NZ GDP and Balance of Payments: Q2 2022 Preview

9 September 2022

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Weaker, but not a game changer for the OCR

Bottom line

- Leading indicators going into the Q2 GDP release have been softer than expected on balance, indicating an economy struggling to get resource to grow (with COVID disruption only adding to that).
- We've pencilled in a 0.4% q/q expansion – a downgrade from our previous pick of 1.0%, and well below the RBNZ's August MPS forecast of 1.8%.
- The data are still pretty noisy and will remain that way for a while. Lingering COVID disruption is meeting the ongoing "normalisation" as services exports (international education and tourism) start to recover and domestic demand softens on the back of monetary tightening.
- Importantly, just like the unexpected contraction in Q1, weaker-than-expected growth in Q2 doesn't mean a lot for the OCR if supply-side hurdles like labour shortages are a big part of the problem (supply-side constraints are inflationary *and* constrain activity).
- In that context, while some indicators suggest the economy was in technical recession over the first half of 2022, given lingering wage and CPI inflation pressures, the RBNZ will need to keep on hiking even if this turns out to be the case. They need to drive demand below the level of potential supply and keep it there for a time. We're nowhere near that point yet.
- Reflecting an overstimulated domestic economy (sucking in goods imports) and the closed border (cutting off international tourism and education exports), we expect the annual current account deficit to widen by 1%pt of GDP to 7.5% (around $27 billion). That'll be the largest deficit as a share of the economy since 2008.

Data summary

	Q1 2022	ANZ Q2 2022 exp
GDP		
Quarterly % change	-0.2%	0.4%
Annual % change	1.2%	-0.7%
Annual average % change	5.1%	0.8%
Balance of Payments		
Current account ($m, actual)	-6,143	-5,250
Current account ($m, sa)	-8,521	-8,430
Annual CAB ($bn)	-23.3	-27.0
% of GDP	-6.5%	-7.5%

The view

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

Consistent with an economy that's run out of resources (particularly labour) to grow, leading activity indicators going into the Q2 GDP data have been pretty feeble, on balance. Activity indicators from business and consumer surveys have been very soft (capacity/cost and cost-of-living stories respectively). The Heavy Traffic Index (which has been one of the more reliable indicators through COVID in that it captures supply-side disruption pretty well) suggests the economy went sideways. Paid hours fell 0.7% q/q. And then drilling down into the bottom-up partial GDP indicators:

- Q2 retail sales volumes came out much softer than expected, falling 2.3% q/q. A simple regression using these data alone can usually predict quarterly GDP growth within 1% point or so, and for Q2 it suggests the economy contracted around 0.5% q/q.
- The quarterly manufacturing survey showed volumes down 4.9% q/q following a 3.5% decline in Q1. But the Q2 decline was driven by a change in classification for petroleum (following the end of domestic

refining). Value add in petroleum will now be measured as part of the wholesale industry, which will get a bump in Q2. Importantly, this isn't a sign of weakening demand for manufactured goods. Excluding petrol, manufacturing was up 3.7% q/q.

- Building work put in place was solid (up 2.6% q/q), suggesting construction had a good quarter despite ongoing supply challenges.
- After adjusting for price changes, wholesale trade was up around 4% q/q, pushed higher by the new classification for petroleum.

While trying not to get hit by all the moving parts, we've landed on a central expectation that the economy expanded 0.4% q/q in Q2, avoiding a technical recession (defined as two consecutive quarters of negative growth). However, with some of the partial indicators such as building work put in place and retail trade seeing downwards revisions to Q1 growth, we wouldn't be surprised if Q1 GDP growth is also revised lower (from -0.2% q/q). Indeed, measurement difficulties and unusual seasonal activity (thanks to the closed border) mean the GDP data are vulnerable to significant revision. That could obviously affect the quarterly growth rate even if we've got the level right.

Table 1 (over page) shows our industry-level forecasts. Overall, our expectation that the economy expanded 0.4% in Q2 is driven by:

- **services industries** bouncing from a flat read in Q1, to be up 0.8% q/q in Q2 (making a 0.6%pt contribution to headline growth). Services account for around two thirds of GDP, and tend to be less volatile than either goods and primary production. For this reason, growth across services industries tends to provide our best steer on underlying economic momentum. But we'll need to look though the petroleum reclassification from a goods-producing to a services industry.
- **primary industries** (which tend to be a lot more volatile than our indicator models predict) lifting 0.4% q/q (0.02% contribution); and
- **goods-producing industries** contracting 0.9% q/q (subtracting 0.2%pts from quarterly GDP growth);

Importantly, weak (or even negative) growth doesn't necessarily mean the RBNZ can afford to call a halt to monetary tightening any time soon. An over-stimulated economy bumping into capacity limits will always hit the wall at some point, and it looks like that wall is well and truly here. And given current wage and CPI inflation pressures, and what the business survey data continue to say about labour scarcity, a significant downside surprise to the RBNZ's August MPS forecast (1.8% q/q) probably doesn't mean a lot for OCR settings. We think they are more likely to chalk up weaker growth to weaker potential GDP in the quarter – meaning they won't change their estimate of how much spare capacity exists in the economy (precious little).

The tricky thing for the RBNZ of course is that activity generally, but particularly both inflation and the labour market tend to react with a decent – and imperfectly predictable – lag to changes in monetary settings, so we're squinting into the rear-view mirror when assessing appropriate monetary conditions based on labour market and inflation data in particular.

But even if activity is now on a net-demand-driven slowdown (which we think it will be by 2023), there's no question it's too soon, with the OCR at 3%, for the RBNZ "to wait and see" how things evolve. With the benefit of hindsight, both fiscal and monetary policy have been too stimulatory for the conditions over the past couple of years, and with Budget 2022 adding even more stimulus to the mix this fiscal year (the year to June 2023), the RBNZ is backed into a corner. It'll need to keep hiking to at least 4% by the end of the year in order to better balance wage-price spiral risks against hard-landing risks (even if Q2 GDP greatly disappoints their forecast).

Turning to the balance of payments, we expect the annual current account deficit to widen by a full percentage point of GDP to 7.5% – marking the widest deficit as a share of GDP since 2008. The big picture for the current account is little changed:

- The annual goods deficit is widening because imported goods have lifted strongly on the back of domestic demand (bolstered by fiscal and monetary stimulus).
- The annual services balance (which tends to be in surplus) is in deficit thanks to closed-border impacts on tourism and education exports. In fact, we expect to see the largest annual services deficit since the data began in the late 1980s (around 2.2% of GDP).
- And while the income deficit is relatively contained for now, it is poised to widen over the coming year or so as global interest rates rise.

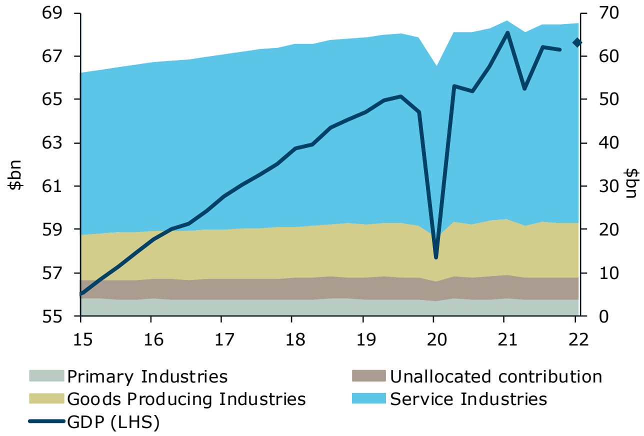
All up, we see the annual current account deficit as a share of GDP picking up an 8-handle over coming quarters. That's a level that will start to raise eyebrows, clearly demonstrating the extent to which our economy has been living beyond its means in recent years.

ANZ Q2 GDP industry-level forecast

Industry	q/q%	%pt cont.	y/y%
Agriculture, forestry, and fishing	0.6	0.03	-6.1
Mining	-1.1	-0.01	-7.5
Manufacturing	-4.0	-0.36	-6.6
Electricity, gas, water, and waste services	0.7	0.02	1.8
Construction	2.5	0.17	2.3
Wholesale trade	4.4	0.24	10.2
Retail trade and accommodation	-0.9	-0.07	-10.0
Transport, postal, and warehousing	2.5	0.09	-5.7
Information media and telecommunications	1.0	0.04	0.6
Financial and insurance services	0.5	0.03	-0.6
Rental, hiring, and real estate services	0.2	0.03	1.5
Prof, scientific, technical, admin, and support	1.0	0.11	6.4
Public administration and safety	0.8	0.04	3.1
Education and training	0.0	0.00	-0.5
Health care and social assistance	0.6	0.04	5.6
Arts, recreation, and other services	0.0	0.00	-11.1
Unallocated	0.4	0.03	-0.1
Balancing item	--	--	--
Gross domestic product	**0.4**	**0.4**	**-0.7**

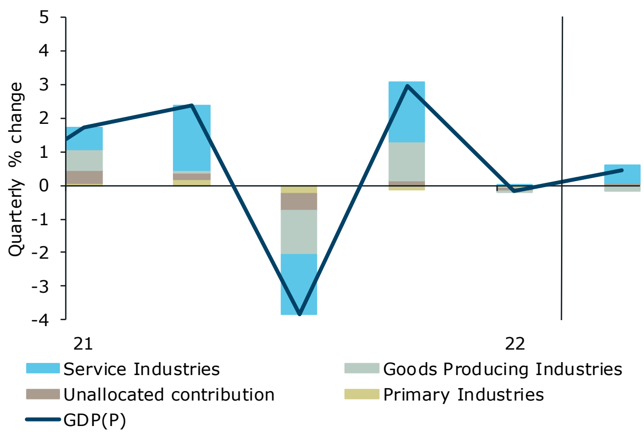
Source: Statistics NZ, ANZ Research

Figure 1. GDP forecast level



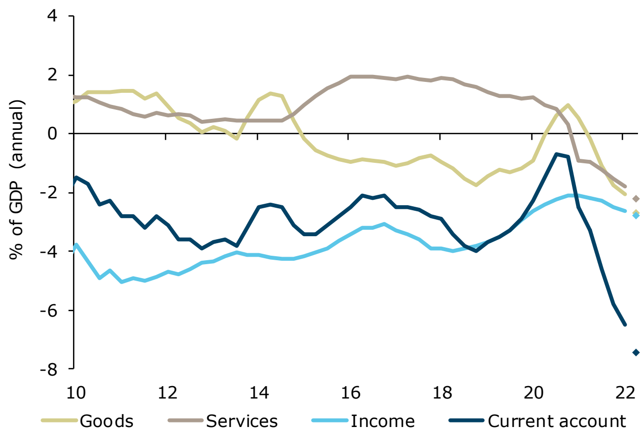
Source: Statistics NZ, ANZ Research

Figure 2. Contributions to quarterly GDP growth



Source: Statistics NZ, ANZ Research

Figure 3. Annual current account deficit



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Last updated: 1 September 2022

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