

Fortnightly Economic Update

5 July 2024

- **Business activity suffering weak sales points to a contraction in June quarter GDP**
- **More households face job insecurity amid an increase in financial hardship**
- **Global growth outlook remains steady as inflation returns to downward path**

Restrictive monetary policy is working to curb demand with businesses reporting weak sales and new orders and consumers experiencing financial hardship under current conditions. The construction and retail sectors are particularly bleak with indicators pointing to weakness for the remainder of this year amid employment retrenchment and company insolvencies. Weak domestic demand is curbing imports but uneven economic activity in New Zealand's main trading partners presents downside risk to export growth. Based on data over the past three months, a contraction in June quarter GDP is looking increasingly likely.

Global growth remained stable but low in the June quarter, and a similar pace of growth is expected over the second half of the year. Inflation has returned to its downward path in the US and Europe, and provided it remains on track, central banks are expected to lower interest rates. Australian inflation is proving to be stubborn, and there are signs activity is increasing, which is raising the risk of further monetary policy tightening.

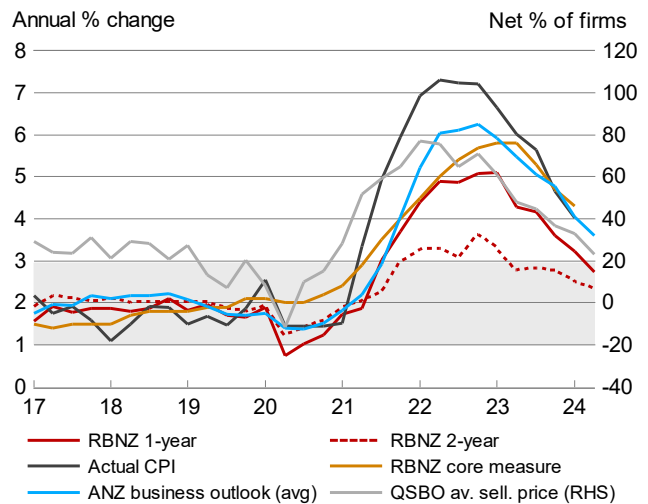
Businesses face reduced pricing power amid low demand and deteriorating profitability...

Monetary policy continues to constrain the economy with weak sales and new orders presenting pressing constraints for an increasing number of firms according to the June quarter Quarterly Survey of Business Opinion (QSBO). A net 61% of firms cited lack of sales as the main constraint to their business, substantially up on 42% just a year ago. The deterioration in demand from the March quarter continued in June with a net 28% of firms reporting lower activity in the past three months, the worst result since the Global Financial Crisis (GFC) outside of the COVID period. As a result fewer firms are choosing to raise their prices despite elevated but stable costs (Figure 1).

The downward trend in business confidence, activity and pricing intentions were also a feature of the June ANZ Business Outlook. Confidence fell 5 points to a net 6% of firms feeling optimistic, well down on the 30-36% bounce between October 2023 and February this year. Pricing intentions dropped across most sectors with a net 36% of firms intending to raise prices, down from a net 41% in May. While firms are still on balance intending to raise

prices, this is well down on the 80% net balance (and 96% in the retail sector) during 2022. Further evidence of firms lack of pricing power was in the steady decline of inflation expectations to 3.5% in June from 3.6% in May.

Figure 1: Pricing intentions ease (ANZBO and QSBO)



Source: Stats NZ, Reserve Bank, Haver

With both surveys pointing to narrowing profit margins, Centrix data revealed a 22% increase in company liquidations (and a 44% rise in the retail sector) during May compared to May 2023. The total of 233 companies is the highest for a May month since 2014. Taken together, a flat if not contraction in June quarter GDP is looking increasingly likely and introduces material downside risk to the *Budget Update* forecasts for 0.2% growth. The steady decline in pricing expectations is consistent with our view that inflation will be within the target range by the end of the year.

... highlighting vulnerability within the construction sector

The QSBO singled out the construction sector as particularly weak by both construction companies and architects. Architects provide an indication of residential, commercial, and government construction in the pipeline. Their activity in the next 12 months is still firmly in negative territory, though there is a slight improvement in expected work 12-24 months ahead. Furthermore, declines in

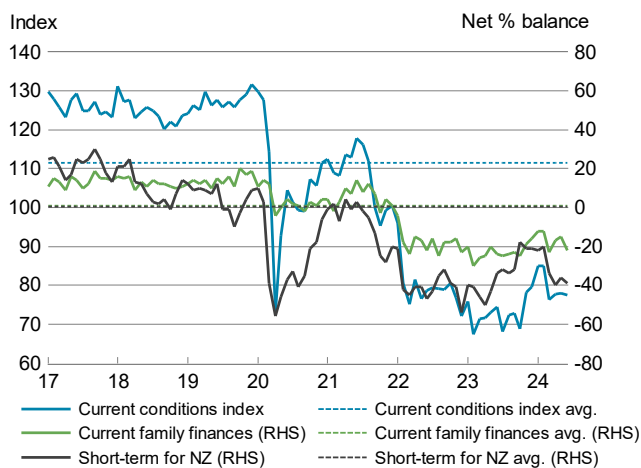
building consent issuance for residential dwellings in May are likely to lead to weaker residential investment activity extending into the first quarter of 2025, given the typical nine-month delay between consent issuance and building work put in place. Building consent issuance continues to surprise on the downside and the 1.7% decline in May on a seasonally adjusted basis casts further doubt whether consents have levelled out or if they have further to fall. May's outturn marks the fourth monthly decline this year and 38% lower than the 4,550 peak reached in March 2022.

The lack of a sustained improvement in building consents and surveys indicating narrow profit margins show the sector is increasingly vulnerable. Construction companies continue to form the majority of insolvencies. Centrix reported 23% of the 269 company insolvencies in May were in the construction sector and a further 16% were in the property and rental sector. Taken together, there is a risk the contraction in residential investment could extend for a longer period than the *Budget Update* forecast. However, the QSBO architects' projected work in 12-24 months is consistent with our view of a recovery this time next year as interest rates ease and migration-led population adds to demand for housing.

Household budgets under pressure

Job security and financial hardship are affecting consumer sentiment. The ANZ-Roy Morgan index fell slightly in June but is still well its 20-year average and failing to recover to levels reached late last year. Higher prices and interest rates are still limiting consumers' plans to purchase large items and a deterioration in families' current conditions is consistent with recent indicators of financial hardship.

Figure 2: Consumer sentiment below 20-year averages



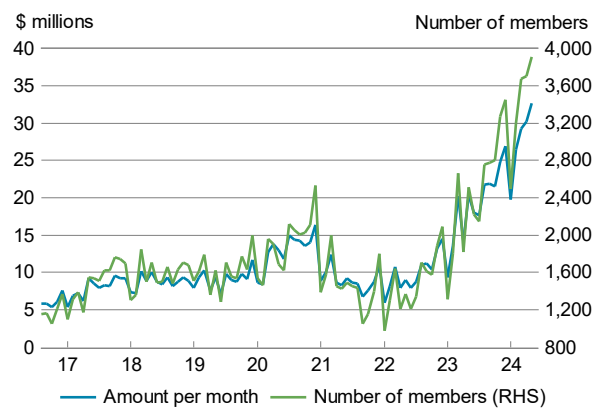
Source: Haver

There is evidence financial hardship is spreading. Centrix reports the number of consumers falling behind on payments increased by 16,000 in May to about 474,000 people, with arrears tracking 8.2% higher than May 2023. Mortgage arrears rose slightly with 22,000 home loans now past due up 12% and 13,150 accounts reported financial hardship 25% higher than May 2023. Mortgage repayment difficulties form almost half of these hardships (44%),

followed by credit card debt (29%) and personal loan repayments (19%). Similarly, withdrawals by KiwiSaver members for financial hardship reached new records. A record 3,910 members withdrew a record \$32.7 million in May, up 8.5% on April and 60% up on May 2023. This suggests household budgets are increasingly stretched due to the high bar for the Public Trust to approve withdrawals for financial hardship. Approvals depend on members' inability to meet everyday bills and expenses, including committed mortgage repayments, but not for paying off mortgages, nor clearing credit card debt, fines, debt collection agency fees, or hire-purchase debt for anything non-essential.

Households are increasingly pessimistic about the labour market. The Westpac-McDermott Miller Employment Confidence Index fell 13 points to 91.4 in the June quarter, bringing it down to its lowest level since the GFC outside of the COVID period in 2020. Own-reported job security fell 14.7 points to a net -7.4% while peoples' perceptions of current job opportunities - which historically tracks closely with the unemployment rate - fell almost 24 points to a net -36%. Separately, Stats NZ reported the number of jobs filled in May was flat compared with April, and just 0.9% higher than a year ago - with some of the larger falls occurring within the construction, manufacturing, and retail trade sectors.

Figure 3: KiwiSaver withdrawals for financial hardship



Source: IRD

Improvement in trade deficit stalled

The trade deficit continued to narrow at a slow pace in contrast to last year's rapid improvement, and similar to the slow progress in the March quarter current account balance. The annual trade deficit narrowed to \$10.1 billion in May from \$10.2 billion in April. May month exports are typically high but they exceeded \$7 billion for the first time leading to a \$204 million surplus. This was largely due to beef exports to the US (up 31% on May 2023) as beef exports to China languish (down 45% in the year). Total exports to the US reached \$1 billion for the first time and has been New Zealand's largest destination for wine exports. As new Zealand's largest trading partner, the Chinese economy remains a key risk, and while the US is picking up some of the slack, the presidential election and uneven performance of other trading partners presents uncertainty and downside risk to our outlook.

Global growth steady over the first half-year

Global business sentiment improved over the past three months, suggesting growth remained steady. Although June's S&P Global Purchasing Managers Index (PMI) reversed much of May's gains, activity over the second quarter picked up compared to the first quarter (Figure 4).

Figure 4: Global PMI and GDP



Sources: Haver, JPMorgan

Asian economies led the gains, although China's services PMI fell sharply in June. China's manufacturing PMIs gave contrasting signals, the export-oriented S&P gauge rose, while the official NBS measure pointed to weaker activity.

There was a similar divergence in the US, with both manufacturing and services PMIs rising in June's S&P reports but falling in the ISM survey, the latter led by a large drop in services sentiment.

European surveys showed manufacturing activity continued to decline over the past three months, although increasing services sector activity provided an offset. In France and the UK, PMIs eased in June as election uncertainty led some firms to delay decisions.

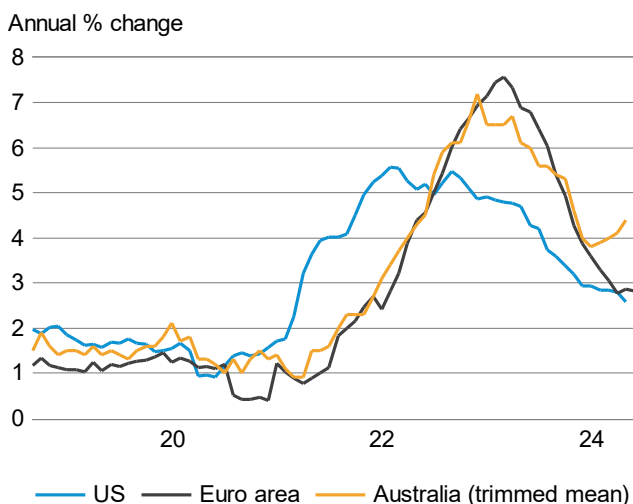
The consensus among forecasters is for steady but low global growth over the second half of the year, although sharply lower sentiment in some countries could shift this view, if it persists.

On the inflation front, easing resumed in the US and euro area following a period of stickiness, but pressures in Australia mounted.

US inflation back on downward path...

US inflation slowed in May but remained higher than at the start of the year. The US Federal Reserve's (Fed) preferred gauge of inflation, the personal consumption expenditures (PCE) index, showed no increase in the month, taking the annual rate to 2.6%. PCE inflation excluding food and energy prices, rose 0.1% from the month prior, the smallest increase since November 2020, which saw the annual index drop two-tenths to 2.6% (Figure 5).

Figure 5: Core inflation measures



Source: Haver

May's PCE report showed higher household spending following April's soft print, although demand for services appears to have stepped down. Nominal spending was up 0.3% in the month, and after factoring in flat PCE prices, real spending increased similarly. The increase in real spending was directed primarily at goods, with a modest 0.1% rise in services spending for the second month in a row, despite income growth of nearly 0.5%.

Commenting on the inflation data, Fed Chair Powell acknowledged the return to a disinflationary path, but said officials needed more data to be confident that inflation would continue to subside. Powell said he expected inflation to be back at the 2% target late next year or in 2026, but to be below 2.5% a year from now.

...as policy uncertainty rises

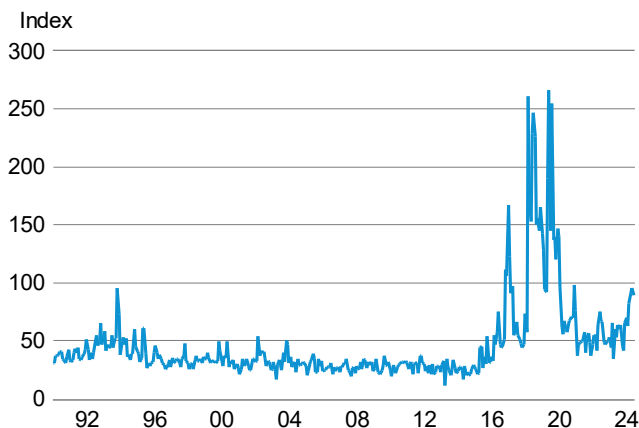
US fiscal deficits and mounting debt were highlighted as growing risks by the IMF in its annual assessment of economic developments. The IMF predicted that current policies would drive government debt to over 140% of GDP by 2032. To reduce debt, an adjustment in the fiscal balance of around 4% of GDP was needed, which entailed "difficult political decisions". In June, the Congressional Budget Office forecast the deficit to be 7% of GDP this year and 6.5% in 2025.

In addition, the IMF cautioned that increasing barriers to cross-border trade and investment could drag on growth. The IMF urged US policymakers to shift their policy positions but acknowledged that globalisation had harmed some communities and those impacts needed to be addressed.

Illustrating the downside risk to growth, researchers at investment bank Goldman Sachs argued that universal US import tariffs of 10%, combined with 60% tariffs on China's imports, as proposed by former President Trump, could slow growth in the euro area and US by 1.0 percentage points and 0.3 percentage points respectively.

The Goldman Sachs analysis was informed by the trade policy uncertainty index, which is at its highest level since the 2018-19 trade war (Figure 6).

Figure 6: Trade policy uncertainty index



Source: Haver

Lower inflation in the euro area...

Euro area inflation also reverted to its downward trend, with June's headline consumers price index (CPI) dipping to 2.5% on an annual basis. Core inflation was steady at 2.9%, with both the services and goods components unchanged at 4.1% and 0.7% respectively.

Across the region, inflation was highest in Belgium, at 5.5%, and lowest in Finland at 0.6%. Headline inflation eased to 2.5% in both Germany and France. As in the US, the European Central Bank is likely to need more evidence that the strength in services inflation will subside and allow inflation to return to target, before easing policy further.

Part of that evidence will come from the labour market, which remained resilient in May. Euro area unemployment was steady at the historically low rate of 6.5%, although business survey data from June, alongside falling job vacancies, suggests some easing is underway.

...but inflation pressures mount in Australia

Australia's monthly inflation indicator moved up in May with both the headline and trimmed mean measures rising three-tenths to 4.1% and 4.4% respectively (Figure 5). Activity data for May also firmed: retail sales rebounded 0.6% in the month, and home building approvals rose 5.5%, although the trend of both measures remained weak.

CoreLogic house prices retained their recent momentum, rising 0.8% in June, to be 3.4% higher since the start of the year, and 8% higher than a year ago. There is considerable divergence across the main cities: house prices in Perth are up 12% this year, Melbourne prices have fallen slightly, and Sydney prices have risen around 2.5%.

Overall, the data flow has reinforced views of increased upside risks to inflation. Meeting minutes from the Reserve Bank of Australia's (RBA) June board meeting revealed inflation was already ahead of expectations, and signs that demand had increased. However, uncertainty around the outlook remained wide and the Board agreed that further information was needed before it was prepared to adjust the policy rate either up or down.

Financial markets are pricing a 50% chance of a rate hike at the RBA's August meeting, with no cuts priced until late 2025.

China's policy makers to discuss the outlook

In China, markets are focused on how two upcoming policy meetings will respond to the internal and external challenges the country now faces. The 3rd Plenum of the 20th Central Committee (15-18 July) will discuss the structural reform agenda for the next five years, while the subsequent Politburo meeting of China's top officials will focus on shorter-term policy settings.

Commentary in the lead up to these meetings has focused on three main issues. First, whether policy support for the economy will increase, second how to manage structural issues in the economy, including local government debt problems and housing market uncertainty, and third, how to balance objectives for growth and security amidst geo-political tensions and rising trade frictions.

In its recent assessment of China's economy, the IMF called for a pull-back in policy support for some industries because of negative effects on productivity and on relationships with trading partners. The IMF's priorities for China included more emphasis on consumption through enhanced social security measures and less services sector regulation.

Oil prices rise

Oil prices moved higher over the past month, with Brent crude reaching US\$88/bbl this week, up from US\$81/bbl at the end of May, and the highest since late April. On the supply side, some analysts point to a delayed and slower phase out of voluntary cuts among OPEC members as a factor behind the rise, alongside geopolitical tensions. Meanwhile, seasonal factors appear to be adding to demand. Analysts anticipate oil prices will remain around current levels this year and though 2025, provided global growth remains stable.

Coming up:

Date	Release
10 Jul	Net Migration (May)
11 Jul	Selected Price Indexes (Jun)
12 Jul	Electronic Card Transactions (Jun), BusinessNZ manuf PMI (Jun)
15 Jul	BusinessNZ services PMI (Jun)
17 Jul	CPI (Q2)

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	...
	apc	6.7	6.0	5.6	4.7	4.0	...
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	...	...
QSBO - general business situation (1,4)	net%	-64.9	-55.5	-50.5	-11.4	-24.9	-35.4
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	...
House sales - dwellings	apc	12.5	47.3	12.2	31.5	6.8	...
REINZ - house price index	apc	2.1	3.2	2.7	3.0	2.3	...
Estimated net migration (12 month total)	people	124,276.0	118421.0	106439.0	98464.0	...	...
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	Mon	Tue	Wed	Thu	Fri
		28/6/24	1/7/24	2/7/24	3/7/24	4/7/24	5/7/24
NZ exchange and interest rates (5)							
NZD/USD	\$	...	0.61	0.61	0.61	0.61	...
NZD/AUD	\$	...	0.91	0.91	0.91	0.91	...
Trade weighted index (TWI)	index	...	72.08	71.72	71.92	72.11	...
Official cash rate (OCR)	%	5.5	5.50	5.50	5.50	5.50	...
90 day bank bill rate	%	...	5.63	5.62	5.63	5.61	...
10 year govt bond rate	%	...	4.69	4.71	4.68	4.69	...
Share markets (6)							
Dow Jones	index	39,118.9	39169.5	39331.9	39308.0	...	...
S&P 500	index	5,460.5	5475.1	5509.0	5537.0	...	...
VIX volatility index	index	12.4	12.2	12.0	12.1	...	...
AU all ords	index	8,013.8	7992.3	7959.7	7986.1	8079.2	...
NZX 50	index	...	11789.4	11776.7	11790.9	11746.7	...
US interest rates							
3 month OIS	%	5.3	5.3	5.3	...	...	...
3 month Libor	%	5.6	5.6	5.6	5.6	...	...
10 year govt bond rate	%	4.4	4.5	4.4	4.4	...	...
Commodity prices (6)							
WTI oil	US\$/barrel	82.8	84.7	84.1	83.9	...	...
Gold	US\$/ounce	2,330.9	2329.1	2331.8	2361.4	2358.7	...
CRB Futures	index	539.3	540.4	540.1	541.1	...	...

(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		Nov 23	Dec 23	2023Q4	Jan 24	Feb 24	Mar 24	2024Q1	Apr 24	May 24	Jun 24
United States	GDP (1)	qpc			0.8				0.4			
	Industrial production (1)	mpc	0.3	-0.2		-0.9	1.0	-0.2		-0.1	0.7	...
	CPI	apc	3.1	3.4		3.1	3.2	3.5		3.4	3.3	...
	Unemployment rate (1)	%	3.7	3.7		3.7	3.9	3.8		3.9	4.0	...
	Employment change (1)	000s	182.0	290.0		256.0	236.0	310.0		165.0	272.0	...
	Retail sales value	apc	4.0	5.5		0.3	2.1	3.6		2.7	2.3	...
	House prices (2)	apc	5.5	6.3		6.7	7.4	7.5		7.2	...	...
	PMI manufacturing (1)	index	46.6	47.1		49.1	47.8	50.3		49.2	48.7	48.5
Consumer confidence (1)(3)	index	101.0	108.0		110.9	104.8	103.1		97.5	101.3	100.4	
Japan	GDP (1)	qpc			0.0				-0.7			
	Industrial production (1)	mpc	-0.6	1.2		-6.7	-0.6	4.4		-0.9	2.8	...
	CPI	apc	2.9	2.6		2.2	2.8	2.8		2.5	2.9	...
	Unemployment rate (1)	%	2.5	2.5		2.4	2.6	2.6		2.6	2.6	...
	Retail sales value	apc	5.4	2.4		2.1	4.7	1.1		2.0	3.0	...
	PMI manufacturing (1)	index	48.3	47.9		48.0	47.2	48.2		49.6	50.4	50.0
	Consumer confidence (1)(4)	index	35.8	36.9		37.7	38.6	39.7		38.3	36.7	37.1
	Euro area	GDP (1)	qpc			-0.1				0.3		
Industrial production (1)		mpc	0.4	1.4		-2.2	0.1	0.5		-0.1	...	...
CPI		apc	2.4	2.9		2.8	2.6	2.4		2.4	2.6	...
Unemployment rate (1)		%	6.5	6.5		6.5	6.5	6.5		6.4	6.4	...
Retail sales volume		apc	-0.6	-0.5		-0.7	-0.3	0.7		0.0	...	...
PMI manufacturing (1)		index	44.2	44.4		46.6	46.5	46.1		45.7	47.3	45.8
Consumer confidence (5)		index	-16.9	-15.1		-16.1	-15.5	-14.9		-14.7	-14.3	-14.0
United Kingdom		GDP (1)	qpc			-0.3				0.7		
	Industrial production (1)	mpc	0.5	0.6		-0.5	1.0	0.2		-0.8	...	...
	CPI	apc	4.2	4.2		4.2	3.8	3.8		3.0	2.8	...
	Unemployment rate (1)	%	3.9	3.8		4.0	4.2	4.3		4.4	...	...
	Retail sales volume	apc	0.1	-3.4		0.3	-0.4	0.2		-2.2	1.2	...
	House prices (6)	apc	-2.0	-1.8		-0.2	1.2	1.6		0.6	1.3	1.5
	PMI manufacturing (1)	index	47.2	46.2		47.0	47.5	50.3		49.1	51.2	50.9
	Consumer confidence (1)(5)	net %	-24.0	-22.0		-19.0	-21.0	-21.0		-19.0	-17.0	-14.0
Australia	GDP (1)	qpc			0.3				0.1			
	CPI	apc			4.1				3.6			
	Unemployment rate (1)	%	3.9	3.9		4.1	3.7	3.9		4.1	4.0	...
	Retail sales value	apc	2.1	0.3		1.2	5.3	1.3		1.2	2.1	...
	House Prices (7)	apc			...					...
	PMI manufacturing (1)	index	-25.3	-23.8		-23.8	-12.6	-7.0		-13.9	-31.1	-26.5
	Consumer confidence (8)	index	79.9	82.1		81.0	86.0	84.4		82.4	82.2	83.6
	China	GDP	apc			5.2				5.3		
Industrial production		apc	6.6	6.8		7.0	7.0	4.5		6.7	5.6	...
CPI		apc	-0.5	-0.3		-0.8	0.7	0.1		0.3	0.3	...
PMI manufacturing (1)		index	49.4	49.0		49.2	49.1	50.8		50.4	49.5	49.5
South Korea	GDP (1)	qpc			0.5				1.3			
	Industrial production (1)	mpc	1.6	-0.4		-1.5	2.9	-3.1		2.4	-1.2	...
	CPI	apc	3.3	3.2		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