14.0	-12.1	4.9

Monthly Indicators		Sep 23	Oct 23	Nov 23	Dec 23	Jan 24	Feb 24
Merchandise trade balance (12 month)	NZ$m	-15,408.3	-14825.2	-13900.4	-13626.5	-12619.9	-11991.2
Dwelling consents - residential	apc	-37.0	-14.2	-36.4	-28.1	-28.3	...
House sales - dwellings	apc	13.7	7.0	14.1	20.3	9.7	37.9
REINZ - house price index	apc	-3.2	-2.4	-0.2	0.6	2.2	3.3
Estimated net migration (12 month total)	people	134,130.0	140635.0	141407.0	139130.0	133836.0	...
ANZ NZ commodity price index	apc	-11.1	-8.7	-2.1	0.8	5.1	6.3
ANZ world commodity price index	apc	-12.5	-6.9	-4.3	-1.8	1.4	3.5
ANZBO - business confidence	net%	1.5	23.4	30.8	33.2	36.6	34.7
ANZBO - activity outlook	net%	10.9	23.1	26.3	29.3	25.6	29.5
ANZ-Roy Morgan - consumer confidence	net%	86.4	88.1	91.9	93.1	93.6	94.5
NZAC	apc	...	...	...	...	...	...

Daily Indicators		Thu 21/3/24	Fri 22/3/24	Mon 25/3/24	Tue 26/3/24	Wed 27/3/24	Thu 28/3/24
NZ exchange and interest rates (5)							
NZD/USD	$	0.6090	0.6050	0.5993	0.6007	0.6001	...
NZD/AUD	$	0.9206	0.9201	0.9197	0.9180	0.9195	...
Trade weighted index (TWI)	index	71.11	70.86	70.50	70.48	70.52	...
Official cash rate (OCR)	%	5.50	5.50	5.50	5.50	5.50	...
90 day bank bill rate	%	5.64	5.64	5.63	5.64	5.64	...
10 year govt bond rate	%	4.50	4.61	4.55	4.62	4.63	...
Share markets (6)							
Dow Jones	index	39,781	39476	39314	39282	39760	...
S&P 500	index	5,242	5234	5218	5204	5248	...
VIX volatility index	index	12.9	13.1	13.2	13.2	12.8	...
AU all ords	index	8,045	8026	8072	8037	8074	...
NZX 50	index	11,916	11979	12067	12032	12011	...
US interest rates							
3 month OIS	%	5.33	5.33	5.33	5.33	...	...
3 month Libor	%	5.58	5.57	5.57	5.57	...	...
10 year govt bond rate	%	4.27	4.22	4.25	4.24	4.20	...
Commodity prices (6)							
WTI oil	US$/barrel	81.07	81.10	82.41	82.41	81.35	...
Gold	US$/ounce	2,170.50	2171.60	2176.70	2179.80	2192.70	...
CRB Futures	index	534.97	534.33	537.25	536.55	...	...

(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		Aug 23	Sep 23	2023Q3	Oct 23	Nov 23	Dec 23	2023Q4	Jan 24	Feb 24	Mar 24
	GDP (1)	qpc			**1.2**				**0.8**			
United	Industrial production (1)	mpc	-0.1	0.2		-0.7	0.4	-0.3		-0.5	0.1	...
States	CPI	apc	3.7	3.7		3.2	3.1	3.4		3.1	3.2	...
	Unemployment rate (1)	%	3.8	3.8		3.8	3.7	3.7		3.7	3.9	...
	Employment change (1)	000s	210.0	246.0		165.0	182.0	290.0		229.0	275.0	...
	Retail sales value	apc	2.8	4.0		2.2	3.6	5.0		0.0	1.5	...
	House prices (2)	apc	2.2	4.0		4.9	5.4	6.2		6.6	...	...
	PMI manufacturing (1)	index	47.6	48.6		46.9	46.6	47.1		49.1	47.8	...
	Consumer confidence (1)(3)	index	108.7	104.3		99.1	101.0	108.0		110.9	104.8	104.7
	GDP (1)	qpc			**-0.8**				**0.1**			
	Industrial production (1)	mpc	-0.4	0.1		1.2	-0.6	1.2		-6.7	...	...
Japan	CPI	apc	3.1	3.1		3.3	2.9	2.6		2.2	2.8	...
	Unemployment rate (1)	%	2.6	2.6		2.5	2.5	2.5		2.4	...	...
	Retail sales value	apc	7.0	6.2		4.1	5.4	2.4		2.1	...	...
	PMI manufacturing (1)	index	49.6	48.5		48.7	48.3	47.9		48.0	47.2	...
	Consumer confidence (1)(4)	index	36.1	35.6		35.9	35.8	36.9		37.7	38.6	...
	GDP (1)	qpc			**-0.1**				**-0.0**			
	Industrial production (1)	mpc	0.2	-0.6		-0.5	0.4	1.6		-3.2	...	...
Euro	CPI	apc	5.2	4.3		2.9	2.4	2.9		2.8	2.6	...
area	Unemployment rate (1)	%	6.5	6.5		6.5	6.5	6.5		6.4	...	...
	Retail sales volume	apc	-2.0	-3.3		-0.9	-0.5	-0.5		-1.0	...	...
	PMI manufacturing (1)	index	43.5	43.4		43.1	44.2	44.4		46.6	46.5	...
	Consumer confidence (5)	index	-16.0	-17.7		-17.9	-16.9	-15.1		-16.1	-15.5	-14.9
	GDP (1)	qpc			**-0.1**				**-0.3**			
	Industrial production (1)	mpc	-0.3	-0.1		-1.4	0.5	0.5		-0.2	...	...
United	CPI	apc	6.3	6.3		4.7	4.2	4.2		4.2	3.8	...
Kingdom	Unemployment rate (1)	%	4.2	4.1		4.0	3.9	3.8		3.9	...	...
	Retail sales volume	apc	-1.2	-1.2		-2.3	0.2	-2.7		0.5	-0.3	...
	House prices (6)	apc	-5.3	-5.3		-3.3	-2.0	-1.8		-0.2	1.2	...
	PMI manufacturing (1)	index	43.0	44.3		44.8	47.2	46.2		47.0	47.5	...
	Consumer confidence (1)(5)	net %	-25.0	-21.0		-30.0	-24.0	-22.0		-19.0	-21.0	-21.0
	GDP (1)	qpc			**0.3**				**0.2**			
	CPI	apc			**5.4**				**4.1**			
Australia	Unemployment rate (1)	%	3.7	3.6		3.8	3.9	3.9		4.1	3.7	...
	Retail sales value	apc	2.0	2.1		1.3	2.1	0.3		1.2	...	...
	House Prices (7)	apc			**...**				**...**			
	PMI manufacturing (1)	index	-19.8	-12.8		-20.9	-25.3	-23.8		-23.8	-12.6	...
	Consumer confidence (8)	index	81.0	79.7		82.0	79.9	82.1		81.0	86.0	84.4
	GDP	apc			**4.9**				**5.2**			
China	Industrial production	apc	4.5	4.5		4.6	6.6	6.8		7.0	7.0	...
	CPI	apc	0.1	0.0		-0.2	-0.5	-0.3		-0.8	0.7	...
	PMI manufacturing (1)	index	49.7	50.2		49.5	49.4	49.0		49.2	49.1	...
South	GDP (1)	qpc			**0.6**				**0.6**			
Korea	Industrial production (1)	mpc	5.4	1.9		-1.7	1.6	-0.5		-1.3	...	...
	CPI	apc	3.4	3.7		3.8	3.3	3.2		2.8	3.1	...

(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