

- Reserve Bank continues to tighten at pace as price pressures remain intense
- Annual headline consumer price inflation in the September 2022 quarter, to be released on 18 October, is expected to be 6.7%, down from 7.3% in the June quarter
- IMF downgrades global outlook as fiscal and monetary policy challenges mount

Inflationary pressures show few signs of easing to date, prompting the Reserve Bank to continue to tighten policy. Recent declines in global oil prices are expected to see headline inflation fall in next week's official data release. However, core measures of inflation are expected to persist. We expect annual headline inflation of 6.7%, a little higher than median of other forecasters and the Reserve Bank's forecast of 6.4%. Globally, the war in Ukraine, high inflation and slower growth in China are contributing to an extremely challenging environment. The IMF's latest forecasts warn that risks to the outlook remain unusually large and to the downside.

Reserve Bank continues tightening...

The Reserve Bank raised the Official Cash Rate by 50 basis points to 3.50% at its October Monetary Policy Review, in line with market expectations. The Monetary Policy Committee (MPC) also debated a 75bps hike, underscoring its commitment to continue raising rates at pace. The MPC summary noted that consumer spending appeared to have been stronger than expected in the September quarter and that the risks of higher inflation had increased with the fall in the NZD over recent weeks.

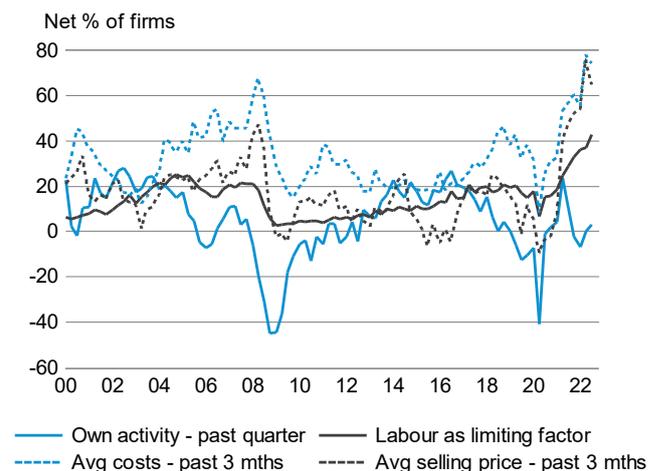
Market participants expect another 50bps rise at the MPC's November meeting and financial market pricing, which has been volatile in recent weeks, suggests the OCR could be above 4.75% by mid-2023. Next week's inflation release will be a key factor in where rates go to from here. We preview next week's CPI release below.

...as price pressures remains intense...

The Reserve Bank's decision followed NZIER's September Quarterly Survey of Business Opinion (QSBO), which showed firms' trading activity had remained steady in the quarter, ongoing intense price pressure, and persistent labour market tightness (Figure 1). However, firms expect weaker conditions ahead and business confidence remained weak (-42), albeit off its June quarter low (-65). Labour demand remained solid, consistent with steady activity and acute labour shortages. Nominal indicators of

costs and prices remained very high, suggesting core inflation remained high, but the breadth of increases appears to have peaked. Overall, firms appear to be comfortably weathering the initial impacts of tighter monetary policy but expect conditions to worsen.

Figure 1: Quarterly Survey of Business Opinion



Source: NZIER

...and consumer spending remains resilient...

Supporting the theme of steady demand, September's Electronic Card Transactions report showed spending rose 2.5% in the month and 4.0% in the quarter, boosted by increased hospitality spending as international tourism returned. Core retail spending, which excludes fuel and vehicle sales, increased 2.6% in the quarter. Higher prices likely made a large contribution to the increase in spending but the boost from tourism provided some offset to the squeeze on real incomes from higher prices.

...despite weak housing market

On the other hand, expectations of weaker conditions were supported by September's REINZ housing market report as house prices continued to ease. House prices fell 1.6% in September to be 8.1% lower than a year ago, and 11%

below their November peak. Sales activity also fell in the month, down 2.4%.

Net migration outflow slows

Net migration outflows are continuing to fall according to data from Stats NZ. Net outflows slowed to 11,000 in the 12 months ended August, down from 12,200 in the year ended July and a peak of 16,000 in February. Visitor arrivals are also increasing following the relaxation of border controls, with nearly 1.3 million arrivals in the year ended August, up from 405,000 in the February year.

Commodity prices fell on weaker global demand...

The ANZ World Commodity Price Index fell 0.5% in September, to be about 10% below its April peak, as weaker global demand continues to pull prices down. The lower New Zealand dollar is, however, providing an offset, with the NZD index rising 3.3%. Dairy prices fell 3.5% in the 4 October *GlobalDairyTrade* auction, as China's economy slowed under the impact of its COVID-19 policies.

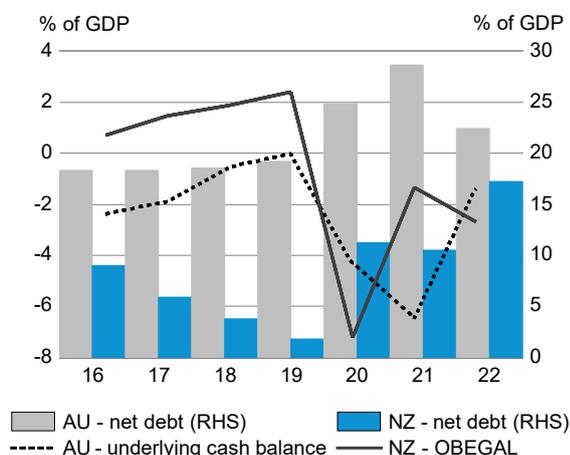
More positively, global shipping costs have fallen markedly in recent months, although ANZ note that these costs have yet to be fully reflected in the cost of exporting goods from NZ. In addition, the weaker NZD is offsetting some of the gains for USD priced shipping.

Government deficit narrows

The government's financial accounts for 2021/22 showed an operating (OBEGAL) deficit of \$9.6bn (2.7% of GDP), almost half the budget forecast of \$19.0bn, driven by stronger-than-expected tax revenue. Net debt was 17.2% of GDP, a little higher than the budget forecast (Figure 2).

This followed the Australian government's year-end accounts, which recorded a budget deficit of AU\$32bn (1.4% of GDP), well below the AU\$80bn forecast in April, and net debt of 22.5% of GDP. The new government is preparing a fiscal package for release on 25 October.

Figure 2: Fiscal indicators in NZ and Australia



Source: Haver, the Treasury

Consumer Price Index Preview

(September quarter 2022, Tuesday 18 October, 10.45am)

We expect the CPI to rise 1.6% in the September quarter compared to the previous quarter (Table 1). That would see annual inflation drop to 6.7% from 7.3% in the June quarter.

Food prices are the main contributor to the expected quarterly rise, up 4.0% and contributing 0.7%-points to the quarterly increase.

Home building costs likely remained strong, with QSBO indicators of industry costs and prices extremely high, while rents and local authority rates are expected to account for the other half of the 0.5%-point contribution from the housing and utilities group.

In other areas we expect similar increases to recent quarters, reflecting the broad-based nature of the inflation impulse and limited signs of substantive easing. Transport is the exception, with petrol pump prices falling around 4% over the quarter as global oil prices fell. This sees annual tradables inflation ease to 7.2% from 8.7% in June. Non-tradables inflation is expected to increase 1.8% in the quarter, keeping the annual rise steady at 6.3%.

Table 1: Expected CPI changes and contribution

Group	Quarterly % change	% point contribution	Annual % change
Food group	4.0	0.7	7.9
Alcoholic beverages and tobacco group	1.4	0.1	4.7
Clothing and footwear group	1.1	0.0	1.3
Housing and household utilities group	1.7	0.5	8.1
Household contents and services group	1.8	0.1	7.3
Health group	1.2	0.0	4.4
Transport group	-1.0	-0.1	8.8
Communication group	-1.0	-0.0	2.6
Recreation and culture group	1.7	0.1	3.8
Education group	0.0	0.0	1.6
Miscellaneous goods and services group	1.2	0.1	5.5
All Groups	1.6	1.6	6.7
Tradables	1.4	0.6	7.2
Non-tradables	1.8	1.0	6.3

Source: The Treasury

Table 2 shows the consensus from the Bloomberg poll is a little higher than the RBNZ expected in August.

Table 2: CPI expectations

	Quarterly % change	Annual % change
Previous quarter	1.7	7.3
The Treasury's latest estimate	1.6	6.7
BEFU 2022 forecast	2.0	6.5
Reserve Bank (August 2022 MPS)	1.4	6.4
Market Median*	1.6	6.6
Market forecast range*	1.3-1.8	6.4-6.9

* Bloomberg Poll, n=5, 14 Oct 2022

Source: Bloomberg, the Treasury

IMF downgrades global outlook...

The IMF's latest World Economic Outlook (WEO) "Countering the Cost-of-Living Crisis" projects global growth to slow under the weight of three key forces: the Russian invasion of Ukraine, a cost-of-living crisis caused by persistent and broadening inflation pressure and the slowdown in China. Global growth is forecast to slow to 3.2% this year and 2.7% in 2023, the latter down from 2.9% in April (Table 3). Growth in China, the euro area, and the US is projected to slow markedly, while growth in Australia and New Zealand is expected to slow by less. Global inflation forecasts were revised up by around 1.5%pts in both 2022 and 2023.

Table 3: IMF WEO forecasts

	Ann. avg. % change, years ended December			
	GDP		CPI	
	2022	2023	2022	2023
World	3.2	2.7	8.8	6.5
US	1.6	1.0	8.1	3.5
Euro area	3.1	0.5	8.3	5.7
China	3.2	4.4	2.2	2.0
Australia	3.8	1.9	6.5	4.8
New Zealand (IMF)	2.3	1.9	6.3	3.9
NZ (RBNZ Aug MPS)	2.4	1.5	6.6	4.4

Sources: IMF, RBNZ

The IMF sees risks to the outlook as "unusually large and to the downside" with about a 25% chance that 2023 growth is less than 2%, which would be one of the weakest outturns since 1970. Key risks include further negative impacts from the war in Ukraine, more persistent inflation, financial market instability and policy errors. On the latter, the IMF observe than "policy trade-offs to negotiate the cost-of-living crisis have become acutely challenging". There is a chance of monetary policy overtightening and a deeper recession, but this would outweigh the costs of tightening too little.

On fiscal policy, the IMF consider that formulating appropriate fiscal responses to the cost-of-living crisis has become very challenging. In their view, fiscal policy needs to focus on reducing deficits and lowering debt to avoid prolonging the fight against inflation and destabilising financial markets. At the same time, fiscal policy should aim to protect the most vulnerable.

...as survey data points to weakness

Incoming surveys point to a contraction in global manufacturing. September's global manufacturing Performance of Manufacturing Index (PMI) dipped into contractionary territory, led by falls in Europe, the US and Asia. The global services PMI lifted, led by a rebound in the US, but remained contractionary. On the positive side, there were further signs of easing in both supply constraints and output price increases. Overall, the global composite PMI is pointing to annualised growth of around 2% - broadly in line with the IMF forecasts.

China's manufacturing and services PMIs were consistent with an economy still struggling under the weight of its zero-Covid policy. The two manufacturing PMI's reflected divergent activity across sectors, with policy support on domestic industrial and construction activity, but further signs of slowing exports. China's services indexes both fell sharply as the zero-COVID policy and various lockdowns took their toll on the services sector.

...but labour markets remain resilient

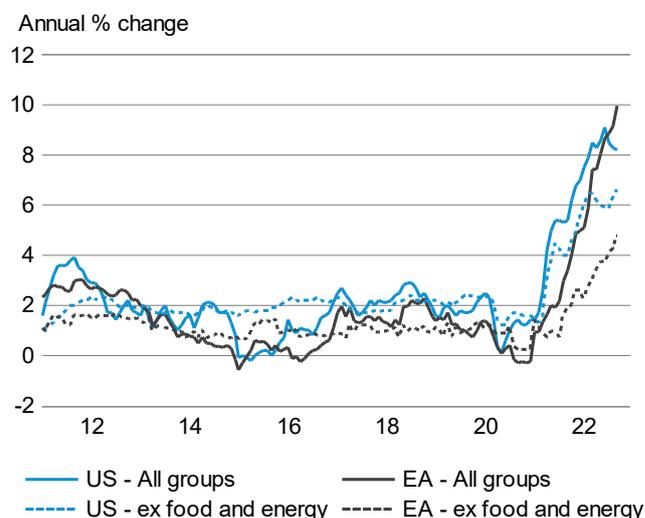
In the US, the unemployment rate unexpectedly fell to 3.5% in September, reversing August's rise. The participation rate also dipped, reducing the prospect that increased labour supply would help loosen conditions. However, there are some signs that the market is beginning to rebalance: September's payroll survey showed employment growth slowed to 263k, the lowest in 18 months, and job openings fell 10%. The ratio of job openings to unemployment is a closely watched measure of labour market tightness and this fall points to an easing in demand. There were signs of slower wage growth too, with annual average hourly earnings down 0.2%-age points, to 5.0%.

Elsewhere, Canada's unemployment rate fell to 5.2% in September, partially reversing the rise in August; the UK unemployment rate fell to 3.5% in August, the lowest level since 1974, as the participation rate dropped; and in the euro area, the unemployment rate was steady at 6.6% in August.

Inflation continues to surprise to the upside

In the US, September inflation surprised on the upside. Headline and core inflation, which excludes food and energy, rose 0.4% and 0.6% respectively from August. Compared to the same month a year ago, headline inflation slowed 0.1%-point to 8.2%, while core inflation rose 0.3%-points to 6.6%, the highest since 1982 (Figure 3). The source of the upside surprise was centred on shelter (housing) costs.

Figure 3: US and euro area inflation



Source: Haver, the Treasury

With no sign of easing inflation pressure, and the Federal Reserve awaiting “clear and convincing evidence” of easing inflation before it stops hiking rates, financial markets locked in a 75bps rise in November. Markets also moved closer to fully pricing a further 75bps rise in December.

In the euro area, annual headline CPI hit 10.0% in September and core CPI hit 4.8%, both above consensus expectations (Figure 3). In Germany, inflation reached 10.9% prompting the government to announce an EUR 200bn (about 5% of GDP) package to shield businesses and consumers from rising energy prices.

In the UK, bond markets have been volatile in the wake of September’s fiscal package announcement, forcing the Bank of England (BoE) to intervene. The government responded by reversing parts of its tax plan, and there is speculation of further changes ahead of the Office of Budget Responsibility’s assessment on 31 October, which has been brought forward from mid-November. The BoE said it expects the package to generate significant inflationary pressures and is poised to lift rates sharply at its November meeting. Meanwhile, real GDP fell 0.3% in August compared to July and, with further weakness anticipated in September, likely signals the UK economy has entered recession.

Inflation has picked up in Asia. September’s data show inflation in Indonesia was 6.0%; 6.9% in the Philippines, 6.6% in South Korea; 6.4% in Thailand and 7.5% in India. In South Korea, inflation eased for the second consecutive month, to 5.6% in September, but a pickup is expected in October owing to energy price rises. The Bank of Korea responded with a 50bps hike, taking its policy rate to 3.0%.

Oil prices increased following the decision by OPEC+ oil producers, which include Russia, to reduce oil supply. Prices for benchmark Brent crude oil traded as low as US\$85 per barrel in late September but have been well over US\$90 following the OPEC+ announcement (see chart in High Frequency Indicators overpage).

Slower pace of hikes in Australia...

The Reserve Bank of Australia (RBA) raised its policy rate 25bps to 2.60% at October’s Board meeting, its 6th consecutive monthly increase since May when it moved the rate up from 0.1%. The rapid pace of adjustment was a significant factor in the decision to tighten by less than the 50bps the market expected. That said, the RBA expects to raise rates further. Financial markets are pricing an additional 100bps of hikes by mid-23, about 50bps less than before to the decision.

In its financial stability report, the RBA noted most Australian households are expected to be able to cope with rising mortgage interest repayments. However, a small group of borrowers are vulnerable because of high debt levels and low buffers. Overall, the report finds that the Australian financial system remains in good shape thanks to high profitability, high capital levels and strong liquidity.

...despite strength in activity

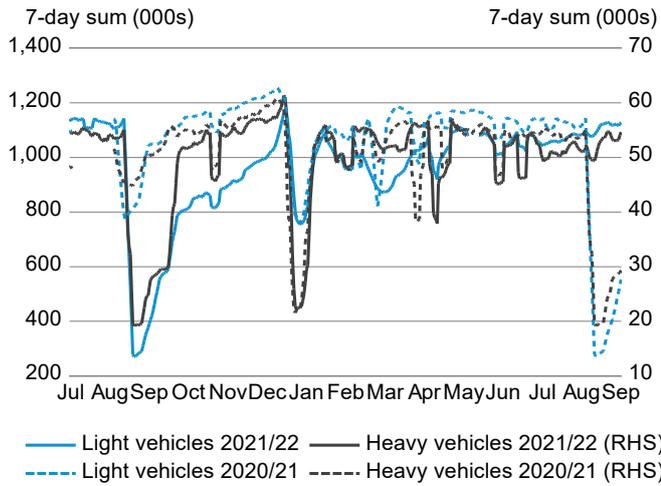
The economy continues to perform strongly according to September’s NAB Business Survey. Business conditions, which are more closely correlated with activity than confidence, rose by 3 index points to +25 on the back of surging trading, whilst confidence fell 5pts to +5, a little below average. Demand for labour is still high but there are tentative signs that inflationary pressures from inputs to final product prices are beginning to ease. Labour costs increased by 3.1% on a quarterly basis, down from a peak of 4.6% in July, while purchase prices and final prices were also down from recent highs. In contrast, consumer sentiment fell by 0.9% to 83.7 pts in the latest Westpac-Melbourne Institute survey, a very low level consistent with major economic disruption.

Coming Up:

Date	Release
17 Oct	PSI (Sept)
18 Oct	CPI inflation (Sept qtr)
21 Oct	International trade (Sept)
26 Oct	ANZ Business Outlook (Oct)
28 Oct	ANZ-RM consumer confidence (Oct)

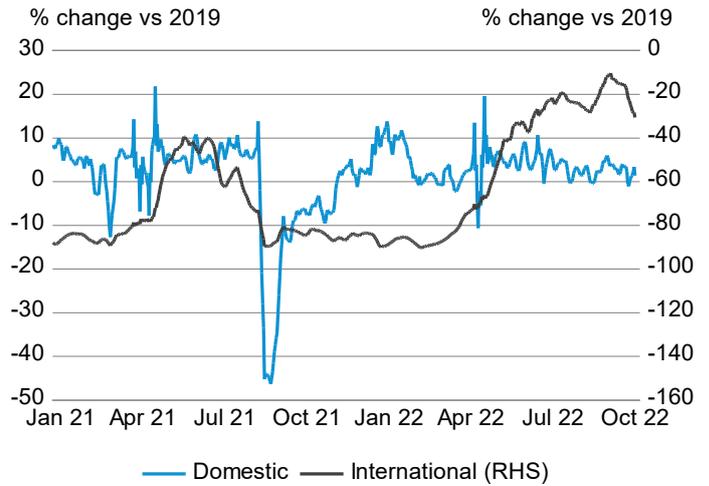
High-Frequency Indicators

Traffic and Freight Movement



Source: Waka Kotahi NZ Transport Agency

Card Spending



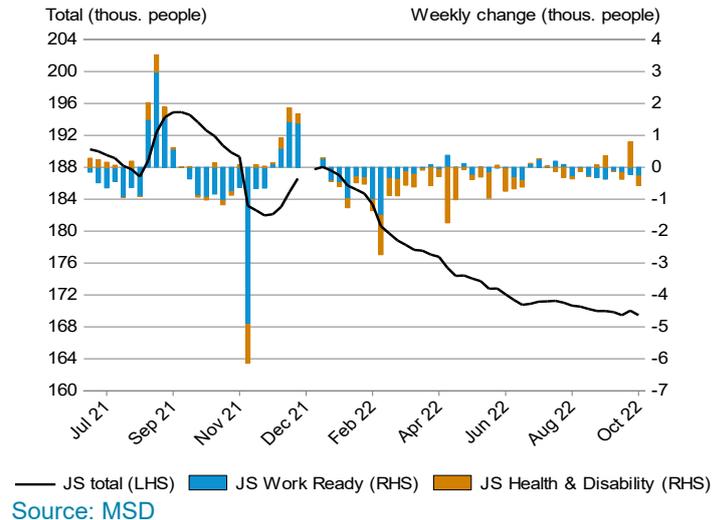
Source: Marketview data via MBIE

People Movements at Selected Locations



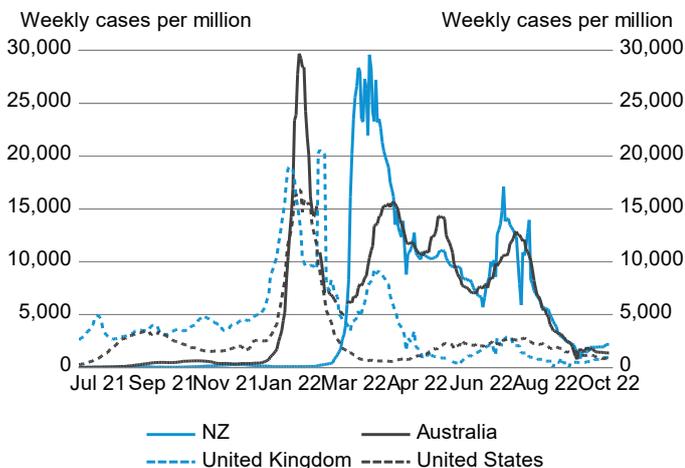
Source: Google/Haver

Jobseeker (JS) and Income Support Receipts



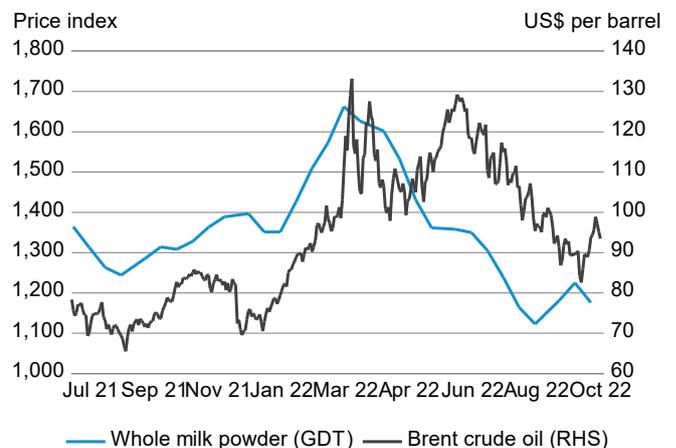
Source: MSD

COVID-19 Cases Per Million People



Source: John Hopkins University/Haver

World Commodity Prices



Source: Haver

Tables

Quarterly Indicators		2021Q2	2021Q3	2021Q4	2022Q1	2022Q2	2022Q3
Real Production GDP (1)	qpc	2.3	-3.9	3.0	-0.2	1.7	...
	aapc	5.1	4.8	5.5	4.9	1.0	...
Current account balance (annual)	%GDP	-3.4	-4.8	-6.0	-6.8	-7.7	...
Merchandise terms of trade	apc	-0.1	5.2	2.8	3.3	-2.4	...
CPI inflation	qpc	1.3	2.2	1.4	1.8	1.7	...
	apc	3.3	4.9	5.9	6.9	7.3	...
Employment (HLFS) (1)	qpc	1.1	1.7	-0.1	-0.0	0.0	...
Unemployment rate (1)	%	3.9	3.3	3.2	3.2	3.3	...
Participation rate (1)	%	70.5	71.2	71.0	70.9	70.8	...
LCI salary & wage rates - total (2)	apc	2.1	2.4	2.6	3.0	3.4	...
QES average hourly earnings - total (2)	apc	4.0	3.5	3.8	4.8	6.4	...
Core retail sales volume	apc	30.0	-3.2	5.1	3.2	-1.8	...
Total retail sales volume	apc	33.1	-5.1	4.4	2.3	-3.7	...
WMM - consumer confidence (3)	Index	107.1	102.7	99.1	92.1	78.7	...
QSBO - general business situation (1,4)	net%	9.0	-11.4	-36.5	-33.8	-61.9	-42.4
QSBO - own activity outlook (1,4)	net%	29.1	10.0	6.9	5.2	-12.0	-14.0

Monthly Indicators		Apr 22	May 22	Jun 22	Jul 22	Aug 22	Sep 22
Merchandise trade balance (12 month)	NZ\$m	-9,247.6	-9596.5	-10946.6	-11965.3	-12279.7	...
Dwelling consents - residential	apc	-6.9	7.8	-6.5	-2.9	0.9	...
House sales - dwellings	apc	-32.9	-25.5	-35.6	-34.7	-16.1	-10.9
REINZ - house price index	apc	6.2	3.8	0.7	-2.8	-5.7	-8.0
Estimated net migration (12 month total)	people	-15,790.0	-15723.0	-13669.0	-12249.0	-10973.0	...
ANZ NZ commodity price index	apc	17.5	16.5	14.5	14.2	10.8	14.0
ANZ world commodity price index	apc	13.2	6.2	4.8	4.3	2.4	0.3
ANZBO - business confidence	net%	-42.0	-55.6	-62.6	-56.7	-47.8	-36.7
ANZBO - activity outlook	net%	8.0	-4.7	-9.1	-8.7	-4.0	-1.8
ANZ-Roy Morgan - consumer confidence	net%	84.4	82.3	80.5	81.9	85.4	85.4
NZAC	apc	...	...	...	...	...	...

Daily Indicators		Fri	Mon	Tue	Wed	Thu	Fri
		7/10/22	10/10/22	11/10/22	12/10/22	13/10/22	14/10/22
NZ exchange and interest rates (5)							
NZD/USD	\$	0.5660	0.5615	0.5580	0.5583	0.5619	...
NZD/AUD	\$	0.8827	0.8823	0.8858	0.8914	0.8939	...
Trade weighted index (TWI)	index	67.42	67.07	66.98	67.25	67.57	...
Official cash rate (OCR)	%	3.50	3.50	3.50	3.50	3.50	...
90 day bank bill rate	%	3.88	3.92	3.91	3.92	3.95	...
10 year govt bond rate	%	4.21	4.33	4.41	4.51	4.49	...
Share markets (6)							
Dow Jones	index	29,297	29203	29239	29211	30039	...
S&P 500	index	3,640	3612	3589	3577	3670	...
VIX volatility index	index	31.4	32.5	33.6	33.6	31.9	...
AU all ords	index	6,976	6872	6844	6842	6834	...
NZX 50	index	11,104	10918	10957	10873	10817	...
US interest rates							
3 month OIS	%	3.08	3.08	3.08	3.08	...	...
3 month Libor	%	3.91	3.92	3.94	4.01	...	...
10 year govt bond rate	%	3.89	...	3.93	3.91	3.97	...
Commodity prices (6)							
WTI oil	US\$/barrel	93.07	91.60	89.75	87.83	...	...
Gold	US\$/ounce	1,696.15	1676.55	1664.70	1670.65	...	...
CRB Futures	index	559.12	559.15	560.99	558.56	...	...

(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		2021Q4	Apr 22	May 22	Jun 22	2022Q1	Jul 22	Aug 22	Sep 22	2022Q2	Oct 22
United States	GDP (1)	qpc	1.7				-0.4				-0.1	
	Industrial production (1)	mpc		0.7	-0.1	0.0		0.5	-0.2	...		...
	CPI	apc		8.3	8.6	9.1		8.5	8.3	8.2		...
	Unemployment rate (1)	%		3.6	3.6	3.6		3.5	3.7	3.5		...
	Employment change (1)	000s		368.0	386.0	293.0		537.0	315.0	263.0		...
	Retail sales value	apc		7.8	8.7	8.8		10.1	9.1	...		...
	House prices (2)	apc		21.3	20.5	18.7		16.1	...	...		...
	PMI manufacturing (1)	index		55.4	56.1	53.0		52.8	52.8	50.9		...
Consumer confidence (1)(3)	index		108.6	103.2	98.4		95.3	103.6	108.0		...	
Japan	GDP (1)	qpc	1.0				0.1				0.9	
	Industrial production (1)	mpc		-1.5	-7.5	9.2		0.8	2.7	...		...
	CPI	apc		2.5	2.5	2.3		2.6	3.0	...		...
	Unemployment rate (1)	%		2.5	2.6	2.6		2.6	2.5	...		...
	Retail sales value	apc		3.1	3.7	1.5		2.4	4.1	...		...
	PMI manufacturing (1)	index		53.5	53.3	52.7		52.1	51.5	50.8		...
	Consumer confidence (1)(4)	index		32.0	33.1	32.3		30.1	32.0	31.2		...
Euro area	GDP (1)	qpc	0.5				0.7				0.8	
	Industrial production (1)	mpc		0.0	1.3	1.0		-2.3	1.5	...		...
	CPI	apc		7.4	8.1	8.6		8.9	9.1	...		...
	Unemployment rate (1)	%		6.7	6.7	6.7		6.6	6.6	...		...
	Retail sales volume	apc		4.4	0.7	-3.0		-1.2	-2.0	...		...
	PMI manufacturing (1)	index		55.5	54.6	52.1		49.8	49.6	48.4		...
	Consumer confidence (5)	index		-22.1	-21.2	-23.7		-27.1	-25.0	-28.8		...
United Kingdom	GDP (1)	qpc	1.6				0.7				0.2	
	Industrial production (1)	mpc		-0.2	0.4	-0.3		-1.1	-1.8	...		...
	CPI	apc		7.8	7.9	8.2		8.8	8.6	...		...
	Unemployment rate (1)	%		3.8	3.8	3.8		3.6	3.5	...		...
	Retail sales volume	apc		-6.1	-5.1	-6.4		-3.2	-5.3	...		...
	House prices (6)	apc		12.1	11.2	10.7		11.0	10.0	9.5		...
	PMI manufacturing (1)	index		55.8	54.6	52.8		52.1	47.3	48.4		...
	Consumer confidence (1)(5)	net %		-38.0	-40.0	-41.0		-41.0	-44.0	-49.0		...
Australia	GDP (1)	qpc	3.9				0.7				0.9	
	CPI	apc	3.5				5.1				6.1	
	Unemployment rate (1)	%		3.9	3.9	3.5		3.4	3.5	...		...
	Retail sales value	apc		11.1	10.2	12.2		15.8	19.4	...		...
	House Prices (7)	apc	27.5				...				...
	PMI manufacturing (1)	index		58.5	52.4	54.0		52.5	49.3	50.2		...
	Consumer confidence (8)	index		95.8	90.4	86.4		83.8	81.2	84.4		83.7
China	GDP	apc	4.0				4.8				0.4	
	Industrial production	apc		-2.9	0.7	3.9		3.8	4.2	...		...
	CPI	apc		2.1	2.1	2.5		2.7	2.5	...		...
	PMI manufacturing (1)	index		47.4	49.6	50.2		49.0	49.4	50.1		...
South Korea	GDP (1)	qpc	1.3				0.6				0.7	
	Industrial production (1)	mpc		-3.2	0.3	1.8		-1.3	-1.8	...		...
	CPI	apc		4.8	5.4	6.0		6.3	5.7	5.6		...

(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