ANZ Research

NZ GDP: Q3 2020 Review

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Contact

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Two-speed economy

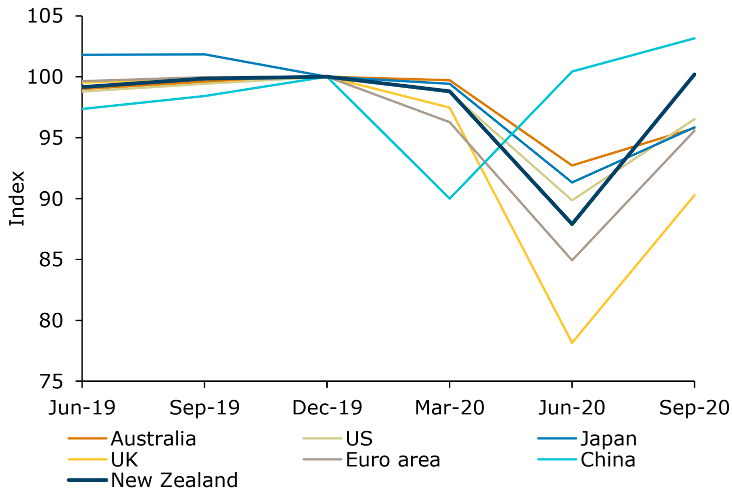
Bottom line

- The NZ economy rebounded 14.0% q/q in the September quarter, in line with our expectation. But the details point to an even more robust economy than we anticipated, with a solid upward revision to the Q2 decline and, wait for it, the (seasonally adjusted) economy coming in 0.2% larger in Q3 2020 than it was before this crisis (Q4 2019). The question is, can this level be sustained or is a recoil on the cards in Q4? Our money's on the latter.
- These data are still very noisy, and while we'll likely lift our expectation for the level of GDP over the medium term on the back of this, that's more of a rebase than a material change to the outlook. Policy makers are equally likely to look through the noise.
- Importantly, the level of per capita GDP (which rebounded 13.8% q/q) is still 1.2% below its pre-crisis level, suggesting the full story is not captured in the headline figures.
- Ongoing divergence across industries suggests New Zealand is experiencing a two-speed recovery. Activity in some industries is off the chain, while others are really struggling. The tug of war between housing-induced domestic demand (and resilient agriculture) versus the lost summer of international tourism suggests this divergence will persist in the near term, with resulting stresses and strains in the labour market due to extreme skills mismatches.

The view

Successful virus containment, alongside an aggressive macroeconomic policy response, has seen New Zealand economic activity record a sharper bounce out of lockdown than most of our key trading partners (figure 1). And with virus resurgence and lockdowns still causing havoc globally, particularly in the Northern Hemisphere, that's a theme that's likely to persist for a while yet, with consequences for the exchange rate.

Figure 1. GDP levels (Q4 2019= 100)



Source: Stats NZ, ANZ Research

Data summary

	Latest	Prev
Quarterly % change	14.0%	-11.0%
Annual % change	0.4%	-11.3%
Annual average % change	-2.3%	-1.8%

This relatively strong starting point (and much more robust economy than any forecaster was expecting back when the economy was being thrust into Alert Level 4) is certainly worth something from an economic momentum perspective. We've recently baked a little more oomph into our medium-term outlook, and provided downside economic and virus risks don't materialise in the near term, we could be baking in a little more next year. But even though New Zealand is a good news story, and today's data are stronger under the hood, the recovery is still poised to become a much harder grind from here. 2021 will bring some significant tests to the economic resilience we've seen so far:

- At the current juncture, housing-induced domestic momentum seems to be winning the tug of war against the lost summer of tourism, but the peak impact for the latter isn't expected until Q1. A key question on our minds is whether or not housing-induced momentum can carry the economy through to when New Zealand can safely reopen its borders to tourists and international students (we're assuming fully open borders from early 2022, though it'll be a progressive opening rather than a 'big bang').
- Let's not forget that the housing market can turn on a dime, and the direction of Government and macro-prudential policy action certainly isn't going to be aimed at supporting further price gains. We think it's likely that the Government will announce some new policies early next year to address the housing crisis; we just don't know how far they will go.
- Beyond housing, we also have to be wary that a significant tailwind to incomes, the wage subsidy, is all done and dusted now. Hefty cash buffers have delayed any obvious drag, but that doesn't mean we've dodged it completely. Another key unknown is whether or not the private sector is ready to take the reins of growth as recent sugar-hit fiscal stimulus wanes. Time will tell.
- Then there's the global economy. Let's not lose sight of the fact that New Zealand is a small open economy and that demand for our goods exports is a significant determinant of our national income. So far, export earnings have been pretty robust. Let's hope it stays that way.

Nonetheless, and despite the possibility that the recovery is unlikely to be a straight line from here, the outlook for monetary policy has become much more nuanced. Risks are very much skewed towards the RBNZ declaring job done earlier than expected. We'll review our OCR forecast in the New Year.

The details

Turning to the details of today's release, GDP bounced back 14.0% q/q in Q3 to be up 0.2% from its pre-crisis (Q4 2019) level in seasonally adjusted terms. Quarterly growth was bang on our expectation, but the underlying details were a little stronger, with revisions showing the economy contracted 11.0% in Q2 rather than the previous published read of -12.2%. But importantly, we think strong quarterly growth in Q3 means there is a material risk of a recoil in Q4 and even Q1. And that's exactly our forecast.

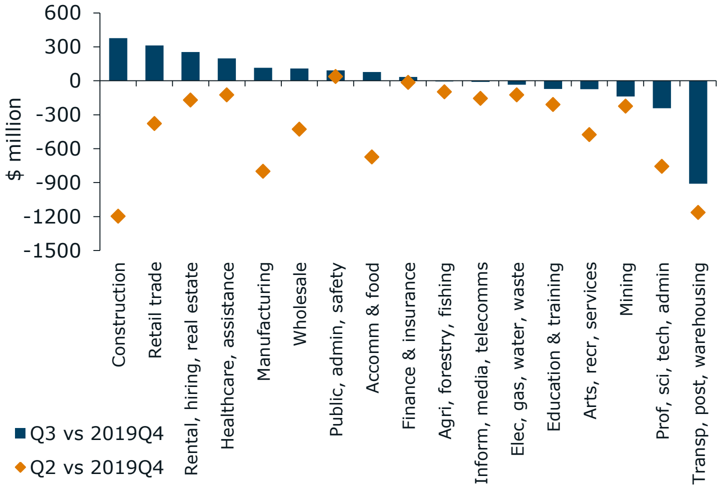
Other than flowing through the higher level of GDP into our forecasts, we don't see a lot in these data to tilt our view on the (very uncertain) medium-term outlook. Policy makers are expected to look though the noise also. That said, a number of more timely economic indicators are pointing to some upside risks to momentum and therefore the medium-term outlook.

Importantly, per capita GDP is still 1.2% below its pre-crisis level, and down 1.7% y/y. And that suggests the recovery isn't complete yet.

Also, diving into the industry-level data, it's quite obvious that the economy is running at two speeds – 100 miles an hour, and reverse. That's awkward.

Benefitting from the policy response and heat in the housing market, nine industries expanded beyond their pre-crisis levels in Q3 with construction, retail trade, rental hiring and real estate and healthcare the standouts (Figure 2). Some industries may be susceptible to a recoil in Q4 (particularly retail trade given supply disruptions). Meanwhile, a closed border is still weighing significantly on transport. But the good news is that all industries improved from the very nasty Q2 read. Divergence by industry is expected to continue for as long as our borders remain closed.

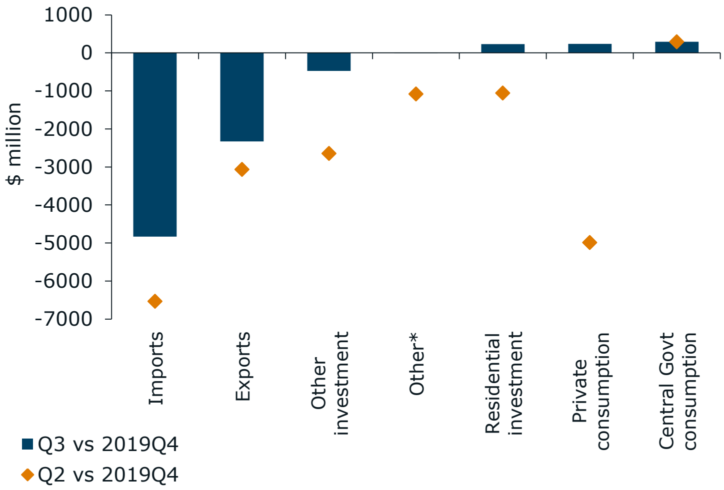
Figure 2. GDP by industry vs pre-crisis (Q4 2019)



Source: Stats NZ, ANZ Research

Expenditure GDP (which rebounded 15.6% q/q) is also displaying significant divergence by component (figure 3). Supply disruption is keeping imports supressed (beyond what you'd typically expect during a crisis), and that's favouring a higher-than-otherwise level of expenditure GDP for now. Exports are also yet to recover. As is typical during highly uncertain times, other investment is underperforming as weak business investment more than offsets the Government's plans to lift its capex game. Unsurprisingly, residential investment is back in the black. Private consumption has more than made up lost ground, and Government consumption has been solid throughout.

Figure 3. Real expenditure GDP vs pre-crisis



Source: Stats NZ, ANZ Research

All up, the Q3 GDP release was about as close to our expectation as possible, but the details point to an even more robust economy than we thought, insofar as the smaller Q2 contraction is concerned. However, a deeper dive into the details shows that this a very complex crisis, and while some industries are booming, others are struggling. And that's still something to be worried about.

We should bear in mind, these data are noisy and also "old news". The more timely economic indicators, such as business and consumer sentiment, are the key thing to focus on right now, particularly from a monetary policy perspective. And on balance, these data have been robust – let's hope that vibe is maintained.

P.S. Merry Christmas!

Figure 4. Production-based GDP

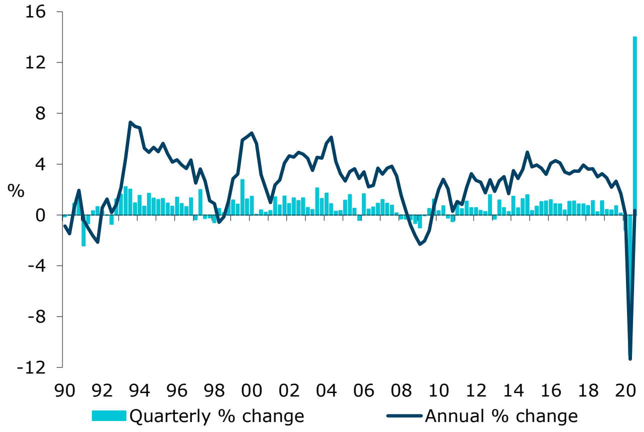
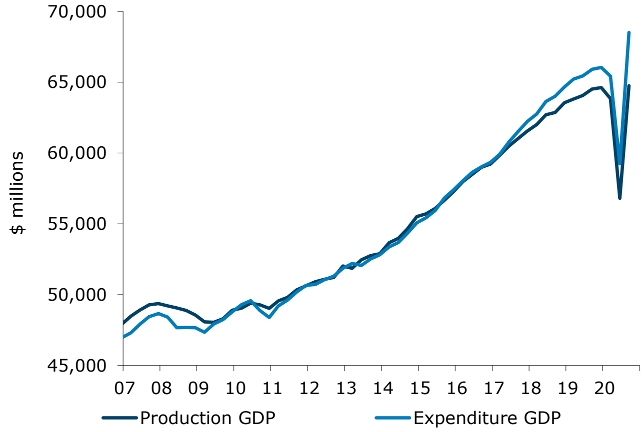


Figure 5.Real GDP level (sa)



Source: Statistics NZ, ANZ

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