ANZ Research

NZ GDP: Q2 2020 Preview

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Contact

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One for the history books, but largely noise for the policy makers

Bottom line

- Brace yourself for the sharpest quarterly economic contraction that you're likely to ever see (touch wood). We've pencilled in quarterly growth of -12%, but the uncertainty band is very wide.
- This is a significant improvement on our previous forecast of -17.5% q/q, and reflects the just-released supplementary and experimental data Stats NZ have used to apply judgement. It's partly a matter of measurement difficulties, rather than activity holding up better than feared.
- Revisions to these data over the next year or so could end up being just as significant as any Q2 forecast "miss". Stats NZ's sources and methods were not developed with lockdown in mind.
- We're not going to get too hung up on the Q2 figures. A smaller (larger) contraction than expected is more likely to see us revise down (up) our expectation for the rebound in Q3 growth than it is to cause us to make material changes to our medium-term outlook.
- For macro-policy settings it's the medium-term outlook that matters, and this will remain riddled with challenges regardless of where Stats NZ estimate Q2 GDP to be. Policymakers will largely look through the data.

The view

New Zealand Q2 Balance of Payments and GDP figures are released at 10:45am next Wednesday and Thursday respectively.

The 12% q/q contraction we've pencilled in for Q2 GDP will see the economy back at levels last seen in 2015. Per capita GDP will be cast back even further – to levels that prevailed in 2005!

However, given how rapidly this crisis has evolved, Q2 is already beginning to feel like ancient history. We're now in the final month of Q3, a quarter that's likely to bring the sharpest quarterly economic expansion we'll ever see. That's despite being hindered by renewed lockdown measures, which will leave the level of GDP lower than otherwise and keep the data noisy for the rest of 2020.

Uncertainty around the Q2 GDP print is extreme, and should be looked through by markets and policy makers for a number of reasons:

- Measurement difficulties faced by Stats NZ mean that revisions to these data over time could actually end up being just as significant as any forecast "miss".
- Lockdown measures will make the data very volatile. A weaker (stronger) Q2 print than expected is more likely to see us revise up (down) our expectation for Q3 growth than it is to cause us to make changes to the medium-term outlook. (eg. our upwardly revised Q2 forecast of -12% q/q has led us to lower our Q3 pick by 7.5%pts to 8.5% q/q, and any surprises in the reported data would be treated similarly).

Data summary

	Last	ANZ exp
GDP		
Quarterly % change	-1.6%	-12.0%
Annual % change	-0.2%	-12.3%
Annual average % change	1.5%	-2.1%
Balance of Payments		
Current account ($m, actual)	1,557	830
Current account ($m, sa)	-1,554	-670
Annual CAB ($bn)	-8.5	-6.6
% of GDP	-2.7%	-2.2%

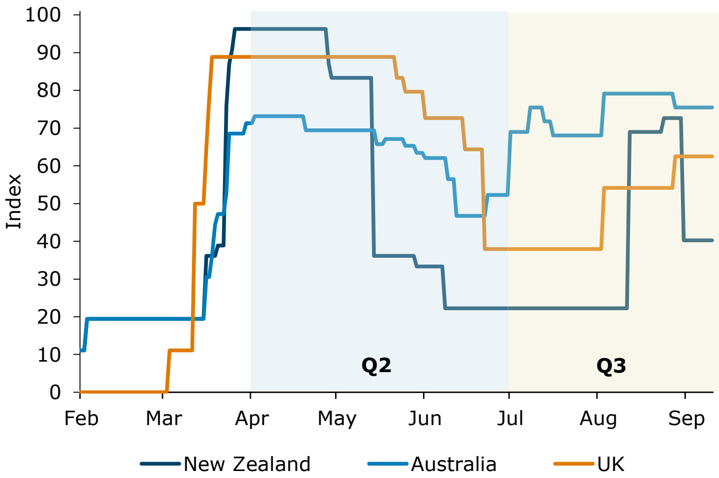
- It's the medium-term outlook that really matters for policy settings, and the lockdown-induced contraction in Q2 is only the first round of this economic shock. We're yet to really feel the full impact of the closed border and the sharp (and very synchronised) global contraction. Not to mention the fact that the economy is yet to be weaned off an unprecedented amount of temporary support (such as the wage subsidy and mortgage relief). When that happens, we think the economic fundamentals will become more visible.

Nonetheless, we've done our best to gauge where the Q2 read might land, following the usual partial indicators (such as retail sales and the quarterly manufacturing survey), and by poring over the supplementary data that Stats NZ have said will inform their judgements in compiling these data. But it's fair to say some of our indicator models are not performing well this quarter (particularly when it comes to some of the services industries), and we've found ourselves spending just as much time trying to understand how Stats NZ might apply judgement as we have estimating where we think activity actually ended up in Q2.

For reference, our models, and varying assumptions about both the impact of lockdown and the degree of pent-up demand after lockdown spits out a very wide range for quarterly growth in Q2: between -8.0% and -20% q/q.

Turning to international comparisons, New Zealand spent half of Q2 with tighter restrictions on activity than Australia (eg no construction activity in Alert Level 4, and no takeaways), but in the second half of the quarter had fewer restrictions (figure 1). Australian GDP was reported at -7% q/q. On the other hand, the UK had tighter restrictions than New Zealand on average over Q2, and reported GDP of -20.4% q/q. It makes intuitive sense for New Zealand to land closer to the Australia end of that range.

Figure 1. Oxford Government Response Stringency Index



Source: Oxford University, Bloomberg

Table 1 provides more international context. New Zealand's fall in Q2 GDP is expected to land at the larger end, but the Q3 recovery should be stronger, due both to the degree of pent-up demand and fewer subsequent restrictions.

Table 1. Quarterly growth among key trading partners

	Australia	US	Japan	UK	Euro area	China	New Zealand
Q1 2020	-0.3	-1.3	-0.6	-2.2	-3.7	-10.1	-1.6
Q2 2020	-7.0	-9.1	-7.9	-20.4	-11.8	11.7	**-12.0**

Source: Macrobond, Stats NZ

Turning to the details of the Q2 release, production GDP is expected to be most robust across the primary sector, as this was less impaired by lockdown.

However, there were some restrictions, which, combined with the impacts of drought, are expected to see primary GDP contract 7.0% q/q. Goods-producing industries are expected to fare the worst (-13.5% q/q). Theoretically, goods-producing industries are relatively capable of bouncing back from a shock like lockdown (you can run factories and shifts into overtime), whereas it's harder to recover lost services GDP (people don't get two haircuts to make up for missing one). That said, some services industries (such as IT, accounting, architecture, law, and finance etc) were likely to have been less impacted by lockdown given the relative ease of working from home. We estimate services industries declined 12% q/q.

Expenditure GDP should contract by a similar amount, but there are some definition and timing differences that suggest the quarterly moves won't be exact. Broadly speaking, we expect gross fixed capital formation (total investment) to underperform the rest of the economy, led by very weak business investment. This not only reflects the impacts of lockdown, but also the typical pull-back of business investment one would expect to see during very uncertain times. Very weak momentum in business investment is likely to be ongoing. Government investment is poised to rise markedly over the coming years, but its small share of GDP means it will only provide a partial offset to very weak private sector investment.

Net exports of goods is poised to contribute strongly to GDP (as imports fell by a lot more than exports), but closed borders should see net services exports drag. Together, total net exports are expected to make a positive contribution to growth. Meanwhile, consumption spending is expected to moderate broadly in line with headline GDP.

Regarding the balance of payments, we expect the seasonally adjusted current account deficit to narrow, but with some very significant and offsetting quarterly moves. The goods deficit is expected to flip into surplus as import values fall more than twice as much as exports (around -15% vs -6%). Meanwhile, the services surplus is expected to flip into deficit in Q2, as closed borders weigh on tourism earnings (with exports down almost 40% q/q) while imports fall by less (down 30%). Meanwhile, the income deficit is poised to narrow as lower global interest rates contain net outflows. Overall, we expect the annual current account deficit to narrow 0.5%pts of GDP to 2.2%.

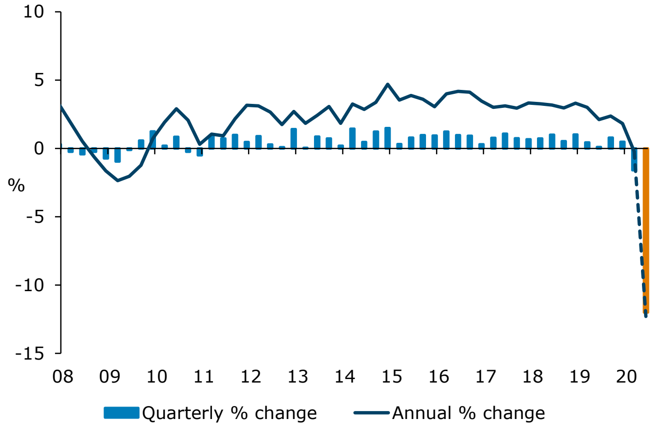
New Zealand's net international investment position should also improve in Q2 on the back of valuation changes after global equities recovered dramatically over the quarter.

ANZ Q2 GDP industry-level forecast

Industry	q/q%	%pt cont.
Agriculture, forestry, and fishing	-5.1	-0.27
Mining	-15.0	-0.19
Manufacturing	-10.6	-0.99
Electricity, gas, water, and waste services	-3.5	-0.10
Construction	-22.0	-1.37
Wholesale trade	-12.0	-0.61
Retail trade and accommodation	-18.8	-1.37
Transport, postal, and warehousing	-14.0	-0.59
Information media and telecommunications	-11.0	-0.40
Financial and insurance services	-10.0	-0.58
Rental, hiring, and real estate services	-10.5	-1.41
Prof, scientific, technical, admin, and support	-10.0	-1.04
Public administration and safety	-6.0	-0.28
Education and training	-14.0	-0.52
Health care and social assistance	-4.0	-0.24
Arts, recreation, and other services	-30.0	-0.93
Unallocated	-13.0	-1.01
Balancing item	--	-0.06
Gross domestic product	**-12.0**	**-12.0**

Source: Statistics NZ, ANZ

Real GDP growth



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