Fortnightly Economic Update

19 July 2024

- **Consumers price index inflation approaches inflation target band**
- **Economic indicators reinforce expectations of weak June quarter activity**
- **IMF sees steady global growth, warns that higher tariffs could keep interest rates high**

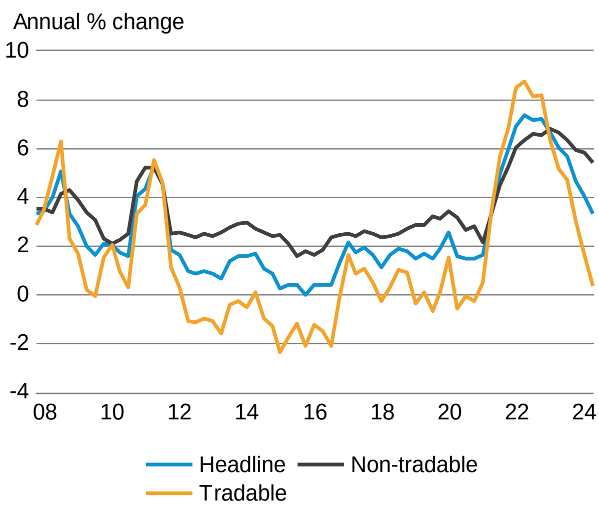
Consumers price index (CPI) inflation came in lower than most forecasters expected, reinforcing market expectations that interest rates will soon fall. Other economic indicators confirm weaker domestic demand as house price momentum slowed further, consumer spending fell, and business confidence falls further. Easing net immigration and the more gradual return of tourism will further dampen demand growth.

In its latest update on the outlook for the global economy, the International Monetary Fund (IMF) kept its 2024 growth forecast at 3.2% and raised its 2025 prediction slightly to 3.3%. The IMF warned that rising tariffs and other trade protections could increase inflation and keep pressure on central banks to maintain higher interest rates.

Inflation weaker than expected…

CPI inflation came in lower than most forecasters expected. Annual headline inflation fell from 4.0% in the March quarter to 3.3% in the June quarter as quarterly inflation eased from 0.6% to 0.4%. A large chunk of this unexpected weakness came from weak tradable inflation.

Figure 1: Inflation breakdown

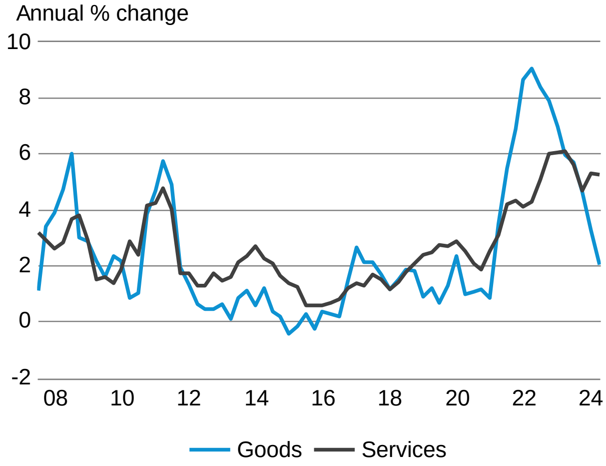


Source: Stats NZ

Prices of tradable goods and services – those influenced by foreign competition – fell for the third consecutive quarter. The annual rate eased to 0.3%, well below forecasters expectations. Meanwhile, inflation in non-tradable goods and services – those not influenced by foreign competition – eased to 5.4%. Although inflation is approaching the 1-3% target band, non-tradable inflation, which includes many services, is proving harder to tame.

Some key services prices are not particularly responsive to monetary policy (Figure 2). A key component of services inflation is rent, which is a highly persistent series. Further, services (and non-tradable) inflation has been subject to some large rises in insurance and local-body rates.

Figure 2: Goods and services inflation breakdown



Source: Stats NZ

…reinforcing market expectations of interest rates falling this year

The release of the CPI reinforced the market's expectation that inflation will fall within the Reserve Bank's 1-3% inflation target band in the September quarter and that the Official Cash Rate (OCR) could soon be cut.

Market pricing indicates rates will fall by at least 50 basis points (bps) by the end of the year. Analysts at the major banks are more cautious, with most expecting a 25-bps cut at the November Monetary Policy Statement (MPS). The Treasury's Budget Update forecasts incorporated interest rates easing over the second half of this year.

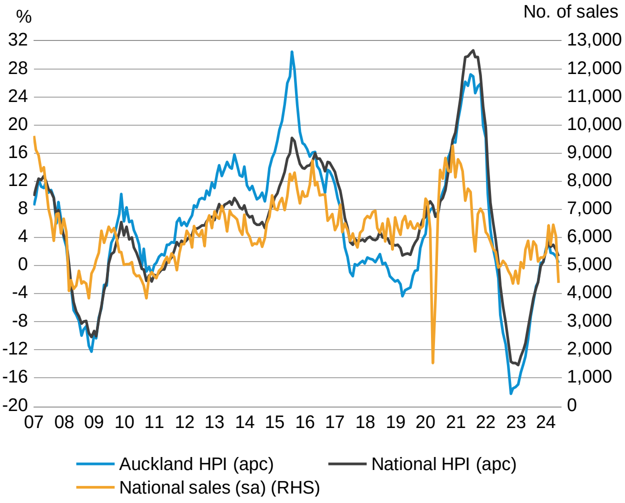
Prepared by the Treasury and released at https://www.treasury.govt.nz/publications/research-and-commentary/fortnightly-economic-updates

Monetary policy constrains housing…

House price growth is continuing to lose momentum. The Real Estate Institute's (REINZ) house price index fell 0.1% in the month of June (seasonally adjusted). House prices have now fallen 0.6% from the start of the year, with annual growth easing from 2.1% to 1.3% (Figure 3).

Activity indicators within the housing market confirmed this weakness. House sales fell sharply – although this may partially reflect the Matariki holiday falling on 28 June – and days to sell rose slightly to 44. While house prices now appear marginally lower than our *Budget Update* forecast, we still expect positive house price growth later this year as interest rates ease.

Figure 3: House prices and sales

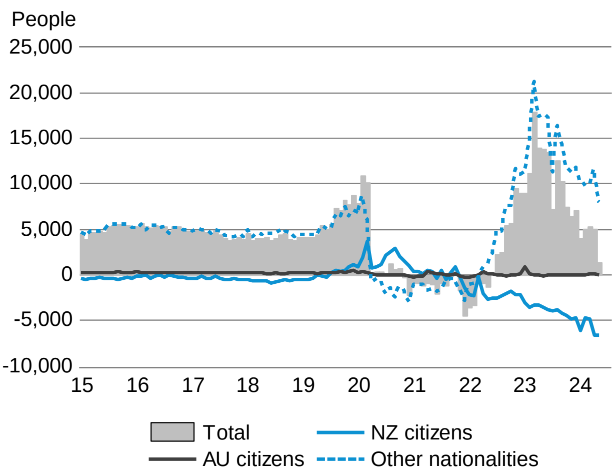


Source: REINZ

…while net immigration continues easing…

Net immigration continued trending down in June with a continued loss of New Zealand citizens. Monthly net immigration fell to 1,400 people in May, down from 5,100 in April (seasonally adjusted) (Figure 4). Annual net migration slowed to 82,800, down from the peak of 136,600 in October 2023. We expect annual net immigration to drop to around 74,000 by the end of the year.

Figure 4: Monthly net migration by citizenship



Source: Stats NZ

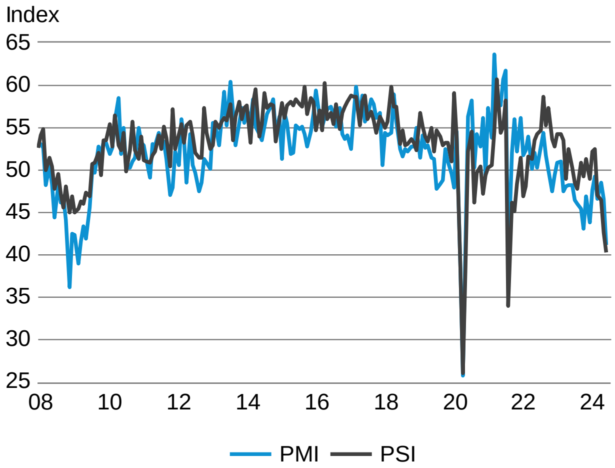
The post-COVID recovery in tourism looks to be progressing more slowly than expected at the *Budget Update*. Visitor arrivals ticked up 4% in May but continue to hover around 80% of 2019 levels, mostly reflecting a weak recovery in Chinese tourism. And with soft economic conditions in China, travel demand will take a while longer to fully return.

…impacting consumers and businesses

Stats NZ's Electronic Card Transactions spending showed a 0.6% fall in retail spending in the month of June and 3.7% in the June quarter – the largest recorded fall outside the COVID period. While this data includes tourism and largely captures goods spending, it also indicates that household consumption may have been weak in the June quarter.

The contraction in manufacturing deepened in June according to the BNZ-BusinessNZ gauge, reflecting weakness in construction and household spending. The seasonally adjusted PMI fell to 41.1 in June and has now been in contractionary territory (PMI less than 50) for 16 consecutive months (Figure 5). The sister survey of sentiment in the service sector also fell to fresh lows outside the COVID period, dropping to 40.2.

Figure 5: PMI/PSI composite index



Source: BusinessNZ-BNZ, Stats NZ

Steady global growth outlook

In its latest update on the global economy, the International Monetary Fund (IMF) kept its forecast for world economic growth this year unchanged at 3.2% and raised its forecast for next year by one-tenth to 3.3% (Table 1).

There were some offsetting changes to country forecasts. Stronger first quarter growth in China lifted the IMF's 2024 forecast to 5.0% from 4.6% previously, although this may prove optimistic in light of slower second quarter growth. Euro area forecasts were given a modest upward revision, while there were slight downgrades for Australia, the US and Japan (no forecasts for New Zealand were included).

The IMF forecast inflation to continue to decline but at a slightly slower pace than earlier as services price rises subside more gradually.

Table 1: IMF forecasts

	GDP (Ann. avg. % change, years ended December)		
	Actual	Forecast	
	2023	**2024**	**2025**
World	3.3	3.2	3.3
US	2.5	2.6	1.9
Euro area	0.5	0.9	1.5
China	5.2	5.0	4.5
Australia	2.0	1.4	2.0
Japan	1.9	0.7	1.0
NZ (Tsy, BEFU)	0.6	0.5	2.8
Inflation	**2023**	**2024**	**2025**
World	6.7	5.9	4.4
Advanced economies	4.6	2.7	2.1
NZ (Tsy, BEFU)	5.7	3.2	2.2

Source: IMF World Economic Outlook Update, July 2024

The IMF described risks to the outlook as balanced, but noted some risks have increased, including rising trade tariffs that could revive inflation and keep interest rates "higher for even longer". The IMF also warned that elections this year could lead to policy changes that "entail fiscal profligacy risks" and lead to higher government debt and higher long-term interest rates.

Slower June quarter growth in China

China's GDP growth slowed to 0.7% in the second quarter as consumer spending slowed and the property sector continued to contract (Table 2). Monthly data showed industrial production and non-construction investment were the main drivers of quarterly growth, with the industry breakdown of the latter showing strong growth in green and high-tech sectors.

The significant imbalance between strong growth in industrial capacity and weak domestic demand was also evident in June's soft inflation data. Headline CPI rose 0.2% on a year ago, while core CPI prices rose 0.6%. Despite prices rising for the second month in a row, producer prices were 0.8% lower than a year ago, hinting at price stabilisation following government actions to spur demand and slow supply.

The Third Plenum Session of the 20th Central Committee of the Communist Party of China was held this week. The communique from the meeting said that the Committee had adopted the decision on "further comprehensively deepening reform and promoting Chinese style modernisation". The high-level communique outlined the path to "a high-level socialist market economy" by 2035. Further details are expected over the week ahead, and after July's Politburo meeting.

Table 2: China economic indicators

	23Q4	**24Q1**	**24Q2**
GDP (apc)	5.2	5.3	4.7
GDP (qpc)	1.2	1.5	0.7
Monthly indicators	**Apr-23**	**May-23**	**Jun-23**
Fixed asset investment (ytd %)	4.2	4.0	3.9
- Infrastructure (ex utilities)	6.0	5.7	5.4
- Real estate	-9.8	-10.1	-10.1
Retail Sales (apc)	2.3	3.7	2.0
Industrial production (apc)	6.7	5.6	5.3
CPI inflation (apc)	0.3	0.3	0.2

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

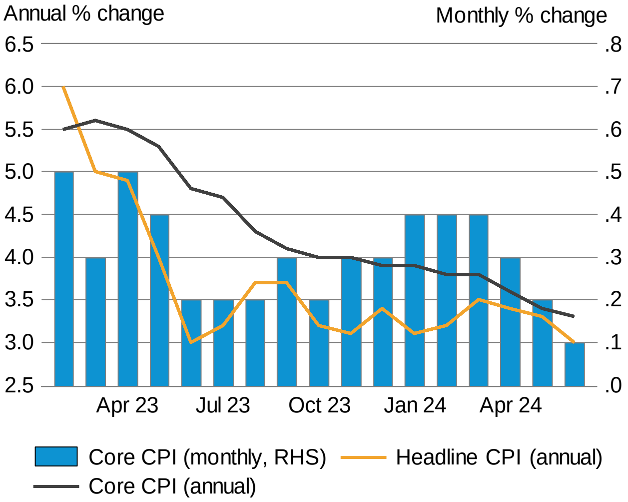
Source: Haver

US inflation eased in June…

Slower price growth in recent months has added to market confidence that US inflation is back on its downward path. Combined with signs of a more balanced labour market, markets believe the Federal Reserve (Fed) will soon begin to relax its policy stance.

June's CPI report was weaker than markets expected as headline inflation fell 0.1%, which dropped the annual rate to 3.0% from 3.3% in May (Figure 6). Most of the surprise came from core CPI, up 0.1% in month (0.2% expected), as shelter prices rose more slowly and reinforced the slowing trend in core inflation seen in April and May.

Figure 6: US CPI inflation



Source: Haver

Following the CPI data, financial market pricing moved to build in a high probability that the Fed will cut its policy rate 25 bps when it meets on 18 September, with an additional 75 bps of cuts expected by March 2025.

Earlier, June's payroll report showed job gains had slowed, averaging 212,000 per month in May and June, still solid but well below that seen in the first quarter. The unemployment rate rose one-tenth to 4.1%, up from a low of 3.4% in early 2023. Wage pressures also dissipated, with June's annual gain of 3.9% the lowest in three years.

…but activity picked up in the goods sector

Meanwhile, consumer spending and manufacturing data for June pointed to solid US growth momentum. Core retail sales, which feed into real GDP, surged 0.9% in June, and after adjusting for inflation, analysts' estimate real core sales grew 0.5% in the second quarter.

Adding to positive signals, industrial production posted a 0.6% rise in June, led by a 0.4% gain in manufacturing activity. For the quarter, manufacturing activity rose at its strongest pace in over three years, although subdued survey measures suggest this will not be sustained.

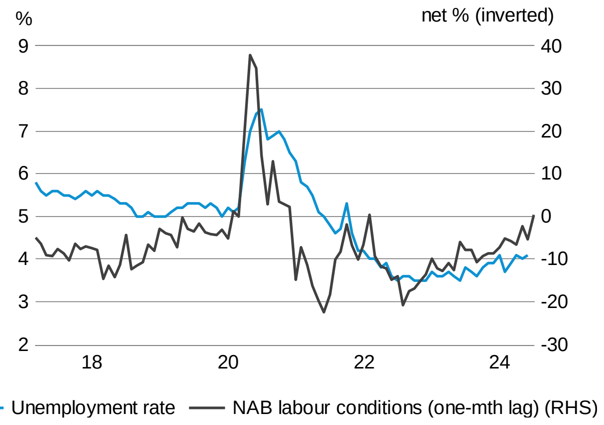
These results lifted the Atlanta Fed's real GDP tracker estimate to 2.7% (annualised), higher than first quarter growth of 1.4%.

Unemployment rises in Australia

There were mixed messages in Australia's June labour force report, but looking through the monthly volatility, capacity pressures appear to be cooling, largely in line with expectations.

The unemployment rate rose to 4.1% in June, taking the average for the quarter to 4.1%, up from 3.9% in the first quarter. Participation also edged higher and helped to relieve some market tightness. On the other hand, employment rose 0.4% in the month, the largest increase since February, pointing to solid demand. Although forward indicators show demand is waning (Figure 7).

Figure 7: Australian labour market indicators



Source: Haver

No change in UK inflation

The European Central Bank (ECB) kept its key policy rate unchanged at 3.75% following its latest deliberations, after a 25bp cut last month. The ECB said the case for further cuts would depend on the data. Markets anticipate a further 25bp cut in September.

In the UK, headline and core inflation were steady in June, at 2.0% and 3.5% respectively on a year-ago basis. Services inflation remained high at 5.7% and is the main barrier to the Bank of England beginning to cut its policy interest rate, which markets expect to be in September.

Coming up:

Date	Release
22 Jul	Overseas merchandise trade (Jun)
29 Jul	Monthly Employment Indicators (Jun)
31 Jul	Building consents (Jun) ANZBO (Jul)
7 Aug	Labour market (Q2)
8 Aug	RBNZ inflation expectations (Q3)

Tables

Quarterly Indicators		2023Q1	2023Q2	2023Q3	2023Q4	2024Q1	2024Q2
Real Production GDP (1)	qpc	-0.3	0.5	-0.3	-0.1	0.2	...
	aapc	2.7	3.0	1.2	0.6	0.2	...
Current account balance (annual)	%GDP	-8.2	-7.6	-7.4	-6.9	-6.8	...
Merchandise terms of trade	apc	-7.1	-5.0	-1.7	-10.7	-3.7	...
CPI inflation	qpc	1.2	1.1	1.8	0.5	0.6	0.4
	apc	6.7	6.0	5.6	4.7	4.0	3.3
Employment (HLFS) (1)	qpc	1.2	1.1	-0.0	0.4	-0.2	...
Unemployment rate (1)	%	3.4	3.6	3.9	4.0	4.3	...
Participation rate (1)	%	72.1	72.4	72.0	71.9	71.5	...
LCI salary & wage rates - total (2)	apc	4.3	4.3	4.2	4.3	4.1	...
QES average hourly earnings - total (2)	apc	7.6	6.9	6.7	6.9	5.2	...
Core retail sales volume	apc	-4.0	-5.1	-3.1	-3.2	-1.7	...
Total retail sales volume	apc	-4.1	-3.5	-3.4	-4.1	-2.4	...
WMM - consumer confidence (3)	Index	77.7	83.1	80.2	88.9	...	...
NZIER QSBO - general bus.situation (1,4)	net%	-64.9	-55.5	-50.5	-11.4	-24.9	-35.4
NZIER QSBO - own activity outlook (1,4)	net%	-7.5	-15.6	-13.3	5.3	-12.3	-10.4

Monthly Indicators		Jan 24	Feb 24	Mar 24	Apr 24	May 24	Jun 24
Merchandise trade balance (12 month)	NZ$m	-12,591.6	-12063.8	-9993.1	-10216.9	-10054.3	...
Dwelling consents - residential	apc	-28.3	-6.0	-26.2	6.0	-14.8	...
REINZ house sales (number)	apc	12.5	47.3	12.2	32.3	9.5	-25.6
REINZ - house price index	apc	2.1	3.2	2.7	3.0	2.3	1.3
Estimated net migration (12 month total)	people	123,228.0	116619.0	104268.0	95590.0	82828.0	...
ANZ NZ commodity price index	apc	5.1	6.3	3.1	7.4	6.3	7.2
ANZ world commodity price index	apc	1.4	3.6	0.9	3.2	4.0	7.4
ANZBO - business confidence	net%	36.6	34.7	22.9	14.9	11.2	6.1
ANZBO - activity outlook	net%	25.6	29.5	22.5	14.3	11.8	12.2
ANZ-Roy Morgan - consumer confidence	net%	93.6	94.5	86.4	82.1	84.9	83.2
NZAC	apc	1.5	2.3	...	...	...	...

Daily Indicators		Fri 12/7/24	Mon 15/7/24	Tue 16/7/24	Wed 17/7/24	Thu 18/7/24	Fri 19/7/24
NZ exchange and interest rates (5)							
NZD/USD	$	0.6	0.61	0.61	0.61	0.61	...
NZD/AUD	$	0.9	0.90	0.90	0.90	0.90	...
Trade weighted index (TWI)	index	71.5	71.49	71.20	71.38	71.18	...
Official cash rate (OCR)	%	5.5	5.50	5.50	5.50	5.50	...
90 day bank bill rate	%	5.6	5.56	5.55	5.53	5.54	...
10 year govt bond rate	%	4.5	4.49	4.41	4.37	4.36	...
Share markets (6)							
Dow Jones	index	40,000.9	40211.7	40954.5	41198.1	40665.0	...
S&P 500	index	5,615.4	5631.2	5667.2	5588.3	5544.6	...
VIX volatility index	index	12.5	13.1	13.2	14.5	15.9	...
AU all ords	index	8,206.2	8262.4	8243.3	8303.5	8272.7	...
NZX 50	index	12,135.0	12123.1	12184.5	12292.0	12329.4	...
US interest rates							
3 month OIS	%	5.3	5.3	5.3	5.3	...	...
3 month Libor	%	5.5	5.5	5.5	5.5	...	...
10 year govt bond rate	%	4.2	4.2	4.2	4.2	4.2	...
Commodity prices (6)							
WTI oil	US$/barrel	83.5	83.2	81.9	82.9	...	...
Gold	US$/ounce	2,406.9	2421.3	2443.2	2480.3	2463.8	...
CRB Futures	index	541.7	542.2	541.2	541.2	...	...

(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		2023Q4	Jan 24	Feb 24	Mar 24	2024Q1	Apr 24	May 24	Jun 24	2024Q2	Jul 24
	GDP (1)	qpc	**0.8**				**0.4**				**...**	
United	Industrial production (1)	mpc		-1.1	1.1	-0.2		0.0	0.9	0.6		...
States	CPI	apc		3.1	3.2	3.5		3.4	3.3	3.0		...
	Unemployment rate (1)	%		3.7	3.9	3.8		3.9	4.0	4.1		...
	Employment change (1)	000s		256.0	236.0	310.0		108.0	218.0	206.0		...
	Retail sales value	apc		0.3	2.1	3.6		2.8	2.6	2.3		...
	House prices (2)	apc		6.7	7.4	7.5		7.2	...	...		...
	PMI manufacturing (1)	index		49.1	47.8	50.3		49.2	48.7	48.5		...
	Consumer confidence (1)(3)	index		110.9	104.8	103.1		97.5	101.3	100.4		...
	GDP (1)	qpc	**0.0**				**-0.7**				**...**	
	Industrial production (1)	mpc		-6.7	-0.6	4.4		-0.9	3.6	...		...
Japan	CPI	apc		2.2	2.8	2.8		2.5	2.9	...		...
	Unemployment rate (1)	%		2.4	2.6	2.6		2.6	2.6	...		...
	Retail sales value	apc		2.1	4.7	1.1		2.0	2.8	...		...
	PMI manufacturing (1)	index		48.0	47.2	48.2		49.6	50.4	50.0		...
	Consumer confidence (1)(4)	index		37.7	38.6	39.7		38.3	36.7	37.1		...
	GDP (1)	qpc	**-0.1**				**0.3**				**...**	
	Industrial production (1)	mpc		-2.2	0.0	0.5		0.0	-0.6	...		...
Euro	CPI	apc		2.8	2.6	2.4		2.4	2.6	2.5		...
area	Unemployment rate (1)	%		6.5	6.5	6.5		6.4	6.4	...		...
	Retail sales volume	apc		-0.9	-0.3	0.6		0.6	0.3	...		...
	PMI manufacturing (1)	index		46.6	46.5	46.1		45.7	47.3	45.8		...
	Consumer confidence (5)	index		-16.1	-15.5	-14.9		-14.7	-14.3	-14.0		...
	GDP (1)	qpc	**-0.3**				**0.7**				**...**	
	Industrial production (1)	mpc		-0.7	1.0	0.2		-0.9	0.2	...		...
United	CPI	apc		4.2	3.8	3.8		3.0	2.8	2.8		...
Kingdom	Unemployment rate (1)	%		4.0	4.2	4.3		4.4	4.4	...		...
	Retail sales volume	apc		0.3	-0.4	0.2		-2.2	1.2	...		...
	House prices (6)	apc		-0.2	1.2	1.6		0.6	1.3	1.5		...
	PMI manufacturing (1)	index		47.0	47.5	50.3		49.1	51.2	50.9		...
	Consumer confidence (1)(5)	net %		-19.0	-21.0	-21.0		-19.0	-17.0	-14.0		-13.0
	GDP (1)	qpc	**0.3**				**0.1**				**...**	
	CPI	apc	**4.1**				**3.6**				**...**	
Australia	Unemployment rate (1)	%		4.1	3.7	3.9		4.1	4.0	4.1		...
	Retail sales value	apc		1.2	5.3	1.3		1.2	2.1	...		...
	House Prices (7)	apc	**...**				**...**				**...**	
	PMI manufacturing (1)	index		-23.8	-12.6	-7.0		-13.9	-31.1	-26.5		...
	Consumer confidence (8)	index		81.0	86.0	84.4		82.4	82.2	83.6		82.7
	GDP	apc	**5.2**				**5.3**				**4.7**	
China	Industrial production	apc		7.0	7.0	4.5		6.7	5.6	5.3		...
	CPI	apc		-0.8	0.7	0.1		0.3	0.3	0.2		...
	PMI manufacturing (1)	index		49.2	49.1	50.8		50.4	49.5	49.5		...
South	GDP (1)	qpc	**0.5**				**1.3**				**...**	
Korea	Industrial production (1)	mpc		-1.5	2.9	-3.1		2.4	-1.2	...		...
	CPI	apc		2.8	3.1	3.1		2.9	2.7	2.4		...

(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