NZ GDP and Balance of Payments: Q1 2022 Preview

10 June 2022

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Data summary

	Q4 2021	ANZ Q1 2022 exp
GDP		
Quarterly % change	3.0%	0.0%
Annual % change	3.1%	1.8%
Annual average % change	5.6%	5.2%
Balance of Payments		
Current account ($m, actual)	-7,261	-6,450
Current account ($m, sa)	-6,495	-8,460
Annual CAB ($bn)	-20.2	-23.5
% of GDP	-5.8%	-6.6%

No capacity

Bottom line

- We've pencilled in a flat quarter (0% q/q) for economic activity. That's a decent downgrade from our previously published forecast of 0.6% and much weaker than the RBNZ's May MPS forecast of 0.7% q/q.
- But there's probably too much COVID noise lingering in these data to comfortably diagnose the trend. Downside Omicron risks in Q1 imply equivalent upside bounce risk in Q2, meaning the RBNZ may well look through a forecast miss to some extent.
- And while some of the timely activity indicators (such as our Business Outlook and consumer confidence) suggest the economy is indeed slowing, the RBNZ's top priority is to get on top of inflation pressures, which still remain far too high. When the RBNZ inevitably does decide to slow down or even pause, we think it'll be when inflation expectations and underlying inflation pressures (including via the labour market) are clearly beginning to soften – that's simply not something the Q1 GDP data is going to shine much light on.
- The annual current account deficit is poised to widen further in Q1, driven by over-stimulated domestic demand (pulling in imports), a closed border (shutting down travel-related exports), and rising global interest rates (increasing NZ's debt-servicing costs). We expect an annual deficit of 6.6% of GDP – the largest deficit as a share of the economy since 2009.

The view

New Zealand's Q1 Balance of Payments and GDP figures will be released at 10:45am next Wednesday and Thursday respectively.

Q1 GDP will be yet another quarter made fuzzy by COVID-related noise. In addition to measurement difficulties and unusual seasonal activity (courtesy of the closed border), there is plenty of scope for COVID-induced surprises. Theoretically, Q4's 3% q/q rebound was held back somewhat by the fact that Auckland was under alert level 3 settings for a large part of the quarter. All else equal, there should be some bounce in Q1 from that. But all else is never equal, and part way through Q1 the Omicron wave came along. And whether it was home isolation or just good old-fashioned people-dodging, mobility wasn't exactly at normal levels over Q1. While our Heavy Traffic Index had largely recovered by the time the new year rolled around, it was mid-February before light traffic was back at pre-Delta levels. Meanwhile, anecdotes of labour shortages have been rife.

All up, this suggests some parts of the economy were trucking along OK in Q1, but capacity pressures were acute, limiting growth. And industries more reliant on foot traffic, such as transport services, retail, and accommodation and food services, will have once again borne the brunt of it.

For the RBNZ, a miss on their forecast (+0.7% q/q) may not carry much in the way of implications for their view of appropriate monetary policy settings – particularly if they tee this up to stronger-than-expected capacity pressures. But more than that, the GDP data are simply too noisy right now, and with inflation and the labour market where they are, it's still very much a "keep calm and carry on" (with front-loaded OCR hikes) situation out there. To the extent that Omicron disruption weighs on Q1, then we (and possibly the RBNZ) may look to factor in some rebound in Q2 as these impacts dissipate. In other words, weaker Q1 activity may not necessarily mean weaker H1 activity.

Markets, on the other hand, will do what markets do, and a stronger-than-consensus print would likely reaffirm pricing along the lines of the RBNZ's May MPS forecast (which had a peak OCR of almost 4%, with at least two more 50 pointers in the near term). However, a weaker read will likely see markets carry a little more sympathy for our view that the OCR will peak at 3.5% and that there's only one more 50-pointer to come (July) before the timely data deteriorate sufficiently to suggest that 25bp hikes better reflect the balance of risks. Indeed, if the RBNZ focus solely on core inflation and labour market indicators (both of which tend to be slow moving and lag the broader economic cycle), then they are almost guaranteed to oversteer and induce a harder landing than intended or quite possibly necessary. But at the same time, the GDP data are still very noisy. So what's the Bank to do?

For now, we think it's better to focus on the timely indicators, such as PMIs, PSIs, consumer confidence, our Business Outlook, and our Truckometer. And there are already troubling signals here, with consumers are saying it's a bad time to buy a major household item (normally a very good barometer for retail trade and private consumption), and businesses downbeat (particularly in the residential construction sector). However, card spending is holding up at decent levels, and our Truckometer, while a little bouncy, is so far on a solid footing too.

Meanwhile, business and consumer inflation expectations and businesses' pricing expectations are still near record levels, and labour market indicators (such as monthly employment and job ads) are still very much in the tight-and-inflationary zone. These indicators will likely need to start turning down alongside activity indicators to convince the RBNZ that it's time to start hiking a little less aggressively.

So bringing it back to the Q1 GDP data, it feels like the bar is higher than normal for these data to significantly alter the RBNZ's policy stance. At the end of the day, COVID has proven itself to be both a source of significant volatility in the GDP data and a shock to economic supply (eg labour mobility and productivity). That means economic activity relative to "trend" is difficult to diagnose right now, making it a relatively poor barometer for underlying inflation pressure. Chances are we see some soft signals in the Q1 GDP release, only to see some reversal of that in Q2.

Turning to the details, the partial Q1 GDP indicators have been mixed. Retail spending fell 0.5% q/q, building work put in place lifted 3.2%, manufacturing volumes fell 3.5% q/q, wholesale trade (adjusted for price changes) was relatively flat, and hours worked across services industries lifted just 0.1% q/q. Table 1 (over page) shows how these have filtered through to our industry-level forecasts. Overall, our expectation for no growth in Q1 is driven by a 0.8% contraction across goods-producing industries and a 0.2% contraction across primary industries, largely offset by a 0.3% q/q lift across services industries (which account for around two thirds of GDP).

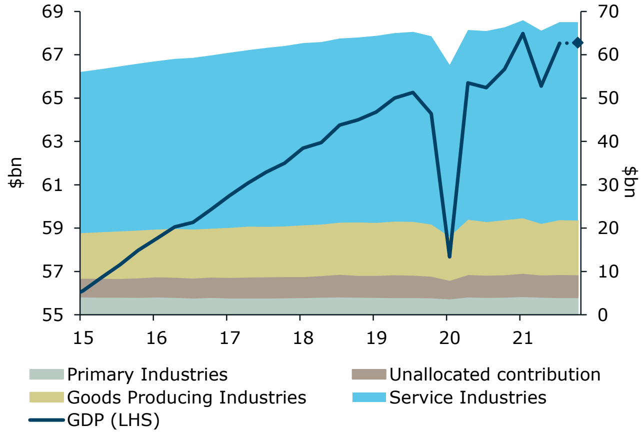
Turning to the balance of payments, we expect the annual current account deficit to widen a further 0.8%pts of GDP to 6.6% – once again marking the widest deficit as a share of GDP since 2009. Consistent with a highly stimulated domestic economy, strong growth in goods imports is expected to outpace goods exports in the quarter, despite the higher terms of trade. On the services side, another summer without international tourists will show up in the services balance, with exports unseasonably weak, and services imports (which are less concentrated in travel services than exports) continuing to lift. The resulting services deficit (around 1.8% of GDP) will be the largest since these data began in the late 1980s. The income deficit is also expected to widen as rising global interest costs bite – hardly a surprise, given NZ is a net borrower from the rest of the world. All up, MIA international tourists, overstimulated domestic demand, and rising global interest rates are a nasty cocktail for the current account deficit, and it's a combo that makes NZ look a lot more vulnerable to global economic and financial shocks. If the current account deficit doesn't start improving soon, and if the Government continues to run pro-cyclical operating deficits, sovereign credit ratings agencies are likely to find this dynamic concerning.

ANZ Q1 GDP industry-level forecast

Industry	q/q%	%pt cont.	y/y%
Agriculture, forestry, and fishing	-0.3	-0.01	-3.7
Mining	0.6	0.01	6.1
Manufacturing	-4.1	-0.38	-4.1
Electricity, gas, water, and waste services	-0.5	-0.01	4.2
Construction	3.1	0.21	1.2
Wholesale trade	0.2	0.01	5.3
Retail trade and accommodation	-0.4	-0.03	-0.2
Transport, postal, and warehousing	0.0	0.00	7.3
Information media and telecommunications	1.0	0.04	-0.3
Financial and insurance services	0.5	0.03	-0.5
Rental, hiring, and real estate services	0.6	0.08	1.7
Prof, scientific, technical, admin, and support	-0.5	-0.06	11.0
Public administration and safety	1.0	0.05	2.8
Education and training	1.0	0.03	-5.5
Health care and social assistance	0.7	0.05	7.6
Arts, recreation, and other services	1.4	0.04	-7.2
Unallocated	0.0	0.00	-3.9
Balancing item	--	--	--
Gross domestic product	**0.0**	**0.0**	**1.8**

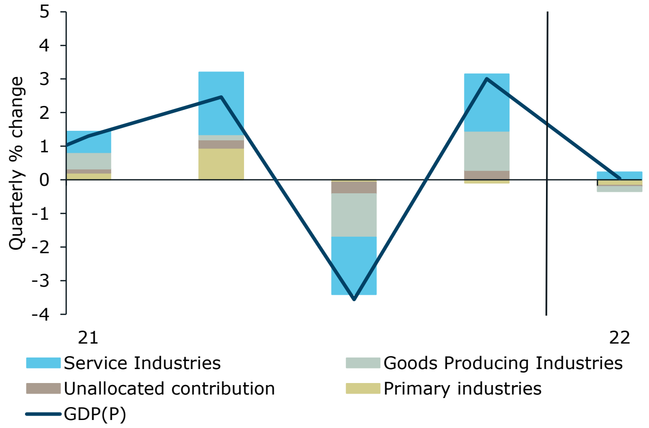
Source: Statistics NZ, ANZ Research

GDP forecast level



Source: Statistics NZ, ANZ Research

Contributions to quarterly GDP growth



Source: Statistics NZ, ANZ Research

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Last updated: 28 February 2022

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