ANZ Research

NZ GDP: Q4 2020 Review

18 March 2021

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Contact

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Data summary

	Latest	Prev
Quarterly % change	-1.0%	13.9%
Annual % change	-0.9%	0.2%
Annual average % change	-3.0%	-2.3%

Shouldn't challenge the narrative

Bottom line

- The NZ economy contracted 1.0% q/q in the December quarter, weaker than our expectation of 0.5% q/q rise. In year-on-year terms the economy was 0.9% smaller in Q4.
- These data are still very noisy under the hood. A fair amount of the quarterly contraction appears to be industries recoiling from Q3's strong expansion as they bump into capacity constraints, rather than signalling a change in the direction of underlying economic momentum.
- Indeed, divergence across industries remains acute – particularly hot housing versus international tourism on ice.
- Overall, while economic resilience remains a key theme across the New Zealand data, today's data go to show positive surprises can't last forever. The absolute story remains that this has been a very significant shock, but the recovery thus far has been impressive. Policy makers will need to remain patient and see how things evolve from here.

The view

The December quarter was just round one of a clash between two economic heavyweights: housing-induced domestic demand vs a closed border. And today's data suggest it's been a close match, with both sides landing some heavy blows. Overlay a significant degree of quarterly volatility, and the fact that the economy contracted in Q4 doesn't really challenge the narrative that New Zealand's recovery has been remarkable to date.

Based on today's data, we'd say odds favour a pretty flat print in Q1, as we should see some of the recoil dynamics reverse.

International tourist receipts typically peak in Q1 (figure 1, over) – that's NZ's largest export earner out for the count until borders reopen (which we assume will be early 2022, though we may see some limited reopening before then). Conversely, the very strong February REINZ data shows housing momentum is looking to come straight from the shoulder in Q1, and that presents some upside risks to our broader economic outlook (albeit with its impact on activity limited by capacity pressures, which appear to be biting rather acutely).

If closed border impacts dominate housing more than we expect, today's data could mark the beginning of a technical recession. But recession is a growth concept that we shouldn't get hung up on in a world of massive volatility in the levels.

We'll be recalibrating our GDP outlook in light of both today's data and a stronger near-term housing outlook (keep an eye out for tomorrow's Weekly Data Wrap). But we're talking forecast tweaks, not dramatic changes to the fundamentals or the outlook for underlying momentum.

For 2021 as a whole, this is going to be a game of stamina and available resources. Mid-year, the drag of a closed border is expected to flip to a small positive, but at the same time, housing is likely to cool. Broadly, speaking, when the points are tallied at the end of the year, we think it's going to be pretty even.

At the industry level, the implication of such strong, yet opposing, forces is significant divergence for some time yet. However, with capacity pressures already biting (including difficulty finding skilled labour), there is limited scope for outperforming industries to do the heavy lifting of headline growth as they did during the rebound from lockdown.

Stepping back, the New Zealand economy still appears better placed than many of our key trading partners (Figure 2), reflecting successful virus containment alongside an aggressive macroeconomic policy response. And now, with the global vaccination programme ramping up, some are looking towards the New Zealand experience as a bellwether for how the global rebound might play out.

It's certainly true that macro policy appears to have now done enough, but that's not the same as saying it's time to declare victory. There is still plenty of residual noise in these data (particularly at the industry level) that policy makers need to look though. Not to mention the fact that the broader recovery remains fragile; there is still a permanent global (and domestic) income shock to navigate; COVID-19 is yet to be delivered a knockout blow; and some pockets of the economy are still really struggling. Policy makers need to be ready to come out swinging if underlying momentum threatens to turn.

Figure 1. Net visitor arrivals

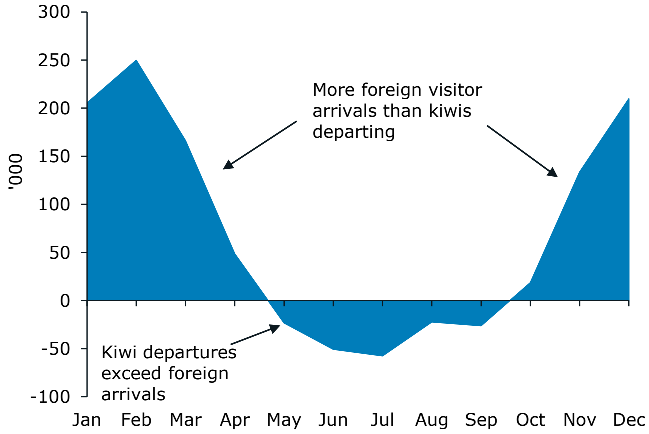
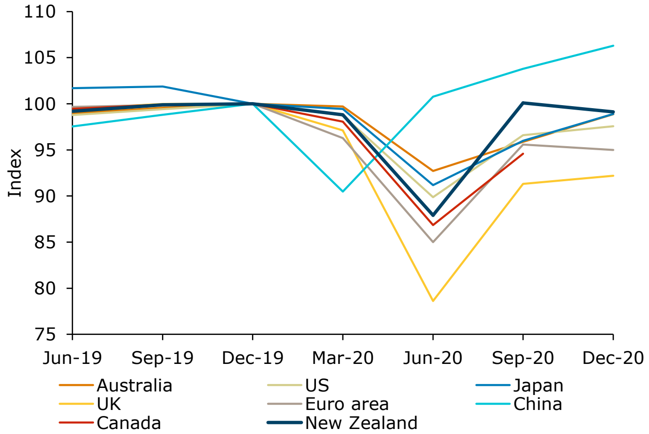


Figure 2. GDP levels (Q4 2019= 100)



Source: Stats NZ, ANZ Research, Macrobond

The details

Turning to the details of today's release, production GDP contracted 1.0% q/q in Q4 to be down 0.9% y/y. Quarterly growth was weaker than our expectation for a 0.5% lift, but there is a lot of quarterly noise at the industry level still being worked through. We always knew the scope for error was wide.

Diving into the industry-level data, it's quite obvious that a stabilising headline quarterly growth rate masks a very complex and divergent situation under the hood. The year on year percentage change is perhaps the best indicator to get a feel for how individual industries are doing compared to the good old days before COVID-19.

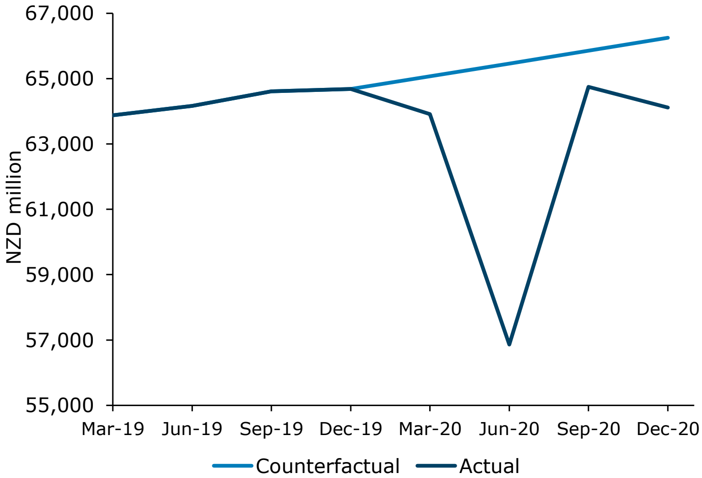
As expected, retail trade, and health care are doing well on that metric despite retail contracting significantly on a quarterly basis. It's very hard to argue that construction activity isn't very very strong overall, but the sharp q/q contraction in Q4 makes it look a lot less rosy in y/y terms than we were expecting. However, that quarterly recoil is more a function of capacity constraints biting and the seasonally adjusted level normalising following Q3's pent-up-demand-driven strength, than it is a signal that underlying demand is fading.

Conversely, transport is struggling (but doing a little better than we feared) and will do so until borders reopen. Primary industries are marching to the beat of their own drum (ie relatively unaffected by COVID-19), and were down 0.7% y/y. That's more a function of weather conditions and herd sizes than the global downturn. The signal from some of our commodity prices is: produce!

The annual average percentage change (ie activity across all of 2020 vs 2019) is perhaps the best indicator to get a feel for the overall impact of the crisis. On this measure the economy was 3.0% smaller in 2020 than it was in 2019.

However, the damage is actually a lot larger than that if we consider the counterfactual that COVID-19 never happened and the economy had expanded at a moderate pace over 2020. Compared to that state of the world, we estimate the economy was actually around 5% smaller in 2020 than it would have been. And also, we've got a lot more debt now, both public and private, that will need to be paid back one day. But for now, the degree of government debt accumulation has effectively meant that policy makers have rather effectively spread a lot of the associated income shock out over time (via the wage subsidy and other policies). But because of that, higher-than-otherwise taxes, or lower-than-otherwise Government services will eventually be forthcoming. But what it means for the here and now is many households (especially those who stand to benefit from the hot housing market) are not feeling the pain, while others (those exposed to MIA international tourism) are still hurting.

Figure 3. Real GDP vs a non-COVID counterfactual



Source: Stats NZ, ANZ Research

Real expenditure GDP contracted 1.5% q/q – an unsurprising catch-up move after this measure outpaced its production equivalent in Q3. This measure of GDP is also working through a noisy patch.

- Supply disruption is keeping goods imports supressed, but there was some catch-up in Q4 (perhaps not enough to meet demand though – suggesting ongoing cost and pricing pressures in the near term).
- As is typical during highly uncertain times, investment is underperforming as weak business investment more than offsets the Government's plans to lift its capex game. Weak business investment doesn't bode well for the medium-term outlook, as the lower capital stock than otherwise will hamper the economy's productive capacity. That said, we do expect to see some pockets of capital switching given labour has been difficult to come by.

- Residential investment fell on a quarterly basis, but remains one of the outperforming components overall – it's just hard to expand when you can't get workers and materials when and where you need them.
- Private consumption also remains quite buoyant, lifting 1.0%, but the mix did shift from things to services – that makes sense given lockdown restrictions didn't hamper activity in the quarter.
- Government consumption (which has been solid throughout) lifted 1.7% q/q.

All up, the Q4 GDP release was a bit weaker than our expectation at the headline level, but that appears to be owing a lot to quarterly volatility rather than being something to get too worried about. However, the fact remains that this is a very complex economic shock – it's a funny old mix of a supply and demand shock that's hitting different industries in different ways. This is a huge challenge for policy makers assessing the permanence of the disruption to both the supply and demand side of the economy.

From a policy outlook perspective, the vaccine rollout and path to border reopening, alongside persistence in housing-induced momentum, are all more important than these historical data. But today's data do reaffirm the need for policy makers to be patient. Underlying momentum doesn't look to be under threat, but looking through the noise, 2021 is shaping up to be a bit of a sideways year for activity – as we've long been saying.

Figure 4. Production-based GDP

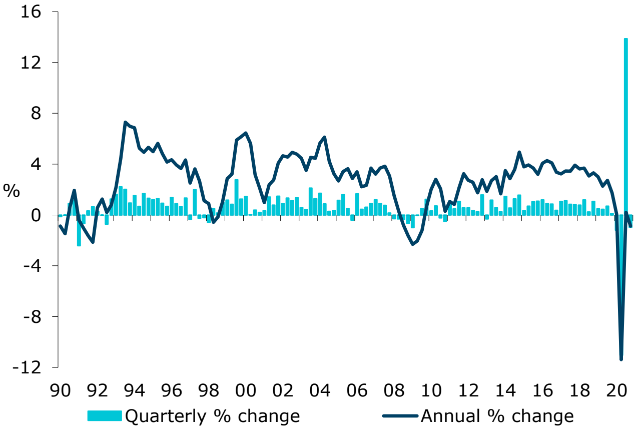
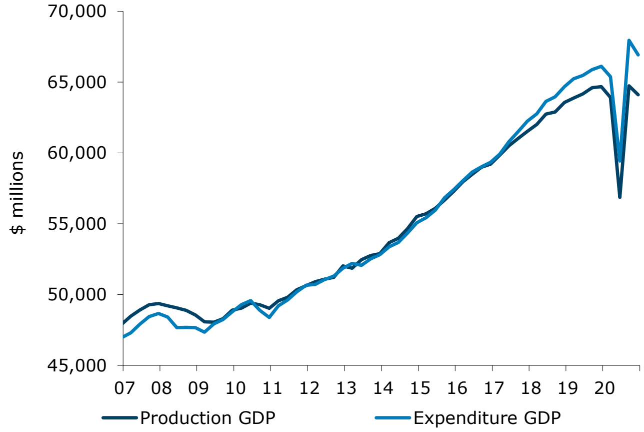


Figure 5.Real GDP level (sa)



Source: Statistics NZ

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