Te Kauae Kaimahi

Monthly Economic Bulletin

June 2023

NEW ZEALAND COUNCIL OF TRADE UNIONS
union.org.nz

Monthly Economic Bulletin

June 2023

Greetings from the NZCTU and welcome to the June edition of the Economic Bulletin.

In this edition we debunk the idea that the New Zealand economy is in the doldrums. Contrary to the narrative being pushed by the National and ACT parties, the New Zealand economy has performed strongly compared to many of our OECD peers in recent years. Higher interest rates and inflation are putting immense pressure on many working families, but cuts to tax and government spending won't solve this. Instead, we need to be supporting those who are currently in need while also turning our attention to the real problem: decades of underinvestment in housing, health, education, and climate change.

We also lift the hood on bank profitability in New Zealand in this edition. The Commerce Commission is set to conduct an inquiry into competition in the banking sector. This is welcome, as the data indicates the big four banks – ANZ, BNZ, ASB, and Westpac – have effectively captured the market in New Zealand and are enjoying super profits as a result.

This edition also covers the latest figures for GDP, wages, and inflation, and discusses the recent set of economic forecasts.

As always, we welcome your feedback and any suggestions for areas of future investigation.

CRAIG RENNEY
Policy Director & Economist
craigr@nzctu.org.nz

JACK FOSTER
Policy Analyst
jackf@nzctu.org.nz

Contents

On narratives and nonsense

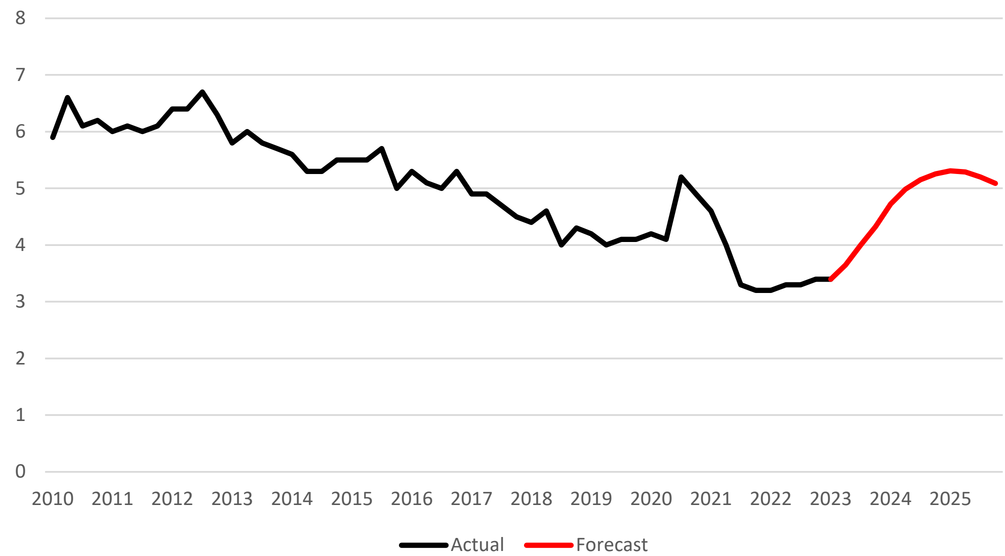
I've been on holiday recently, and many people take a book with them when they have a break. I took a copy of Nobel Laureate Robert Shiller's book *Narrative Economics*. The central premise of the book is that economics shouldn't just be the study of dry statistics, or impossibly complicated algebra. Economics should also examine the 'narratives' that are occupying society – or, as Shiller says, 'traditional economic approaches fail to examine the role of public beliefs in major economic events'.

Economic narratives are stories or ideas that seem to have persuasive force at a point in time. Narratives don't need to be rational, or evidenced-based, and they are frequently political. They simply provide an 'answer' to the problems that many people perceive to exist. Like the idea that extreme deregulation and market liberalisation in the 1980s would make everyone in New Zealand better off, or that excessive government spending caused the Global Financial Crisis (hint – they didn't). They capture a mood and provide an easy answer to often complex problems.

Right now, a new narrative is trying to take hold around the state of the NZ economy: that we are in the economic doldrums. The National party talks about the need to 'kick-start New Zealand's economy' and get 'New Zealand's economic engine humming again'. Somehow New Zealand has 'lost its mojo'. ACT's economic policy says that we need to 'cut taxes to get the economy moving again and Kiwis back into work'. The narrative is that things aren't all well in the New Zealand economy and that jobs are being lost. A tax cut or cutting government spending is often touted as the panacea for these ills.

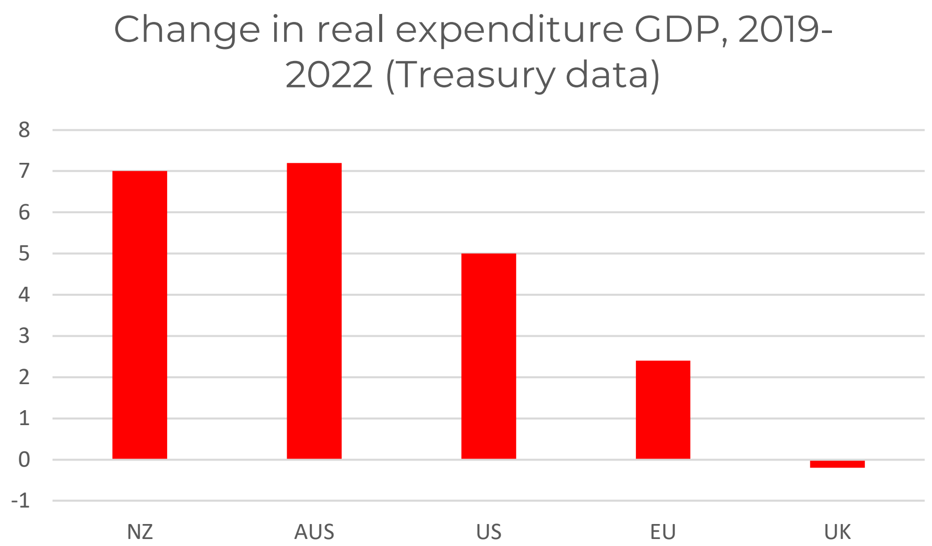
But like many economic narratives, this one should be treated with caution. Take unemployment, which has been at or around its lowest level since 1986. It is forecast to peak at 5.3% in 2024, where it will still be lower than at any time during the period between 2009 and 2015. Wages are forecast to grow faster than inflation in each of the next four years according to the Treasury. New Zealand has never had as many people working, nor working as many hours, as there are right now.

Unemployment, actual and forecast (Treasury data)



It's not just workers who are benefitting. Profit levels since the start of the pandemic have grown significantly. Profits have grown 64% between 2019 and 2022 – and are forecast to grow another 27% over the next four years. New Zealand's big four banks made record profits last year of $7.2bn – or $1,384 per person in Aotearoa. Air New Zealand profits have surged, as have profits in energy companies and a range of other sectors. The NZX50 index is up 5.8% this year. This is not what an economy just limping through looks like.

Then let's look at economic growth. Between 2019 and 2022 the New Zealand economy grew faster than the US, the UK, and the EU region, and at the same pace as Australia. Yes, we are in recession, but only just – with GDP declining by $45m last quarter. That may sound like a lot, but in the context of a $70bn economy its well within the margin of error. To give you some idea of the size of the current recession, it's about the same as the loss of one minute of output per day if you worked 24 hours a day. It's essentially well within the margin for error when we measure GDP.



Now let's forget the dry numbers that take up too much airtime and concentrate on one of the issues that really matters, child poverty. Since 2017 the number of children living in poverty has fallen by 77,000. The proportion of children living in what is called 'after-housing cost poverty' is on target to have fallen from 30% in 2009 to 10% in 2028. Our recent progress is the acceleration of a trend that started in 2010, which is a testament to the actions of both governments. There is much more work to be done, but we aren't heading backwards here.

I'm not saying that everything is perfect. Indeed, for too many Kiwis they are struggling to pay the bills and deal with the cost of living. Many will face higher mortgage payments as a consequence of a higher interest rate. Low wages and insecure work are a constant reality. But these problems are not short-term in their origin, nor are they readily answered with a tax cut. They certainly aren't answered with a cut to public spending. They are the problems of an economy in which there has been underinvestment for decades – in housing, health, education, climate change, and delivering more competitive markets. Disasters such as COVID and Cyclone Gabrielle have simply exposed the consequences of that underinvestment.

Governments internationally have fallen on the back of economic narratives such as this, and the government will have a job to do to change the story. That's perfectly fair, but the ramifications of this 'vibe' at this election may be highly significant. Accepting this narrative of decline may mean becoming a country where people are increasingly left to fend for themselves, and where your ability to pay dictates your access to once-universal public services.

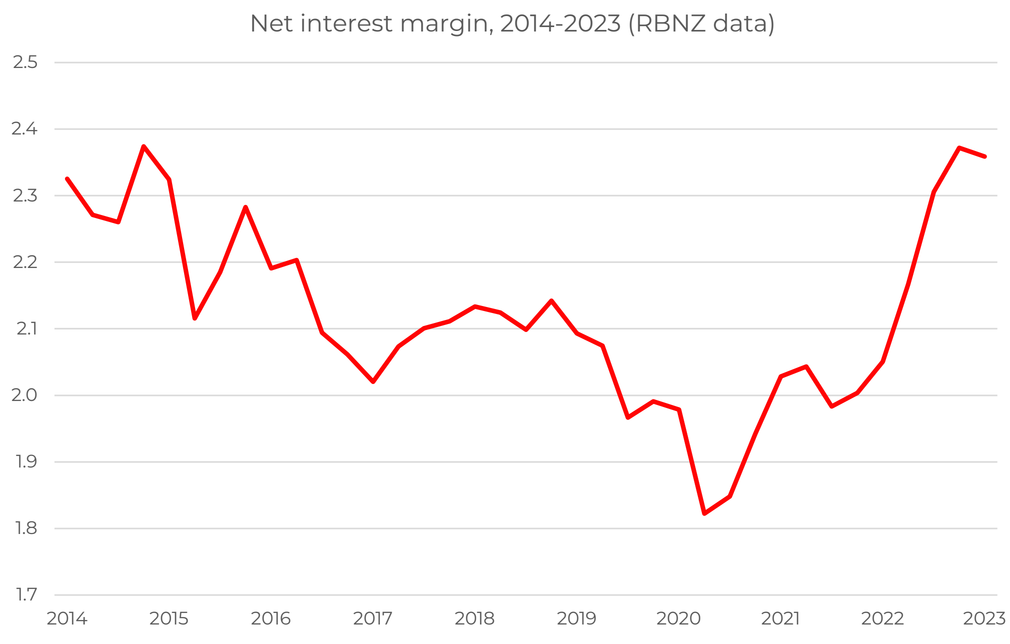
We should examine carefully the stories being told to us about the economy. That's why at the CTU we will be examining the claims of the different political parties in the lead-up to the election and making sure that they hold up to scrutiny. But it's also more important than ever that you, dear reader, stop and ask questions about what various people are saying on the economy. The CTU as ever will be delighted to help you understand the real reasons why things are happening, not just the spin.

Banking on super-profits

There has been a lot of talk recently about bank profits in New Zealand, and whether the four big banks have been enjoying 'super-profits' during the economic recovery from COVID-19. In welcome news, the government has announced the Commerce Commission will undertake an *inquiry* into competition in the retail banking sector. This will include examining barriers to entry and expansion for smaller banks, the extent of innovation in financial products and services, and customers' ability to change banks.

The big banks and their outriders in the media would have us believe that the nominal profits they rake in are explained by the simple fact that they are big businesses. Is this really the case? Usefully, the Reserve Bank's recent *Financial Stability Report* has already shed some light on this issue, with a special section dedicated to bank profitability. In this note, we examine what the data tells us about bank profitability in New Zealand, and whether the big banks are indeed making super profits.

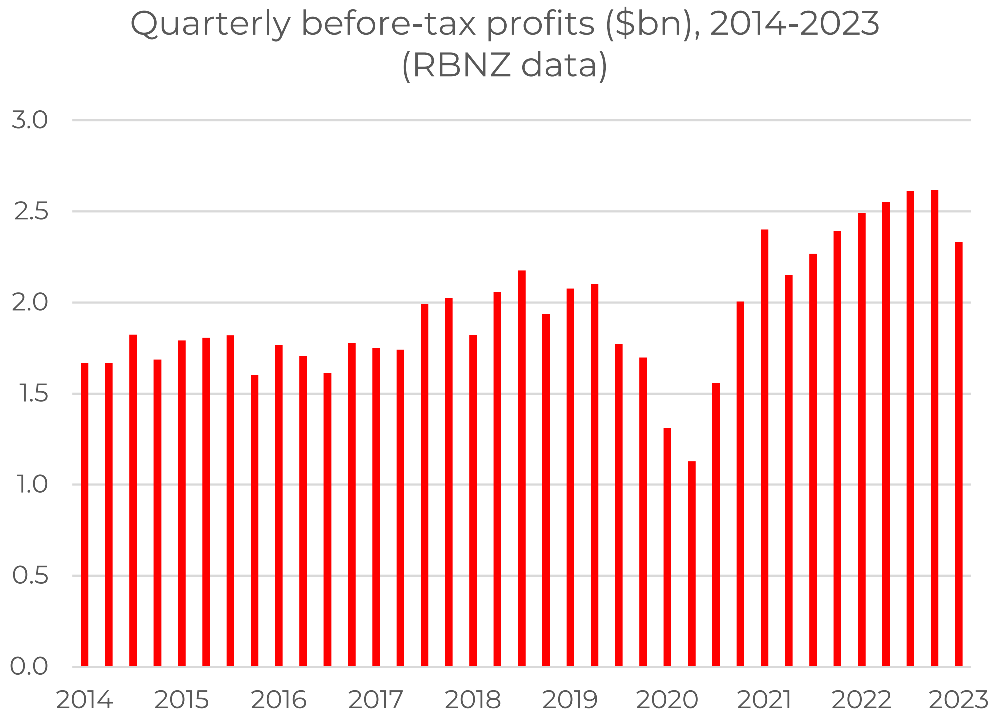
The first graph, using data from the Reserve Bank, shows the net interest margin (NIM) for the banking system as a whole. The NIM is the difference between the interest a bank earns on its assets (such as mortgages and business loans) and the interest it pays on its liabilities (such as term deposits and debt owed to other banks). The lion's share of banks' earnings in New Zealand come from the NIM, which makes it a good measure of how well the banks are faring.



As this graph shows, from 2014–2020 the NIM slowly trended down (partly the result of very low interest rates globally), before falling sharply during the outbreak of COVID-19. However, it recovered through 2021 and then rose rapidly over the course of 2022 and early 2023 as the Reserve Bank hiked the Official Cash Rate. This is because the banks have been able to increase their mortgage rates while still enjoying access to relatively cheap funding. The NIM will likely narrow over the next year as the cost of funding catches up somewhat with mortgage rates.

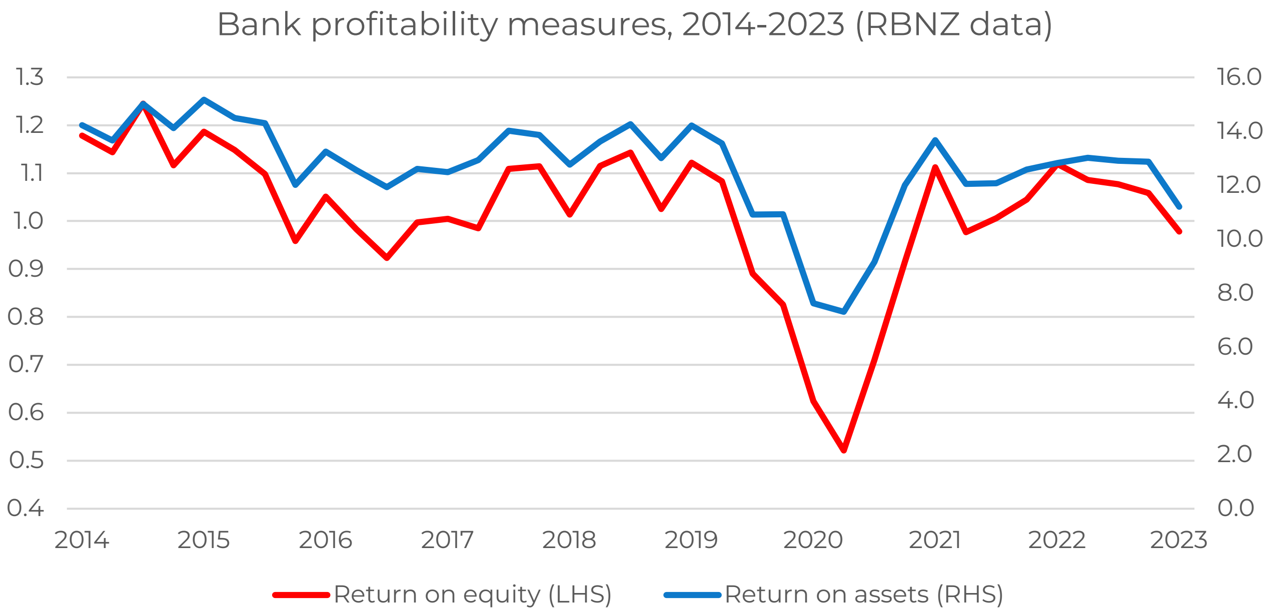
A stronger NIM has been partially responsible for the rise in banks' nominal profits over the past two years, as illustrated in the second graph. At the same time as the banks' nominal profits have been happily climbing north, many working New Zealanders have seen their real incomes shrink in the face of high inflation and rising mortgage rates – the latter being the result of the policy response to the former.

The impact of rising mortgage rates on disposable incomes is massive. The Reserve Bank estimates that, for households with mortgages, the share of disposable income going to interest costs will increase from a low of 9% to around 22% by the end of 2023. First-home buyers who took on large loans during the bubble years will be even worse hit. In this respect, the banks have been clear winners in the post-COVID recovery, raking in big profits while the disposable incomes of working families shrink.



However, as the Reserve Bank notes, 'measuring profitability in nominal terms does not control for variables such as growth in the size of a business over time and inflation'. This is important because, in addition to higher inflation over the past two years, banks' assets have also increased significantly – an outcome of the growth of mortgage-lending in 2020 and 2021.

More reliable measures of bank profitability, then, are the return on equity and the return on assets, which are illustrated in the third graph. The return on equity is the annual rate of return to a bank's shareholders, while the return on assets is the annual rate of return on all the assets that a bank holds on its books (mostly mortgages and other debt securities). As this graph shows, neither return on equity nor return on assets have risen above their pre-COVID trends. This suggests that, overall, the banking system is not necessarily any more profitable today than it was pre-COVID – the size of their mortgage books has simply gotten bigger. Does this mean that the recent super-profits are an illusion then?



That is certainly what the banks would have us believe. However, a simple comparison of the profitability of the big four (Australian-owned) banks against both the smaller New Zealand banks (such as Kiwibank) and the large banks of other wealthy countries helps clarify the picture.

The average rate of return on common equity (a measure that enables reliable profitability comparisons across countries) for the big Australian-owned banks was 15.3% over 2018-2022. This is *more than double* the rate of return for the smaller New Zealand banks over this period, and significantly more than the peer country average of 11.3%. Indeed, of the countries we like to compare ourselves to, only Canada's big banks generated a higher rate of return, at 19.6%. In Australia it was 12.9%, in Denmark 7%, and in Ireland only 4.8%.

Profitability of banks in New Zealand and peer countries (5-year averages, 2018-2022)	
Country (number of banks)	**Return on common equity**
New Zealand large banks (4)	15.28%
New Zealand small banks (5)	7.35%
Canada (4)	19.59%
Norway (3)	13.91%
Australia large banks (4)	12.87%
Australia small banks (3)	10.28%
Netherlands (4)	8.28%
Denmark (4)	7.03%
Ireland (4)	4.82%
Peer country average (37)	11.25%
Source: RBNZ	

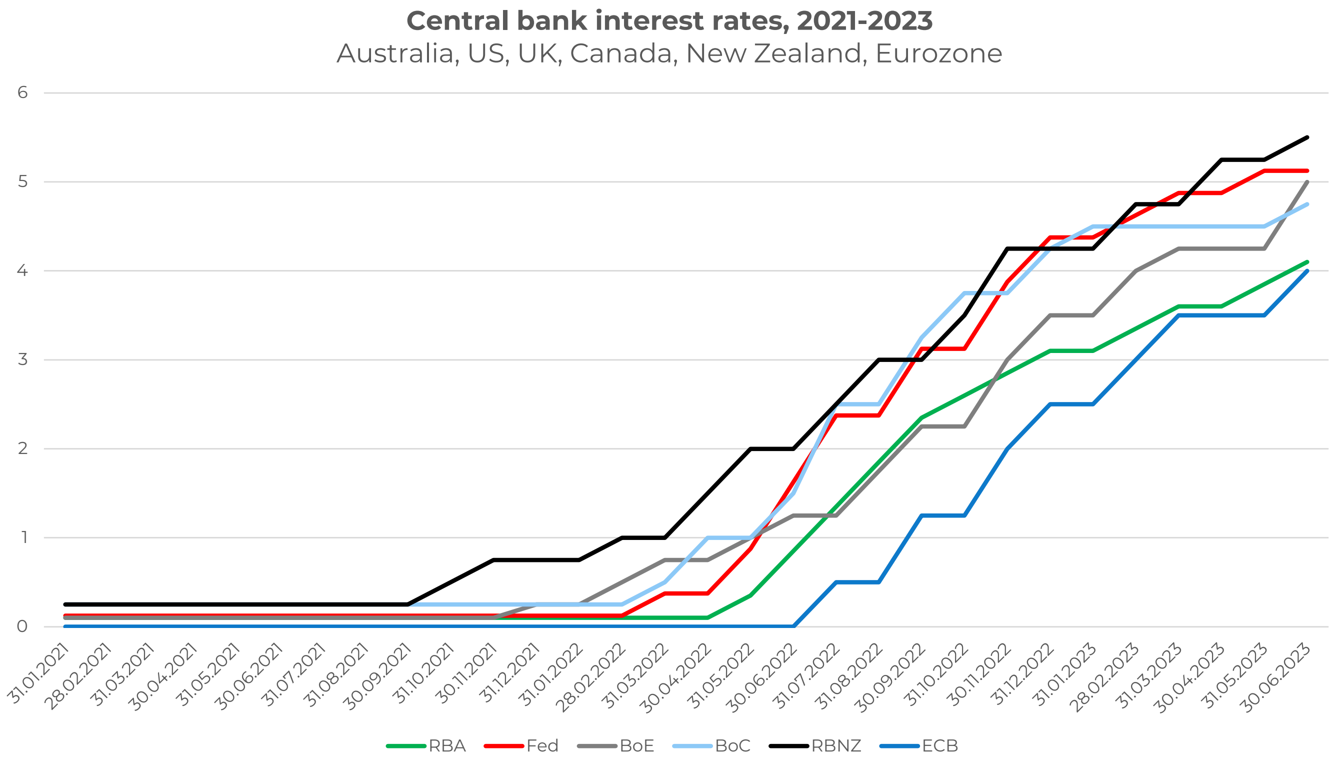
What these figures suggest is that the big Australian-owned banks are indeed earning super-profits. But these super-profits have less to do with the post-COVID economy and more to do with the structure of the banking system in this country. This structure is one in which a small number of very powerful corporations have a monopoly over a scarce and important resource: finance. The smaller banks, such as Kiwibank, lack the size to compete with their larger Australian cousins, and New Zealand's shallow capital markets mean that businesses have little option other than to secure financing from the banks.

One further ingredient completes the happy picture for the big Australian-owned banks: the fact that we haven't been building enough houses for several decades now, which, in combination with the absence of a comprehensive capital gains tax, has inflated property prices and therefore the size of the big banks' mortgage books. In these conditions, the banks' super-profits that we have been hearing about are not a post-COVID aberration but simply business as usual.

As with other dysfunctional sectors of the New Zealand economy such as the supermarkets and the electricity sector, the only way to change this is through political action. The Commerce Commission's inquiry is a good start and may provide recommendations on how government can make the banking system more competitive. Ultimately, though, bold action will be required from government itself.

Economic outlook

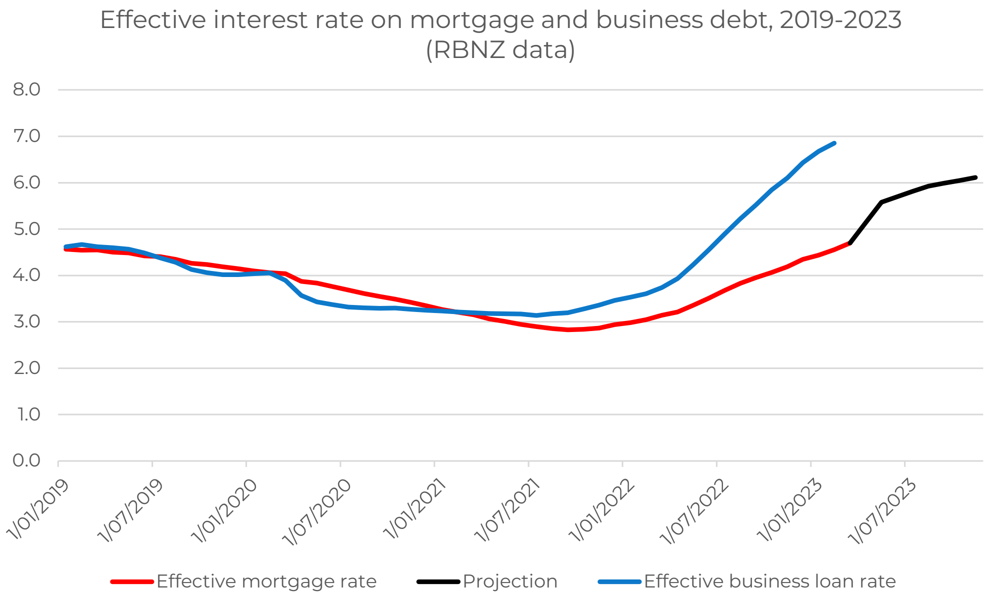
The Reserve Bank has continued to hike the Official Cash Rate (OCR) over recent months, increasing it to 5.5% in May. The Bank has now raised rates higher and faster than almost all other wealthy country central banks. The OCR has been hiked a cumulative 525 basis points since late 2021, the steepest rise since it was introduced in 1999.



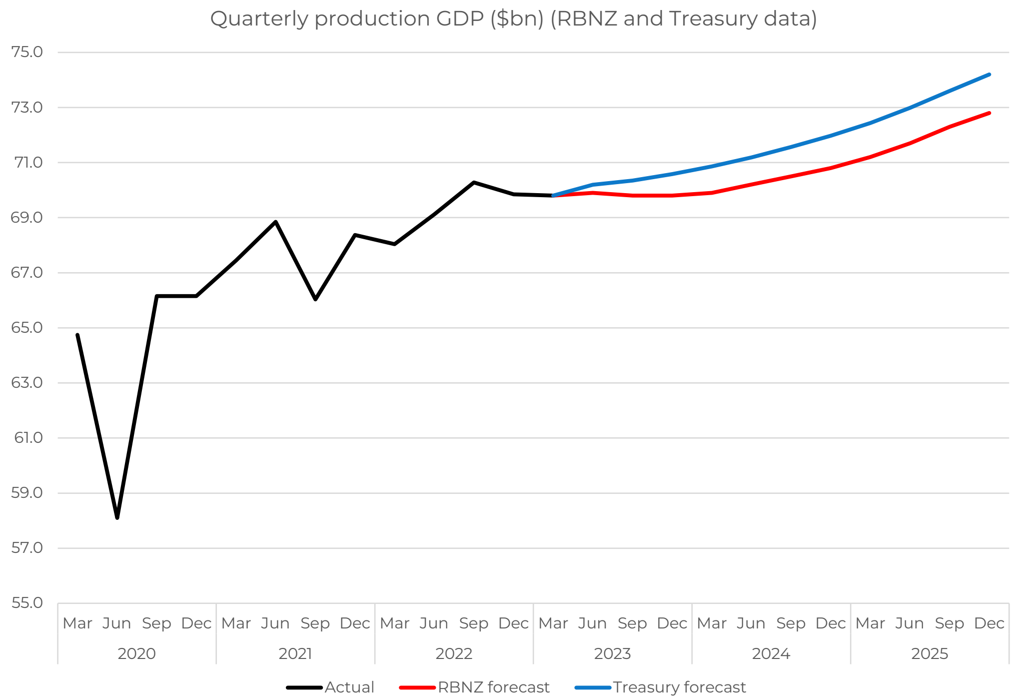
According to the Reserve Bank's own forecasts, the OCR has now peaked and is expected to stay above 5% through 2024 before slowly coming down again. Whether or not this happens will depend on how fast inflation falls, the extent to which the New Zealand economy withstands the pressure of higher interest rates, and how inflation evolves overseas.

The average effective interest rate on mortgage debt (that is, the average rate households are paying on their mortgage) has risen from a low of 2.8% in late-2021 to 4.7% in March 2023; the Reserve Bank projects that it will climb a further 140 points by the end of the year to reach 6.1%.

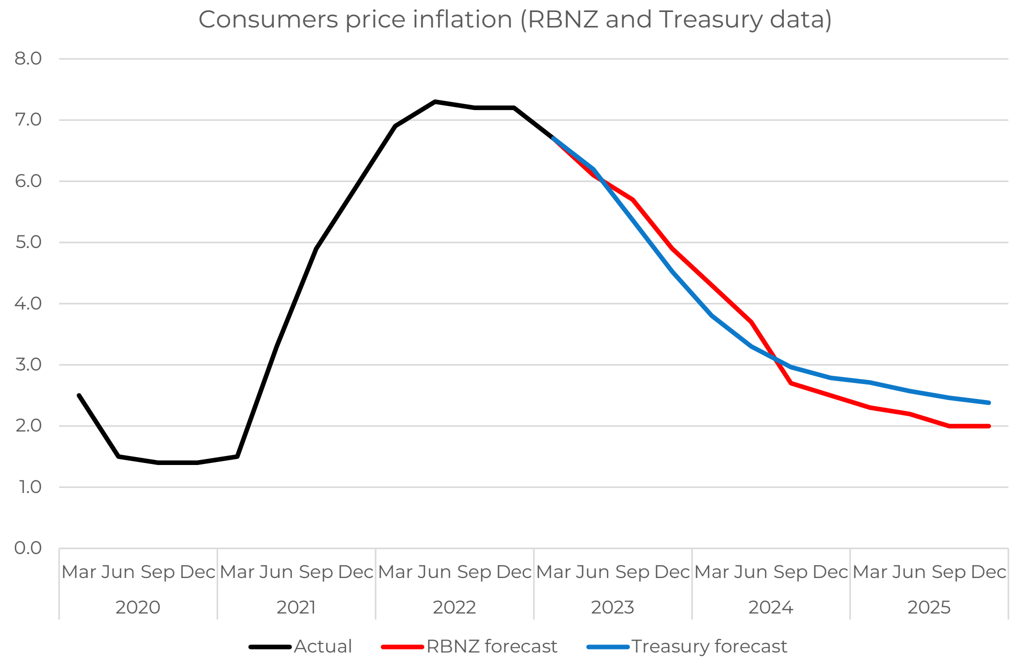
Meanwhile, the average effective interest rate on business debt has shot up from its late-2021 low of 3.1% to 6.9%. It is no surprise, then, that the Reserve Bank believes monetary policy has reached restrictive territory, meaning higher interest rates are actively holding back investment and consumer spending. The recent GDP and inflation figures, discussed below, bear this out – economic output appears to be suffering under higher interest rates and inflation has fallen sharply off its 2022 peak. As yet, however, we are yet to see significant change in the labour market.



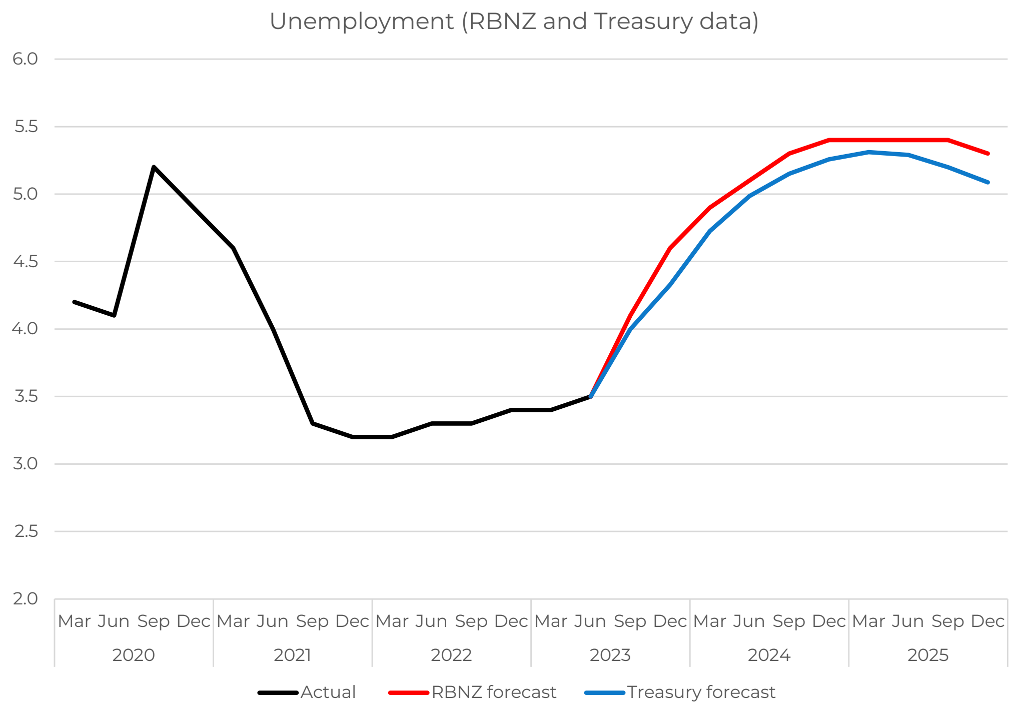
The *Treasury* and the *Reserve Bank* both released their economic forecasts in May. These institutions both expect that GDP growth will be weak for the rest of the year, with further quarters of negative growth possible. The Treasury's forecasts are a touch more optimistic than the Reserve Bank's, as the graphs below indicate.



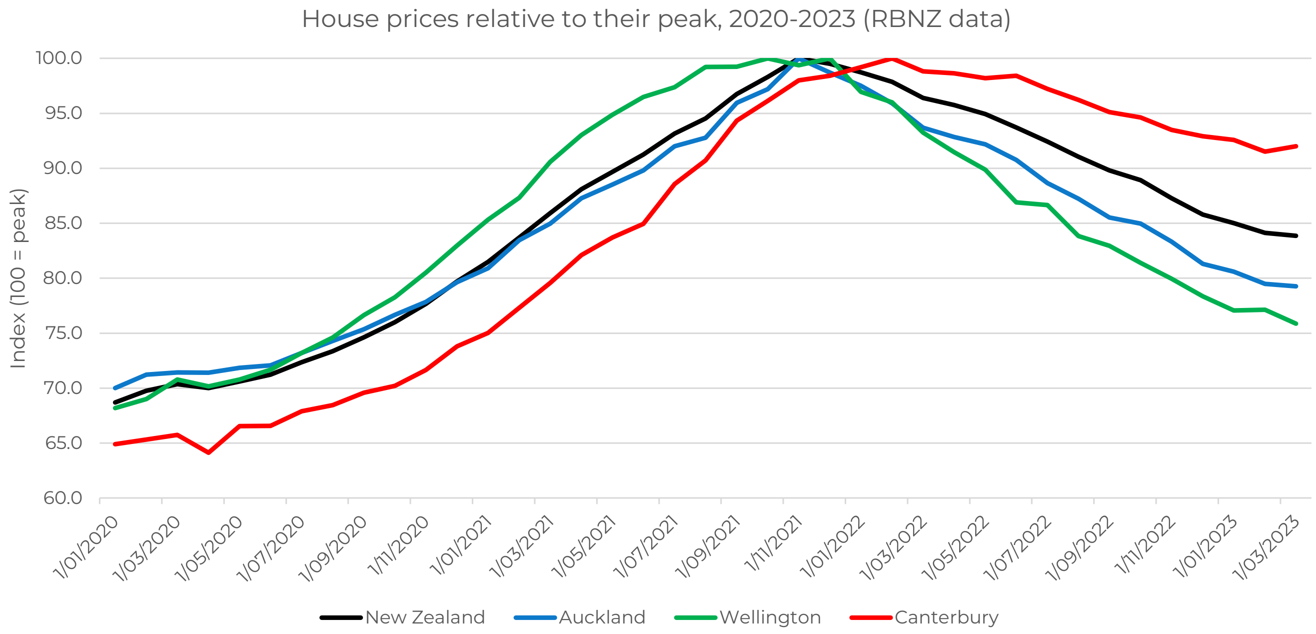
CPI is expected to fall sharply over the course of 2023, coming back into the Reserve Bank's target range of 1–3% by late next year. At the same time, wage growth is expected to outstrip inflation, meaning most workers will be experiencing real wage rises over the forecast period.



It is expected that higher interest rates will cause unemployment to rise over the next two years, peaking somewhere in the 5–5.5% range. In real terms, this would mean somewhere between 50,000-70,000 more Kiwis out of employment. The basic trade-off underpinning the Reserve Bank's monetary policy is that unemployment must rise for inflation to fall. As we have argued in previous *Bulletins*, and in the *Inflation and Incomes Act*, this approach to managing inflation disproportionately impacts low-income workers who are precariously attached to the labour market and is not well-suited to tackling the supply-side drivers of inflation.



Meanwhile, the housing bubble has continued to deflate, with the steepest declines registered in Auckland and Wellington. Forecasters are expecting that prices will continue to decline until the end of the year, albeit at a slower rate than 2022. From there, house prices are expected to begin slowly climbing north again. However, the *Reserve Bank* has recently eased loan-to-value-ratio restrictions on higher-risk mortgage lending and this, combined with the pause in further OCR hikes, may turn things around sooner than expected.



NZIER released its consensus forecasts in early June. Compared to its March forecasts, NZIER expects that GDP growth will be slightly higher through 2023/24 and 2024/25, and that consumers price inflation (CPI) will fall faster than previously expected over the forecast period. The consensus forecasts also expect wage growth will outstrip inflation over the forecast period and unemployment will rise to over 5% by 2024/25.

NZIER Consensus Forecasts, June 2023

	2022/23*	2023/24	2024/25	2025/26
GDP	▼ 2.8%	▲ 0.6%	▲ 1.4%	▲ 2.4%
Private consumption	▲ 1.6%	▼ 0.0 %	▼ 0.9%	▼ 2.1%
Public consumption	▼ 2.0%	▲ -0.1%	▲ -0.3%	▲ 1.0%
CPI	▼ 6.7%	► 3.9%	▼ 2.4%	► 2.2%
Unemployment	► 3.4%	► 4.6%	► 5.2%	► 5.0%
Wages	▲ 8.0%	▲ 6.9%	► 5.0%	► 3.8%

** Year ending March.*

Arrows denote direction of change from the March 2023 Consensus Forecasts.

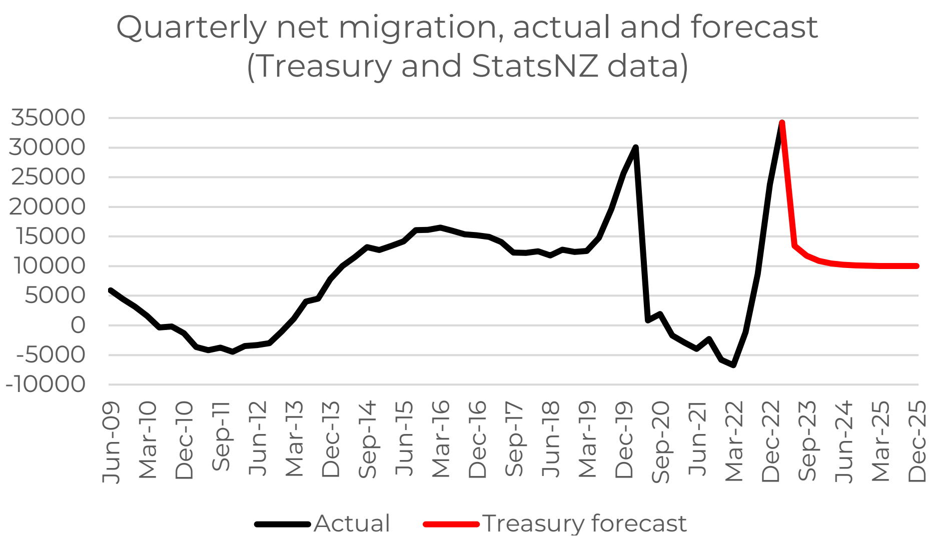
Source: NZIER Consensus Forecasts

Internationally, economic forecasters continue to turn out gloomy-looking numbers for global economic development. While the reopening of the Chinese economy has been good news for global growth, this is offset by ongoing central bank rate hikes, the war in Ukraine, and financial instability (the US has recorded its second and third largest bank failures in history this year). With all this uncertainty, it is no wonder economic forecasts have been so volatile over the past year, with sentiment seesawing between mildly optimistic and deeply pessimistic as the data moves around.

Turning to the numbers, the *IMF's World Economic Outlook*, released in April, forecasts that global growth will decline from 3.4% in 2022 to 2.8% for 2023, before settling at 3% for the next couple of years. This is a downward revision from its January forecasts. Growth is expected to be sluggish in the wealthy countries, which are forecast to grow by only 1.3% in 2023 and 1.4% in 2024. Of the biggest economies, the US is forecast to grow by 1.6% in 2023, the Euro Area by 0.8%, and China by a healthy 5.2%. Consistent with its earlier forecasts, the IMF expects that inflation will moderate over 2023 and 2024, coming down fastest in the wealthy economies.

Economic forecasts should be taken with a healthy pinch of salt at the best of times, and the peculiarity of the post-COVID economy mean even heavier seasoning than usual is advised. What we can say is that the New Zealand economy has been reasonably strong over the past several years, and this puts us in a good position to weather the expected downturn.

We should be particularly concerned about the validity of economic forecasts for New Zealand given recent changes in international migration. Statistics NZ data suggests that net migration is increasing much more rapidly than had been forecast previously. This is likely to flow through to increased demand for goods and services such as housing, food, and transport – meaning higher economic growth but also potentially higher inflation. Its impacts are also likely to be felt very unevenly across the country, with a larger effect in urban centres such as Auckland, and less of an impact on more rural and provincial locations.



Migration may well be creating an ‘upside’ risk to the economic forecasts being presented by the Treasury and the Reserve Bank. While extra economic growth would be welcome, we should also ensure that we are looking after new migrants by making sure that we have the health, education, and housing services that they will need. If we as a country are happy to take migrant labour and skills, we should also be happy to make sure we are looking after their wellbeing. That means more investment in public services, not less.

Economic indicators

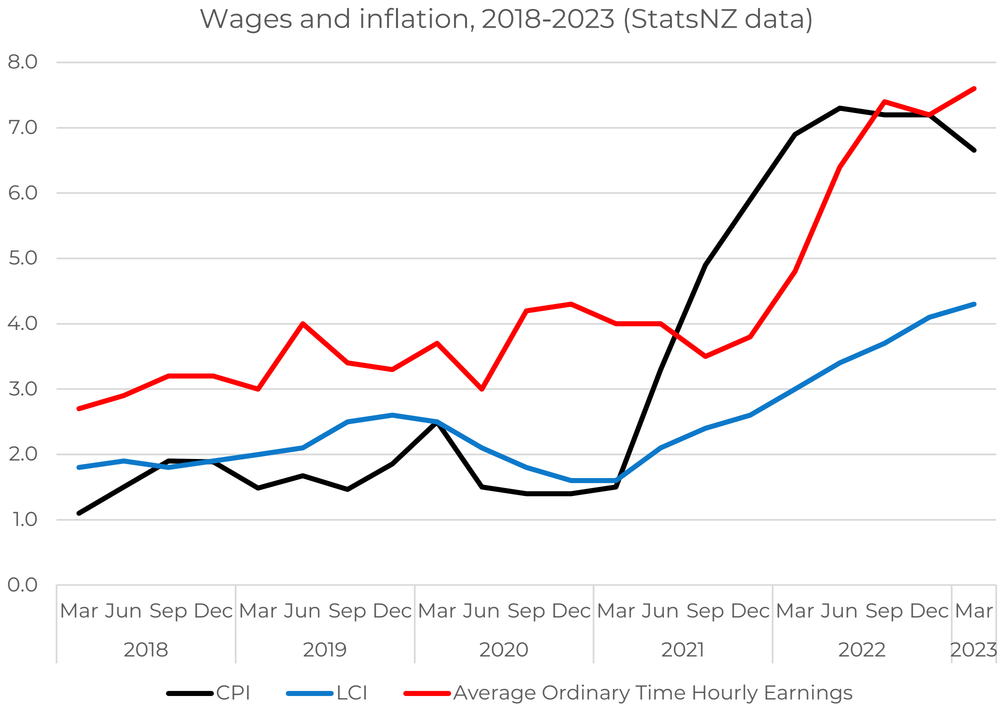
Wages

Wages continued to increase in the March 2023 quarter. Year on year, the *Labour Cost Index* (LCI), which measures the price for a fixed quality and quantity of labour, increased 4.3%. Wage growth has been strongest in the private sector, which increased 4.5% for the year, compared to a 4.3% increase in the public sector.

For the year ending March 2023, average ordinary time hourly earnings increased by 7.6% to $38.93. This measure comes from the *Quarterly Employment Survey* (QES); it captures the income received by workers and includes pay rises from promotions and switching jobs. Average ordinary time hourly earnings have now matched or outstripped CPI for the past three quarters, as shown in the graph below.

The private sector has seen the biggest gains here, with average wages increasing by 8.2% for the year to March 2023; by contrast, public sector average ordinary time hourly earnings have increased by 4.9%. In real terms, this means that private sector wages have increased by $2.83 to $37.19 while public sector wages have increased by $2.15 to $45.62.

Breaking wage increases down by industry, construction has seen the largest increase, with average ordinary time hourly wages rising 10.5% for the year. Accounting for annual CPI of 6.7%, this means that construction workers have, on average, seen their real wages grow over the past year. By contrast, wages in forestry and mining have increased only 3.9%, meaning workers in this industry have, on average, taken a real pay cut of 2.8%. Annual wage growth has also been below par in wholesale trade, at 4.8%, and accommodation and food services, at 5.4%. All other industries have seen wage growth of between 6–9%.



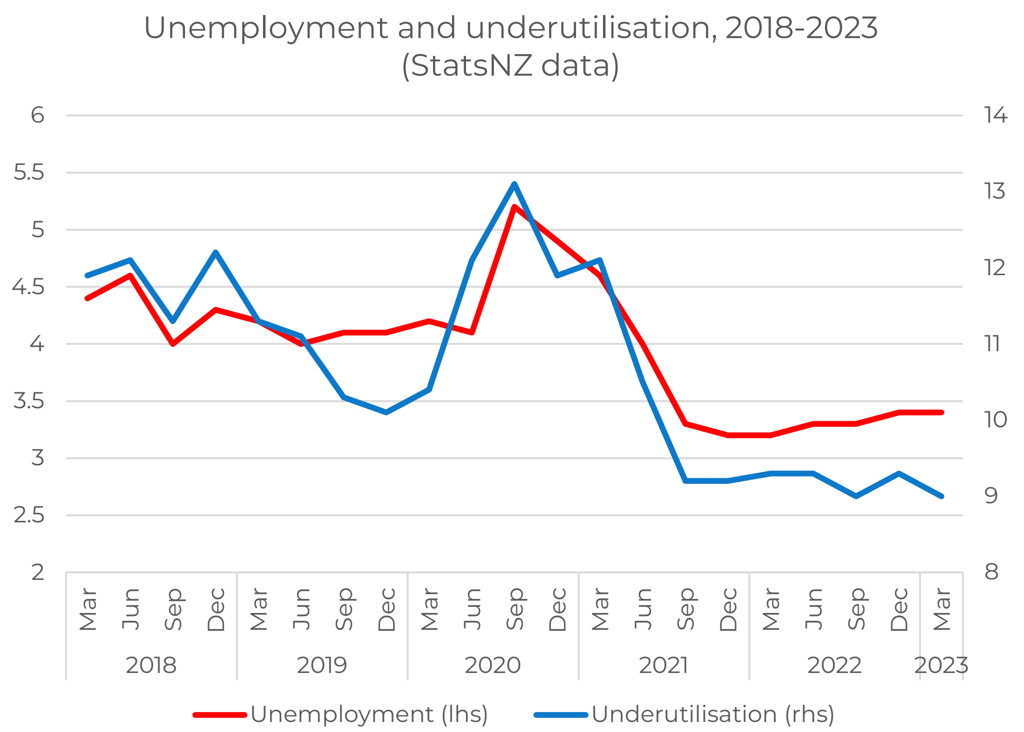
Employment, unemployment, underutilisation

The strong wage growth discussed above is underpinned by a strong *labour market*. For the March 2023 quarter, the employment rate ticked up marginally, rising to 69.5% – which is high relative to pre-COVID levels. In concrete terms, this represents 2.89 million people in some form of employment.

Unemployment was unchanged from the December 2022 quarter, at 3.4% – close to the record low of 3.2% set in 2021. In real terms, this means 102,000 people are currently out of work and actively seeking it.

Meanwhile, underutilisation – a broader measure that includes the unemployed, the under-employed, and potential jobseekers not yet looking for employment – fell 0.3 points to 9% (227,000 people), matching the record low of September 2022.

These figures show that, thus far, the Reserve Bank's attempt to cool the New Zealand economy by raising interest rates is yet to have a significant impact on the labour market. However, as discussed in the economic outlook section of this Bulletin, it is widely expected that unemployment will rise to somewhere in the range of 5–5.5% over the next two years as higher interest rates work their way through the economy.



Filled jobs

The *business employment data* for the March 2023 quarter show that filled jobs increased 1.1% (24,363 jobs) from the previous quarter. Except for agriculture, forestry, and fishing, all industries saw the number of filled jobs increase this quarter. Accommodation and food services (up 3.9%, or 5,708 jobs) and administrative and support services (up 2.9%, or 2,964 jobs) posted the strongest growth. On an annual basis, the number of filled jobs increased in all industries except for agriculture, forestry, and fishing, which shrank 2.4% (2,387 jobs). Accommodation and food services saw the largest annual increase, adding an additional 12,196 jobs (8.9%) compared to March 2022.

Gross domestic product

GDP contracted 0.7% in the December 2022 quarter and then 0.1% in the March quarter, meaning that the New Zealand economy has technically been in recession. Growth per capita fell 1.1% in the December quarter and 0.7% in the March quarter, due to the combination of slowing output and a rising population.

The contraction has been broad based, with the primary sector shrinking by 0.5% in each of the past two quarters, the goods-producing sector shrinking by 0.3% and 0.4%, and the services sector shrinking by 0.2% and 0.6%.

Breaking each sector down, for primary industries, mining has continued its upswing, growing 1.6% in the March quarter. However, mining makes up a very small proportion of the primary sector, and this growth has been more than offset by a 0.7% contraction in agriculture, forestry, and fishing – which has shrunk in five of the last six quarters.

In the goods-producing sector, manufacturing contracted by 1.1% in the March quarter – meaning activity has declined in this sector for five consecutive quarters. Electricity, gas, water, and waste services also registered a decline in activity, shrinking 0.9%. By contrast, construction has continued to expand, growing 0.5% in the March quarter, with this coming off the back of 1.8% growth in the December quarter.

In the services sector, which accounts for the bulk of economic activity in New Zealand, wholesale trade (-0.1%), retail trade and accommodation (-1.0%), transport, postal, and warehousing (-2.2%), business services (-3.5%), education and training (-1.9%), and healthcare and social assistance (-0.4%) all contracted. The other service industries registered weak expansions, except for information media and communications, which grew a healthy 2.7%.

Expenditure on GDP fell 0.2%, primarily driven by weaker export earnings and a flattening of central government expenditure. While gross capital formation was down overall, capital investment in plant, machinery, and equipment increased by 3% and capital investment in non-residential buildings increased by 4.3%. A full breakdown of quarterly movements in expenditure is provided in the table below.

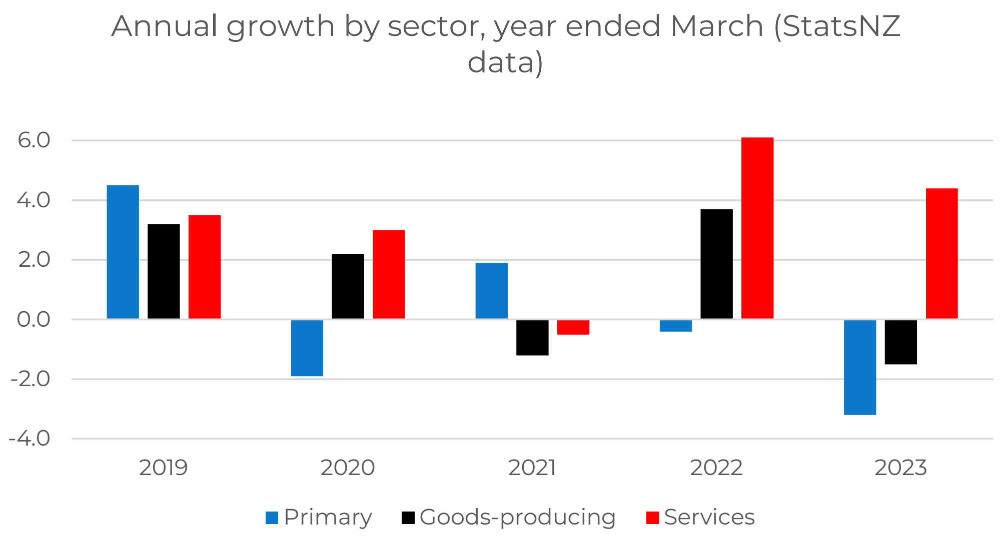
Expenditure on GDP – Quarterly Percent Change

	Jun 22	Sep 22	Dec 22	Mar 23
Private consumption	▼ 2.8%	▲ 0.4%	► 0.0%	▲ 2.4%
Central government	▲ 0.4%	▼ 0.9%	▼ 2.8%	▼ 0.1%
Local government	▲ 2.2%	▲ 1.7%	▲ 1.1%	▲ 2.0%
Gross fixed capital formation	▼ 3.3%	▲ 4.6%	▼ 1.0%	▲ 2.0%
Gross capital formation	▼ 0.8%	▲ 1.2%	▼ 0.4%	▼ 3.0%
Exports	▲ 16.7%	▲ 7.6%	▼ 1.7%	▼ 2.5%
Exports less imports	▲ 1.2%	▲ 2.3%	▲ 2.5%	▼ 1.6%
Total expenditure on GDP	▲ 1.4%	▲ 1.5%	▼ 0.9%	▼ 0.2%

Arrows denote direction of change.

Source: StatsNZ

All up, for the year ending March 2023, the New Zealand economy grew 2.9%. However, this growth was very uneven. Services grew by 4.4% for the year, with transport, postal, and warehousing (up 14.3%) and healthcare and social assistance (up 8.3%) registering the largest annual expansions. On the other side, the goods-producing sector contracted by 1.5%, this driven by a 7% contraction in manufacturing. Finally, the primary sector shrank 3.2% for the year, with mining contracting by 7.6% and agriculture, forestry, and fishing contracting by 2.7%.



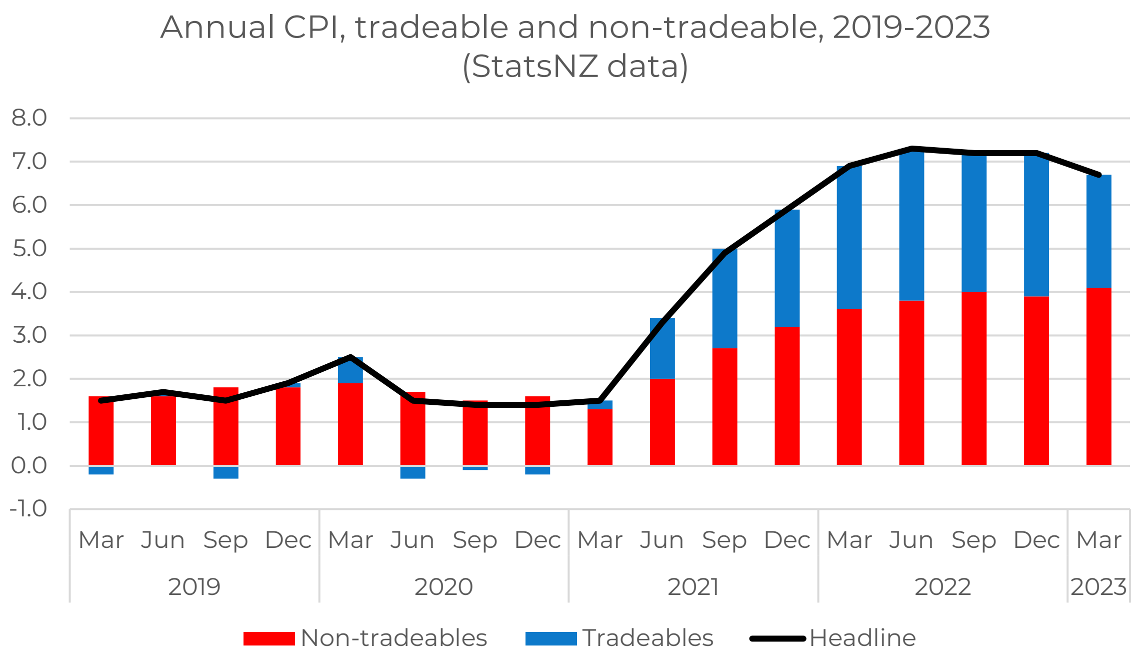
Consumers price inflation

The *consumers price inflation* figures for the March 2023 quarter surprised the economic commentariat, coming in lower than anticipated. Annual CPI fell from 7.2% in the December 2022 quarter to 6.7%. The largest contributions to annual CPI were:

- **Food, 11.3%** – driven by a 20.2% increase in the price of fruit and vegetables, a 12.3% rise in the cost of grocery food, and an 8.9% rise in the cost of meat and fish. All up, food accounts for 31.2% of total CPI change (2.09 percentage points of the 6.7).
- **Housing and household utilities, 7.1%** – driven almost entirely by the increase in the cost of construction. This group accounts for 30.4% of total CPI change (2.04 percentage points of the 6.7).
- **Recreation and culture, 6.9%** – recreational equipment and supplies have risen in price by almost 9%, while accommodation services have increased 12.3% in price. The recreation and culture group accounts for 9% of total CPI change (0.6 percentage points of the 6.7).
- **Transport, 3.7%** – driven largely by a 20.6% increase in passenger transport costs, with higher domestic and international airfares the main culprit. All up, transport accounts for 7.4% of total CPI change (0.5 percentage points of the 6.7).

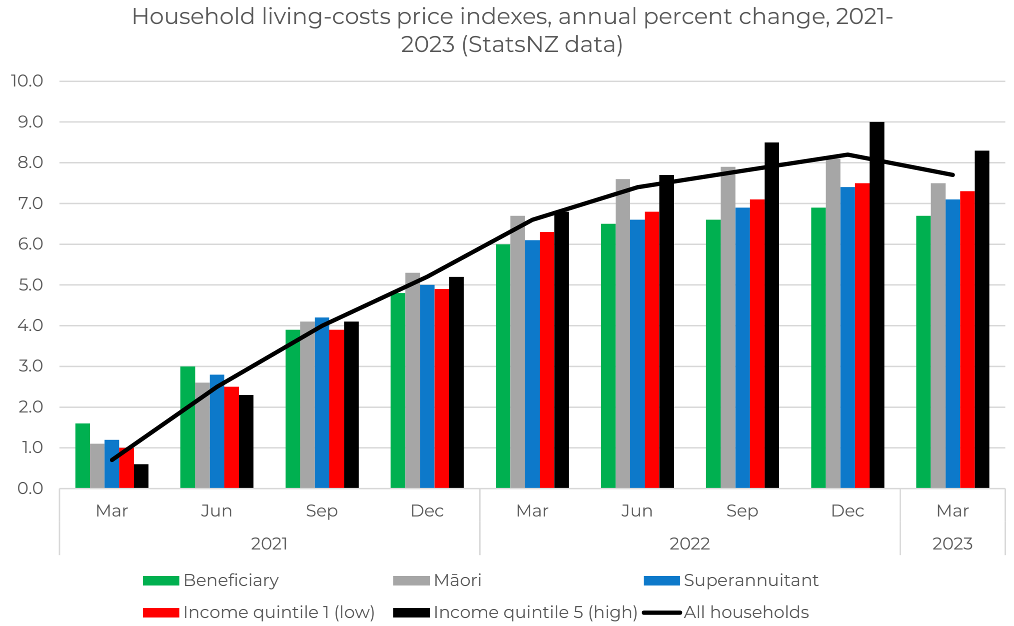
Inflation continues to be imported to a significant degree, with close to half of total inflation driven by tradeables (goods and services that are imported or are exposed to international competition). However, the quarterly data indicates this is changing, with tradeable inflation falling from 1.4% to 0.7% for the March 2023 quarter, while non-tradeable inflation rose from 1.5% to 1.7% for the quarter.

All up, quarterly CPI inflation fell from 1.4% to 1.2% for the March quarter, marking the second straight quarter of declining inflation after the high of 2.2% registered in September 2022.



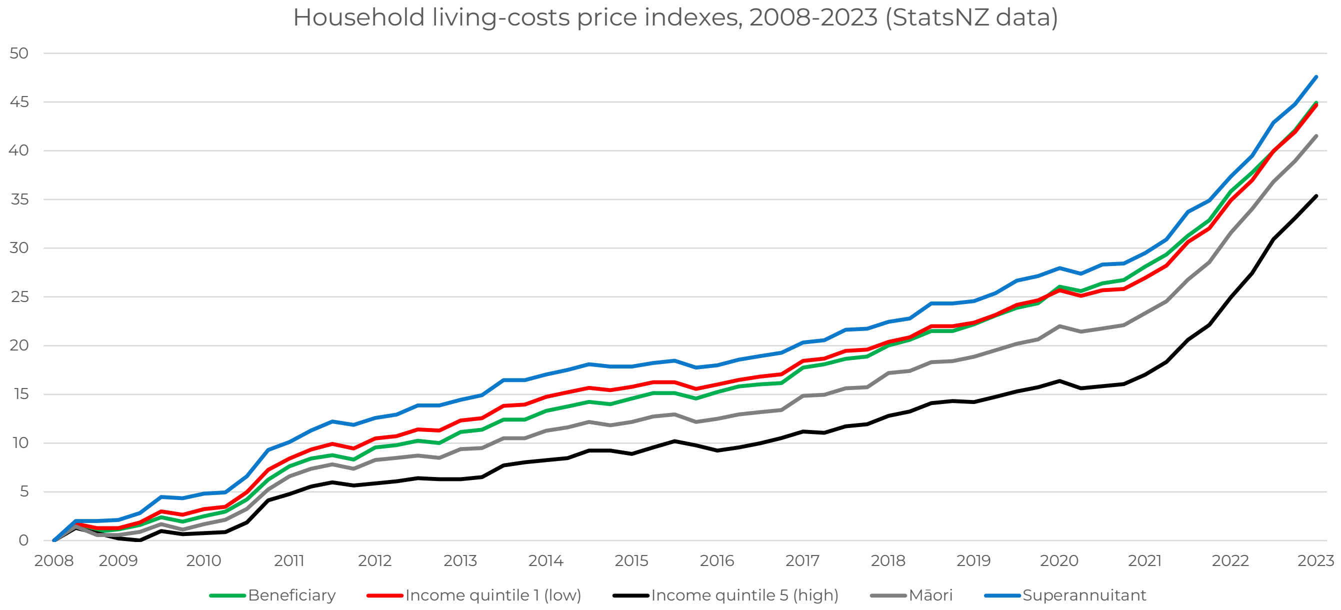
Household living costs

The *household living-costs price indexes* (HLCPI) detail changes in the cost of living for different household groups. One important difference between the HLCPI and the CPI is that the former includes interest payments that households make on debt (such as mortgages). The HLCPI therefore provides a more accurate picture of actual changes in the cost of living for different groups.



The first graph shows that, over the past year, those households in the highest income quintile have experienced the sharpest increase in the cost of living. This is likely because these households have more mortgage debt and have therefore had to spend a greater proportion of their income on servicing that debt as interest rates have increased.

However, as the second graph shows, over the long run it has been low-income households – in which Māori and Pasifika are disproportionately represented – as well as beneficiaries and superannuitants who have borne the brunt of rising prices. There has long been a 'cost of living crisis' for these New Zealanders.



Food prices

For the year ended March 2023, the *Food Price Index* (FPI) increased 12.1%, outstripping overall CPI. Readers will note that this differs from the figure for food price inflation given in the CPI; this is because the CPI is a selected basket of goods while the FPI covers all food and grocery items.

Fruit and vegetables have seen the largest increase, up 18.4%. Grocery food has seen the next largest rise, up 12.7% overall. The milk, cheese, and eggs sub-category has increased by 13.2%, while eggs have shot up a staggering 68.4% in price – partly the result of the ban on battery-caged eggs that came into effect at the beginning of the year. The meat, poultry, and fish group has increased by 11.7%, with the cost of poultry rising 15%, pork 13.5%, and fish 13%; by contrast, the price of beef and veal has only risen by 5.5%, while the cost of mutton, lamb, and hogget has fallen 2.8%.

Month-on-month, food prices have continued to rise, although May 2023 saw a smaller increase than previous months. A breakdown of the seasonally adjusted monthly movements is provided in the table below.

Food Price Index, May 2023 – Monthly Percentage Change				
	Feb 23	**Mar 23**	**Apr 23**	**May 23**
Fruit and vegetables	▲ 6.0%	▼ 0.9%	▼ 2.9%	▼ 2.9%
Meat, poultry, fish	▲ 0.6%	▼ 1.0%	▲ 1.1%	▲ 1.4%
Grocery food	▲ 0.8%	▲ 2.3%	▲ 1.0%	▼ 0.1%
Non-alcoholic beverages	▲ 1.6%	▲ 0.2%	▼ 1.0%	▲ 4.5%
Restaurant and ready-to-eat food	▲ 0.4%	▲ 0.5%	▲ 1.7%	▲ 0.7%
Total	▲ 2.1%	▲ 0.5%	▲ 0.8%	▲ 0.5%

Arrows denote direction of change.

Source: StatsNZ

Rental prices

For the year ending May 2023, the *Rent Price Index* increased 3.8% on both the flow and stock measures. The flow measure captures price changes of new tenancies while the stock measure captures price changes across the whole rental population.

This increase of 3.8% on both measures is below the average wage growth recorded in both the LCI and QES, discussed above. This is good news for renters, as they get to keep more of their paycheck after housing costs. However, the monthly price increase in the stock measure crept up to 0.4% through February, March, and April, a faster rate of increase than seen through the second half of 2022. Long-term, the best way to restrict rental inflation and ensure working people get to keep more of their paycheck is to build more affordable housing.

Rent Price Index, May 2023 – Percentage Change from Previous Month				
	Feb 23	**Mar 23**	**Apr 23**	**May 23**
Flow, NZ	▼ 1.3%	▲ 1.5%	▲ 0.9%	▲ 0.2%
Flow, Auckland	▲ 0.9%	▲ 1.7%	▲ 1.7%	▼ 0.3%
Flow, Wellington	▲ 0.5%	▲ 0.5%	▲ 0.6%	▲ 0.0%
Flow, rest of North Island	▲ 3.5%	▲ 0.6%	▲ 0.9%	▲ 0.1%
Flow, Canterbury	▲ 0.6%	▲ 2.1%	▼ 0.8%	▲ 2.0%
Flow, rest of South Island	▲ 1.3%	▼ 1.6%	▲ 0.1%	▲ 1.8%
Stock, NZ	▲ 0.4%	▲ 0.4%	▲ 0.4%	▲ 0.3%

Arrows denote direction of change.

Source: StatsNZ

Petrol prices

Petrol prices have remained steady over the past couple of months. Thanks to the ongoing 25c/litre petrol levy cut, which will come off at the end of June, the price at the pump is reasonably close to its pre-pandemic levels. MBIE's *weekly fuel-price monitoring* has 91 octane petrol at $2.47 per litre, 95 octane at $2.64 per litre, and diesel at $2 per litre for the week ending 11 June.

Lower prices at the pump have also been driven by falling oil prices globally. Oil prices spiked following the Russian invasion of Ukraine, peaking at $120 per barrel during the middle of last year, before falling back to $80 per barrel by November 2022; they are currently hovering around $70 per barrel.

Balance of payments

The latest *balance of payments* figures show that New Zealand's current account deficit has continued to widen. For the year ended March 2023, the current account deficit was 8.5% of GDP ($33 billion), up from 6.8% of GDP ($24.2 billion) for the previous year. This is close to the largest annual current account deficit on record.

This deficit is driven by New Zealand importing more goods and services than it exports, as well as profits, interest, and dividends flowing out of the country to overseas investors. For the year ending March 2023, goods imports exceeded goods exports by $13.6 billion, services imports exceeded service exports by $7.4 billion, and primary income outflow exceeded primary income inflow by $11.9 billion.

On a seasonally adjusted quarterly basis, New Zealand's goods exports fell 6% from the December 2022 quarter to $17.3 billion. This was mainly driven by falling income from dairy, meat, and logs. Goods imports also decreased, falling 5.6% to $21.2 billion. This was driven primarily by falling imports of industrial supplies, cars, and transport equipment. Meanwhile, services exports and imports both fell marginally.

New Zealand's net international liability position narrowed slightly, moving from $194.6 billion for the year ending December 2022 to $189.1 billion for the year ending March 2023. The international investment position shows the value of financial claims held by New Zealand residents on non-residents against the financial liabilities of New Zealand residents to non-residents.

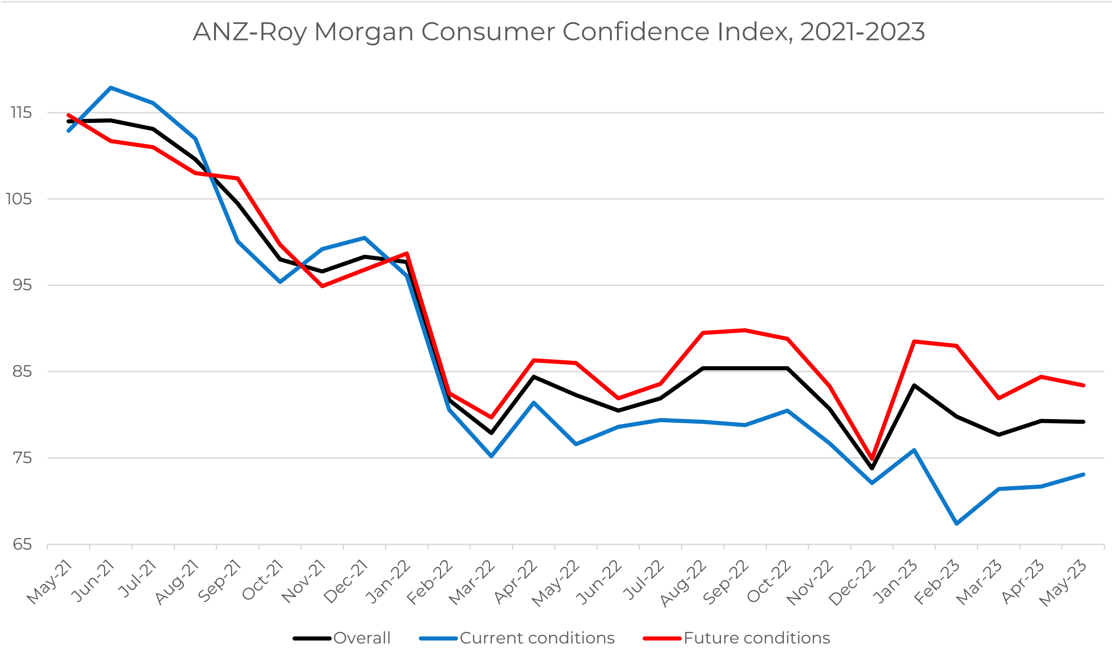
All told, New Zealand's net international debt position for the year ending March 2023 was -$180.6 billion. The lion's share of this deficit is accounted for by the commercial banks, who collectively have a net liability of $122 billion to the rest of the world – a decline from the recent high of $137.5 billion recorded in September 2022. Meanwhile, general government's net liability increased 14% to $39.3 billion, while the Reserve Bank's net asset position declined 16.5% to $12.7 billion.

Consumer and business confidence

Both consumer and business confidence remain very low. The *ANZ-Roy Morgan Consumer Confidence Index* for May was 79.2. This is slightly up from the record-low of 73.8 recorded in December 2022 but is still deeply pessimistic. A score above 100 on the index demonstrates that consumers have confidence in current and future economic conditions; less than 100, and they are pessimistic.

A net 34% of those surveyed reported it was a bad time to buy a major household item and a net 20% of those surveyed reported they were worse off financially than a year ago. However, reflecting slightly stronger confidence in future economic conditions, a net 5% of respondents reported that they expect to be better off financially one year from now.

Business confidence, while still low, has risen 13 points to -31.1, the highest it's been since December 2021. Investment and employment intentions both remain low, suggesting that economic activity will be muted in the near future. Confidence is lowest in agriculture, with a net 68.4% of respondents expecting deteriorating economic conditions. However, the outlook for construction has seen a bounce upwards, likely the result of the Reserve Bank indicating it will not be hiking interest rates further and the increased demand caused by the Cyclone and Auckland floods rebuild process.



Card spending

Low consumer confidence has been matched by falling consumer spending. All up, the seasonally adjusted total value of all retail *electronic card spending* for May 2023 was $6.6 billion, down $114 million (1.7%) from April. The largest falls in seasonally adjusted monthly sales values by spending category were on fuel, down $25 million (4.5%), apparel, down $13 million (3.7%), durables, down 0.8% ($13 million), and consumables, down $6.8 million (0.3%).

Performance indexes

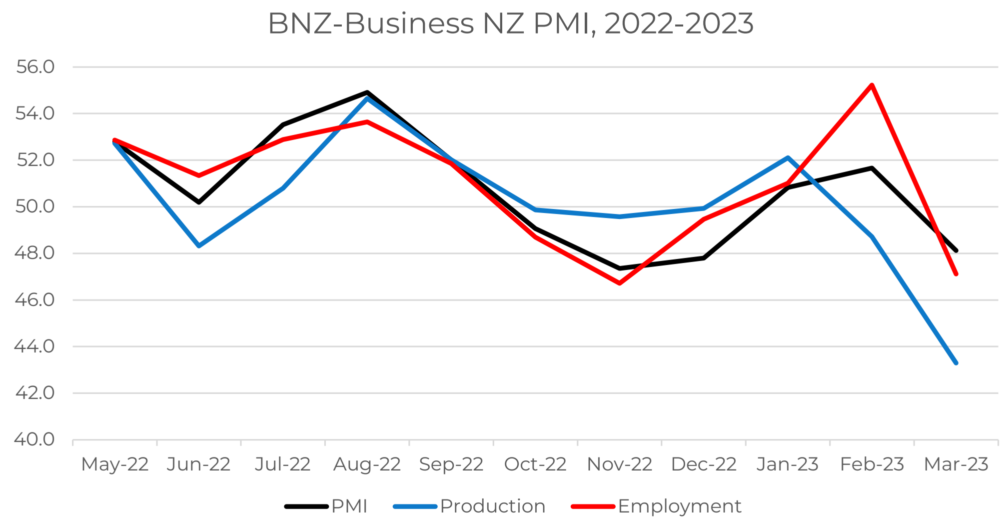
After a brief stint in expansionary territory, the *BNZ–Business NZ Performance of Manufacturing Index* (PMI) has fallen back over the past three months to 48.9 points. The PMI provides an indication of the levels of activity in the domestic manufacturing sector. A figure above 50 indicates that manufacturing activity is generally expanding, while a figure under 50 indicates it is generally declining; the long-term average of the index is 53.

The key sub-index of production has fallen from its January high of 51.6 to 45.7, while employment has fallen from its February high of 55.1 to 49.5; however, new orders rose marginally to 50.8.

Slowing demand caused by central bank interest rate hikes is largely to blame for the weak outlook in manufacturing. New Zealand is not alone in this, with the US, the Eurozone, the UK, and Australia all registering negative PMIs.

On a more positive note, the *BNZ–Business NZ Performance of Services Index* (PSI), was 53.3 in May, close to the survey's long-run average of 53.6. Across the sub-indexes, activity/sales rose 7 points to 52, employment ticked up 2 points to 52.6, and new orders/business rose 5 points to 55.4.

The proportion of negative comments in the survey was evenly matched by the proportion of positive comments from businesses, suggesting that, while the sector contracted by 0.6% in the March quarter, the June quarter could see a lift in activity.



Real estate

The housing bubble has continued to deflate across the country. As of May 2023, the *REINZ House Price Index* was down 18% from its late-2021 peak. Auckland and Wellington have experienced the steepest declines, down 23.2% and 26% from their respective peaks. Meanwhile, the national median house price has fallen to $780,000, down 15.7% from its peak. However, faster-than-expected population growth, the Reserve Bank's announcement that it is easing loan-to-value ratios and halting further rate rises, and increased sales activity in recent months suggests that the deflation of the housing bubble may be nearing an end.

Median House Price, May 2023 – Percentage Change				
	Price	**Monthly**	**Annually**	**From Peak**
National	$780,000	▸ 0.0%	▾ 8.2%	▾ 15.7%
National excl. Auckland	$685,000	▾ 2.1%	▾ 6.5%	▾ 11.6%
Auckland	$1,000,600	▴ 0.5%	▾ 10.4%	▾ 23.4%
Wellington	$750,000	▾ 1.2%	▾ 11.7%	▾ 20.5%

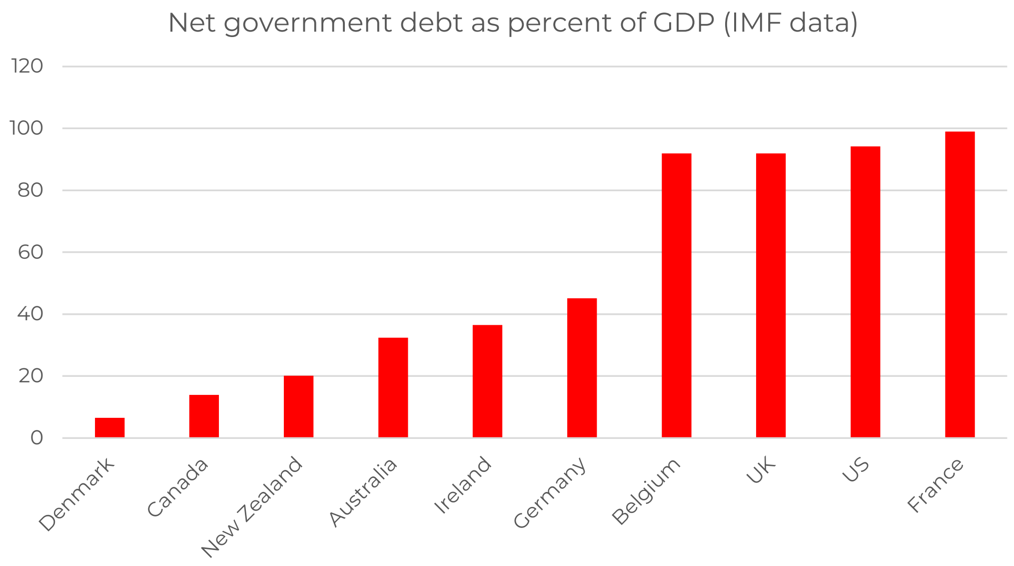
Arrows denote direction of change.

Source: REINZ

Government fiscal position

The *Interim Financial Statements* of the Government for the ten months ending 30 April 2023 show that Government is well-positioned to continue to support the cyclone recovery and rebuild process. It has plenty of fiscal capacity to invest in 'building back better' without needing to cut spending elsewhere.

Net Crown debt sits at 20.1% of GDP ($76.4 billion), which as the graph shows is very low by international standards. Net debt is close to Treasury's BEFU (Budget Economic and Fiscal Update) forecast of 20% of GDP.



Tax revenue was $1.4 billion lower the BEFU forecast, at $101.4 billion, due to lower-than-anticipated corporate tax revenue. However, source deductions revenue (PAYE tax) was slightly higher than forecast, reflecting ongoing strength in the labour market.

Meanwhile, core Crown expenses were $103.5 billion, $0.3 billion below forecast. Spending was lower than expected across social security and welfare, core government services, education, transport and communication, and health.

Comparing the April 2023 accounts to the April 2022 accounts, tax revenue is up by $4.3 billion (4.9%). This growth has come from source deductions, which is up 11.4% due to the strong labour market, and GST revenue, which is up 8.2% largely because of inflation.

Core Crown expenses have also risen year-on-year, up $0.7 billion (0.7%). The composition of expenses has changed significantly over this period. The ending of COVID-19 wage subsidy and resurgence support payments mean expenses were $8.7 billion lower than the same period last year. However, this is offset by debt servicing costs (up $3 billion because of higher interest rates), health expenditure (up $1.6 billion), and Superannuation (up $1.4 billion).

The movements described above are set against a backdrop of rising interest rates and slowing economic activity. While this is a difficult set of economic conditions, the government's books are in good health, with plenty of capacity to make the investments that the long-term health of the country demands.

Government Accounts for the Ten Months to April 2023

	April 2023	BEFU forecast	April 2022
Tax revenue ($m)	**92,274**	93,626	87,940
Total revenue ($m)	**101,375**	102,838	95,399
Total expenses ($m)	**103,537**	103,867	102,835
Net debt (% of GDP)	**20.1%**	20.0%	17.8%
OBEGAL* ($m)	**-7,018**	-5,749	-9,370

** OBEGAL = operating balance before gains and losses*

Source: Treasury