ANZ Research

NZ Insight: Recession?

15 January 2024

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Confused by acronyms or jargon? See a glossary here.

Recession?

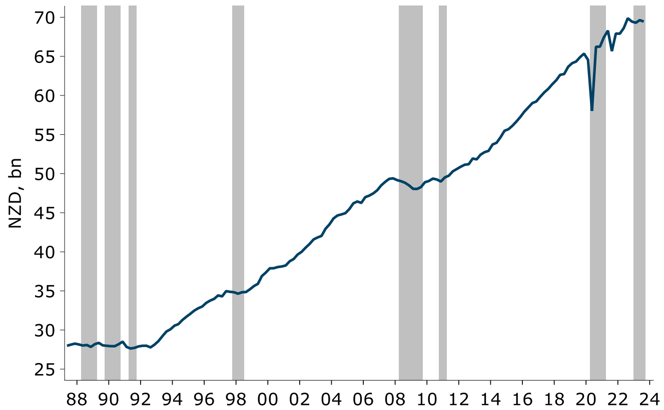
Summary

- We've applied US recession indicators to the New Zealand economy to determine if the 0.6% y/y fall in GDP is broad-based and sustained enough to be called a true recession, rather than merely a "technical recession".
- Economic activity over the last 12 months looks recessionary (albeit not to the same extent as in the GFC), but the labour market does not. But labour markets tend to lag the broader economy by around six months and we expect the unemployment rate and other labour market data to start looking recessionary very soon.
- In per capita terms, it's a slam dunk. GDP per-capita declined 3% in the past year, equal to its trough during the recession following the GFC.
- Ticking the 'recession' box alone isn't sufficient to cause the RBNZ to rush to the cutting table. With headline inflation still at 5.6% and pricing intentions stubbornly high the RBNZ is still some way from confidently declaring victory. But that day is now looking closer than it was.
- We will refresh our OCR call later this week following the release of the QSBO survey.

What is a recession, anyway?

New Zealand's GDP has gone backwards, declining 0.6% over the last year. Economic commentators and the media often define a recession technically as two consecutive quarters of decline in GDP, but that arguably isn't particularly useful – GDP can be volatile, and swings in activity can be caused by both persistent and temporary factors. Was 2010 really a 'recession', for example, or just a stuttering recovery from the 2008/09 recession (figure 1)? Such a simplistic definition misses the broader context of what makes a recession meaningful (and painful) to the average kiwi: people losing their jobs, businesses closing and standards of living falling. Typically that's seen in a broad-based and sustained decline in economic activity.

Figure 1. Technical recessions in New Zealand



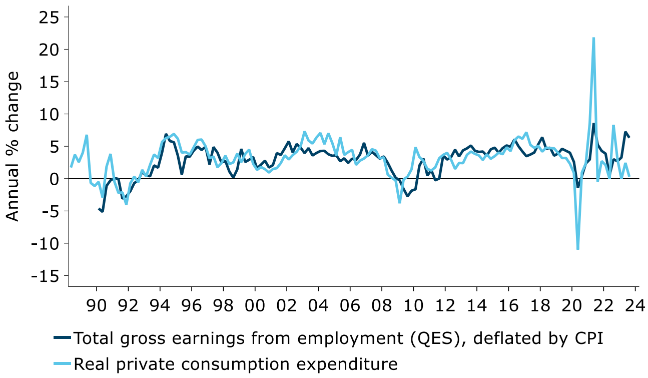
Source: Stats NZ, Macrobond, ANZ Research

So are we in recession now? GDP has fallen (and is dire in per-capita terms) but is a large proportion of the population going backwards? Or is this just an episode of post-Covid data volatility that is best described as a "technical recession"?

A more nuanced definition

In the United States the National Bureau of Economic Research (NBER) is tasked with determining whether the US is in a recession. They define a recession as a "period between a peak and a trough in the business cycle where there is a significant decline in economic activity spread across the economy that can last from a few months to more than a year". In order to make their decision, they monitor six indicators: real personal consumption expenditures, real personal income less transfers, nonfarm payroll employment, real manufacturing and trade industry sales, employment as measured by the household survey, and industrial production. We have reconstructed those measures using the closest available New Zealand data, noting that not all of them are a perfect match.

Figure 2. NBER consumer metrics

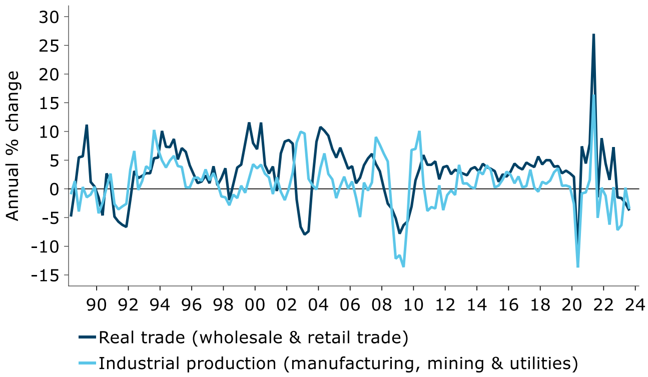


Source: Stats NZ, Macrobond, ANZ Research

Consumption growth has been sluggish, but is not obviously recessionary, not least because it's been supported by population growth. It's above its lows in the GFC or the early 1990s, but is below where it was in the 1998 recession, a slowdown that was sparked by the Asian Financial Crisis and was focused in exports.

Real income growth has been strong, boosted by the tightest labour market in a generation. No sign of a recession here yet, but as the labour market stalls income growth will too.

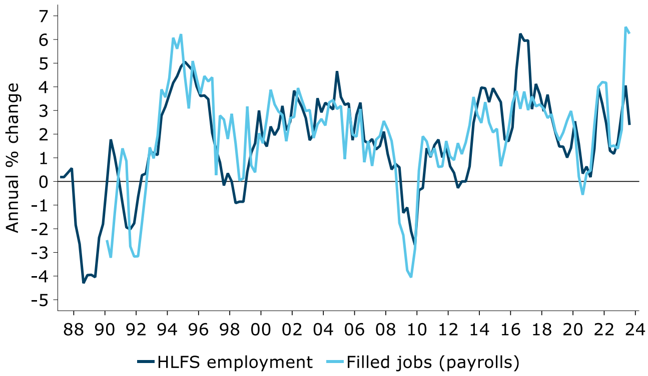
Figure 3. NBER industry metrics



Source: Stats NZ, Macrobond, ANZ Research

Industrial production, while volatile, is clearly in recessionary territory. Real trade is shrinking also; retailers especially are facing tough economic times. These sectors have borne the brunt of higher interest rates, being areas where one would expect contractionary monetary policy to bite promptly (along with housing).

Figure 4. NBER labour metrics



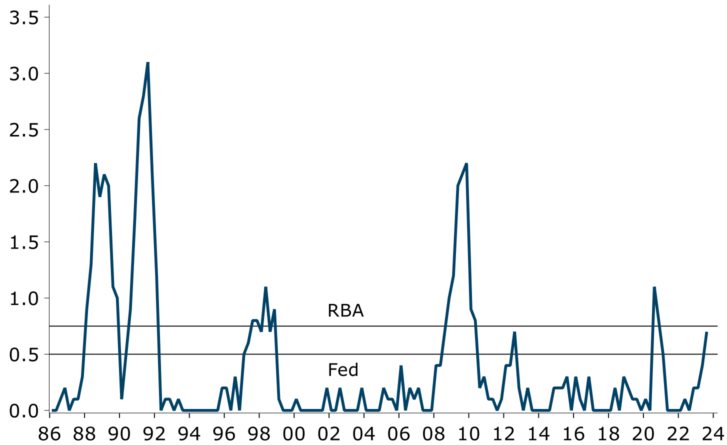
Source: Stats NZ, Macrobond, ANZ Research

The labour market is still looking robust, with both employment and payrolls in expansionary territory. Record net migration has seen pent-up demand from when the border was closed filled, with the resulting strong employment preventing any sign of a labour market recession. However, the labour market tends to lag broader economic activity by around six months, so this may just be a question of timing. Employment declined in Q3 and we expect the annual measure to go negative in H1 2024.

All up, the NBER's measures of economic activity over the last 12 months look recessionary in the New Zealand context (albeit not to the same extent as in the GFC), but the labour market indicators do not. However, labour markets tend to lag the broader economy by around six months and given the softness in activity, the slowdown in employment looks set to continue. We would also expect self-reinforcing effects to some degree: that as employment begins to decline, this will reduce firm sales, causing more businesses to lay off staff, further decreasing employment.

One signal the Federal Reserve and RBA use to measure whether the labour market in real time is in recession is the Sahm rule. The Fed estimates the US has entered recession if the 3-month moving average (3mma) of the unemployment rate rises 0.5%pts above its low in the preceding 12 months. The RBA has estimated that the equivalent threshold in Australia is 0.75%pts. New Zealand currently exceeds the Fed's calibration, but is lower than the RBA's calibration, so it's a line-ball call here whether the data to-date should be classed as a "recession" (figure 5).

Figure 5. Sahm rule in New Zealand



Source: Stats NZ, Macrobond, ANZ Research

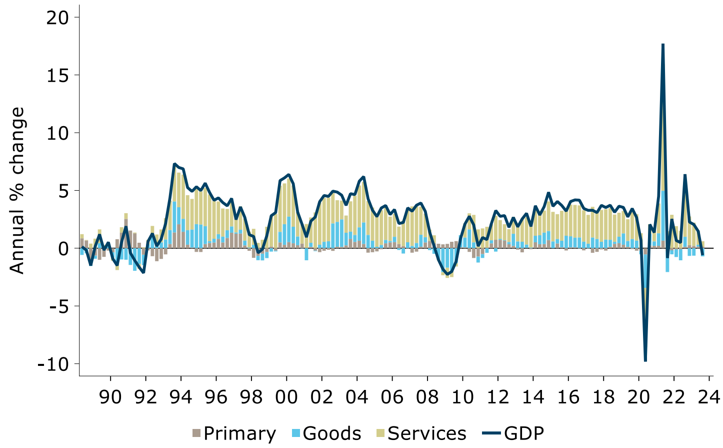
Using the Sahm rule, based on our forecasts New Zealand's labour market is comfortably in recessionary territory now, in Q1 2024, though we won't get this data until 1 May. We expect the unemployment rate to rise to 4.7% in Q1 2024, which would be a 1.3%pt rise from a year earlier and a larger y/y rise than observed during COVID or the 1998 recession.

Is New Zealand different?

For the most-part, the NBER measures do a good job of capturing whether a downturn in New Zealand is broad-based enough to be thought of as a "recession". Historical recessions have often been driven by a stalling services sector and falls in goods production, dynamics which have begun to play out in New Zealand currently (figure 6, over).

Droughts, and slowdowns in agricultural production more widely, often exacerbate New Zealand recessions, but given they tend to be exogenous to broader economic conditions, they aren't needed for a recession to be considered "broad based". Even so, food manufacturing, which is incorporated in the NBER's metrics, is sufficient to capture the effect of droughts. Thankfully, broad-based drought conditions are not yet present in New Zealand despite El Niño, given the droughts during the 1998 and 2008 recessions had large effects on goods production.

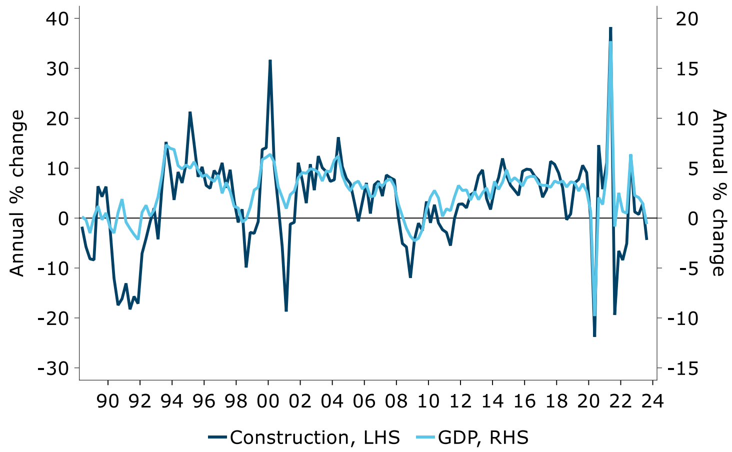
Figure 6. GDP decomposition



Source: Stats NZ, Macrobond, ANZ Research

One useful addition to the NBER's metrics in the New Zealand context is construction. Our construction sector is infamous for its boom-bust cycles. This alone isn't sufficient to cause a recession (as seen in 2001), but can cause a nasty hangover for the economy. The construction sector is currently going backwards (figure 7) despite record population growth. This is further evidence, beyond the industries in the NBER's measures, that the current decline in activity is broad-based.

Figure 7. Construction and GDP



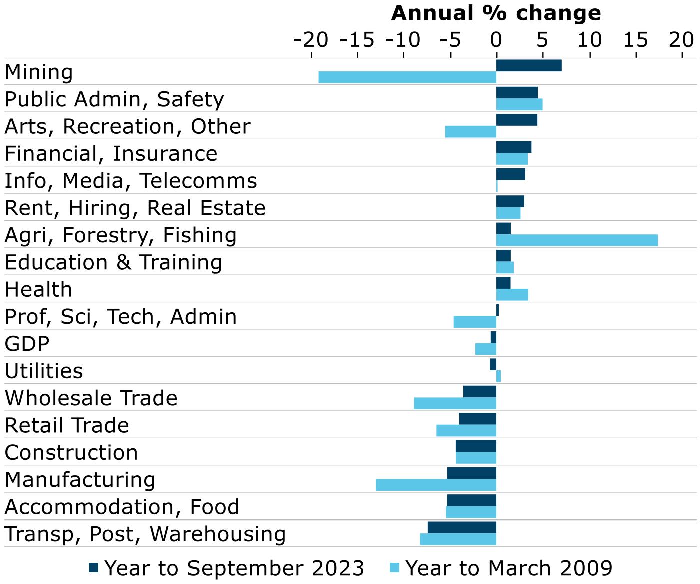
Source: Stats NZ, Macrobond, ANZ Research

All up, the ups and downs on a sectoral level the economy looks a lot like it did in the recession following the Global Financial Crisis (GFC) (figure 8, over). Headline growth isn't currently as bad as it was in 2008, because of:

- Record inbound migration;
- the tourism recovery providing a one-off boost to arts and recreation services;
- the lack of a drought meaning manufacturing, while soggy, isn't dire; and
- the absence of a global credit shock, which means that some sectors are more robust, notably professional, scientific, admin and support services, which make up ~10% of the economy.

But overall, the declines in GDP look broad-based, a necessary requirement for an "actual" recession (as opposed to a 'technical' one).

Figure 8. Annual change in GDP components vs GFC



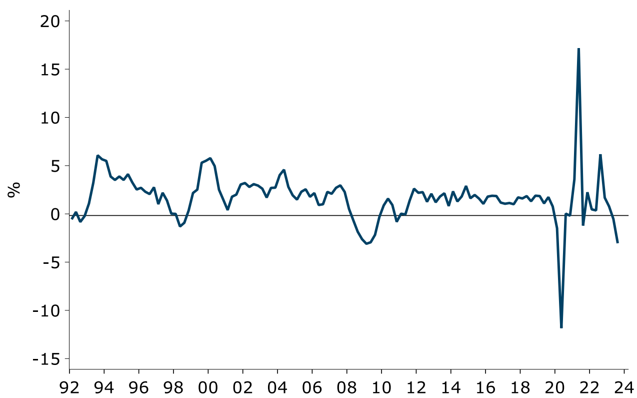
Source: Stats NZ, Macrobond, ANZ Research

Despite the broad-based falls, the evidence isn't yet conclusive. The labour market remains robust and the declines in GDP are borderline for meeting the criteria of "sustained", given GDP rose 0.5% in Q2 2023. But it's very plausible that without the cyclone and Auckland floods rebuild supporting GDP growth in Q2, this quarter may have been negative too.

Per capita recession

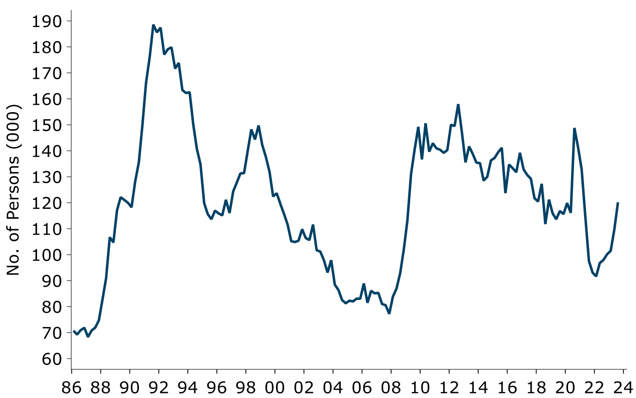
In per capita terms, the evidence is conclusive. GDP has declined 3% in per-capita terms in the past year, equal to its trough during the recession following the GFC. Record inbound net migration, combined with the deteriorating labour market, means that since the start of 2022 there are 22,000 more unemployed people in New Zealand. Given migrants tend to come to New Zealand with jobs lined up, since that's typically required to get a work visa, these extra unemployed people are likely to be disproportionately New Zealand permanent residents and citizens.

Figure 9. GDP per capita



Source: Stats NZ, Macrobond, ANZ Research

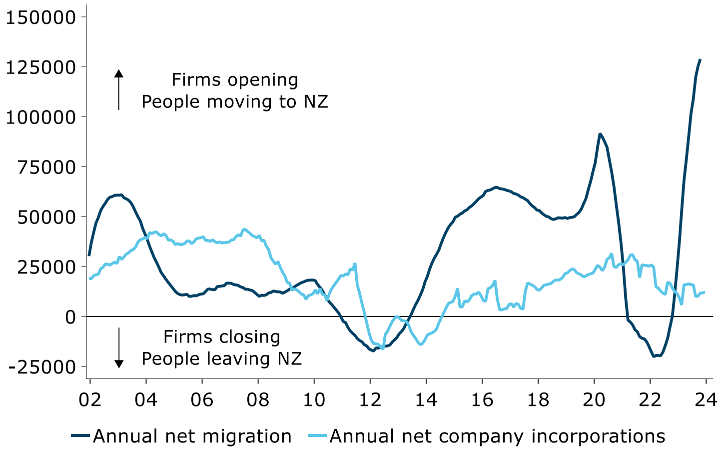
Figure 10. Number of unemployed people



Source: Stats NZ, Macrobond, ANZ Research

The marked fall in per capita GDP means New Zealand's ability to sustain our standard of living is currently going backwards, with consumers taking the brunt. However, not everyone will feel this way. The population is growing faster than the number of businesses (figure 11), meaning on average each company has a larger customer base, which can for a time outweigh the impact of the average person buying less.

Figure 11. Migration and firm openings



Source: NZ Companies Office, Stats NZ, Macrobond, ANZ Research

Implications for 2024

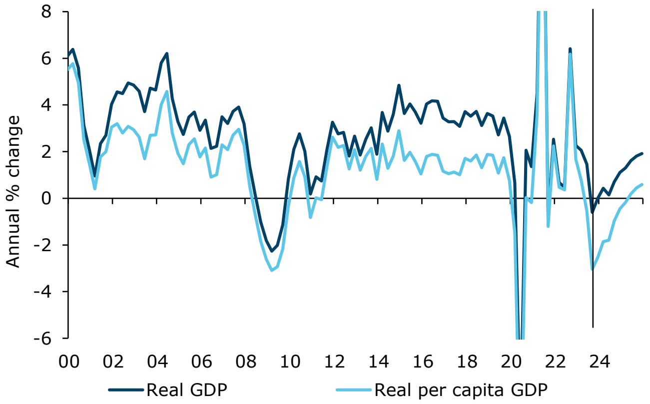
2024 is likely to be another tough year. A number of the factors that supported growth in 2023 are likely to dissipate this year and we expect the OCR to remain well into contractionary territory for some time yet. Much of the tourism recovery is done and dusted. Migration, while high, is slowing in line with the rest of the economy. And the productivity boost from the resolution of the acute skills shortages that developed during the border closure is likely mostly behind us.

The labour market remains a bright patch, but we expect this to deteriorate rapidly over the first half of 2024. When future economists look back on this period, we expect them to describe the current economic situation as the 2023/2024 recession, rather than merely a technical blip.

However, we expect high (albeit easing) migration, the ongoing recovery in international tourism and education and falling imports to keep the economy from posting any more negative quarterly GDP prints this year, although we certainly wouldn't rule it out, given recent data volatility and elevated uncertainty. Interest rate-sensitive pockets of the economy such as residential investment, business investment, and household spending on durable goods are expected to underperform.

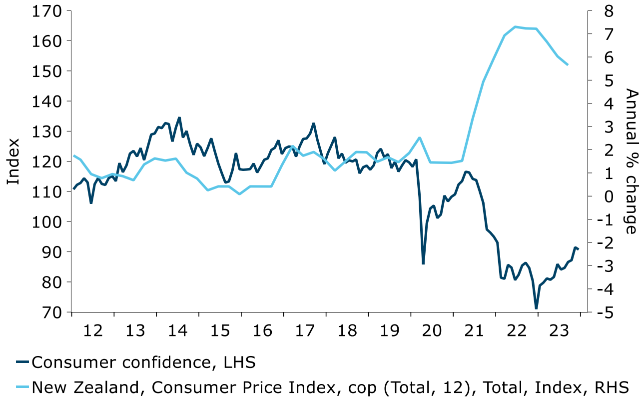
On our forecasts, then, this is the low point for annual GDP growth, both headline and per capita (figure 12, over). However, the labour market lags activity, meaning things will continue to feel worse on the street for a time. That said, the relief of falling inflation may well provide an offset, going by the way high inflation smashed consumer confidence when it arrived, even while the economy was still going strong (figure 13, over).

Figure 12. Our GDP forecast



Source: Stats NZ, ANZ Research

Figure 13. Consumer confidence and CPI inflation



Source: Macrobond, ANZ Research

Monetary policy implications

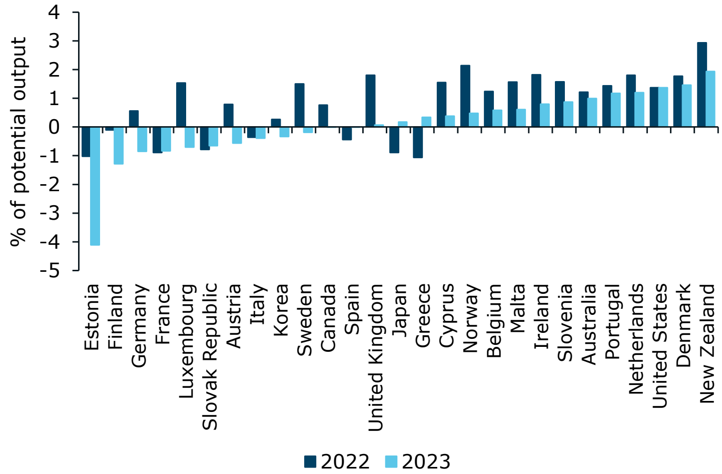
In November 2022, at Parliament's Select Committee the RBNZ Governor conceded that they were deliberately engineering a recession. If you believe our (and their) labour market nowcasts for Q1, they've achieved it by any widely accepted definition.

That matters for the monetary policy outlook. The deeper the slowdown, the shorter is the period the economy needs to be in the doldrums to bring down inflation, all else equal. So the market was quite right to respond to the startlingly weak GDP data released in mid-December by bringing forward their estimates of when the RBNZ will cut the OCR.

However, ticking the 'recession' box alone isn't sufficient to cause the RBNZ to rush to the cutting table. If recession is the antibiotic (nasty side effects and all), it wouldn't be helpful to stop taking it before the inflation infection is beaten. The RBNZ noted at that time that "an economic contraction is likely. Any fiscal or monetary policy actions that try to offset this with further stimulus will ultimately lead to a longer period of high inflation, with higher interest rates subsequently needed to control inflation and return the economy to a more sustainable path." And in subsequent Monetary Policy Statements the RBNZ has reiterated that a *sustained* period of sub-par growth is likely to be needed to do the job.

While the economy has clearly cooled significantly, the RBNZ will remain wary of lagged demand-side impacts of net migration and the housing market turnaround. On some metrics they also had a much larger job to do than most other central banks, meaning a far larger or longer period of subdued economic activity is needed to tame the inflation dragon (figure 14, over).

Figure 14. IMF annual output gap estimates



Source: IMF, ANZ Research

In the end, it all comes down to inflation, and when the RBNZ can feel confident that it's beaten. Things are generally going the right way in that regard, but with headline inflation still at 5.6% and pricing intentions stubbornly high the RBNZ is still some way from confidently declaring victory. But that day is now looking closer than it was. We will refresh our OCR call later this week following the release of the QSBO survey.

Meet the team

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