ANZ Research

NZ GDP and Balance of Payments: Q3 2023 Preview

8 December 2023

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Contact

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Headline above water; per-capita treading it

Bottom line

- We've pencilled in a 0.3% q/q economic expansion for Q3, unchanged from our previous forecast and in line with the RBNZ's November MPS pick.
- The November MPS attributed more of Q2's strong GDP read (+0.9% q/q) to demand than we expected given the recent easing across a number of key capacity indicators. While the Q3 data will be important insofar as it could provide light on whether strength in Q2 was momentum or perhaps cyclone related, the evolution of capacity indicators from here (including the labour market) will be the most important data for diagnosing the implications for inflation pressures.
- Brace for noise: Q3's usual annual benchmarking process, ongoing data quality improvements, and lingering quirky seasonality add a healthy dose of uncertainty to our forecast. We could see sizable data revisions too.
- The annual current account deficit is expected to narrow just 0.1%pts of GDP to 7.4%, still way too wide to call sustainable but at least moving in the right direction.

The view

New Zealand's Q3 Balance of Payments and GDP figures will be released at 10:45am next Wednesday and Thursday respectively.

The economy is unambiguously slowing on the back of past monetary tightening, but it's not one-way traffic:

- Near-term fiscal settings are stimulatory, reflecting the 1.4% of GDP increase to Government spending in Budget 2023.
- Surging net migration is flattering headline growth but makes for particularly sad reading in per-capita terms.
- The housing market is no longer a drag, and housing-related Government policy will loosen the shackles on investors going forward.
- The weaker exchange rate is supporting the services exports recovery and exporter incomes more generally (although global demand is not flash right now).

When it comes to the implications for monetary policy it's important to note that Q2's 0.9% q/q economic expansion was a big upside surprise to both our and the RBNZ's forecast at the time. And despite many measures of capacity stretch easing since then, the November MPS appeared to flow more of Q2's strength into demand momentum than into supply estimates, adding to the RBNZ's concern that monetary tightening may not be getting as much traction as previously expected.

As we noted in this Insight, GDP matters for inflationary pressures only insofar as how it's traveling relative to the economy's speed limit (aka potential GDP, which is estimated, as opposed to observed). While we'll be trawling through the Q3 GDP release to compare it to the RBNZ's latest forecast, it's worth highlighting that capacity indicators between now and the February MPS could prove just as important for policy settings.

Data summary

	Q2 2023	ANZ Q3 2023 exp
GDP		
Quarterly % change	0.9%	0.3%
Annual % change	1.8%	0.6%
Annual average % change	3.2%	1.7%
Balance of Payments		
Current account ($m, actual)	-4,208	-11,000
Current account ($m, sa)	-6,674	-7,300
Annual CAB ($bn)	-29.8	-29.7
% of GDP	-7.5%	-7.4%

Looking forward, the bigger picture for the economy isn't likely to be a pleasant one until it's clear the RBNZ have CPI inflation under control. Too much economic resilience could threaten to slow the pace in which inflation returns to the target band – the RBNZ is in no mood to tolerate that!

It's also important to note that the annual benchmarking process that typically takes place in Q3, ongoing data improvements, and lingering quirky seasonality all mean we could be in for some big surprises on the day, and not just in terms of Q3's growth rate. Historical revisions are likely too.

Turning to the details of the GDP release, the partial indicators have been mixed.

- The **retail trade** survey showed volumes unchanged (0.0% q/q) in Q3, as "core" sales (ex- fuel and auto) lifted 1.0% q/q. While the industry is certainly struggling in the wake of monetary tightening, it could be finding a floor (at very subdued levels, particularly in per capita terms).
- The **volume of building work put in place** fell 2.4% q/q in Q3, with Q2 growth undergoing a healthy upward revision from -0.1% q/q to +1.9% q/q. Residential building fell 0.6% q/q in Q3, while non-residential led the charge lower, falling 5.9% q/q.
- The quarterly **manufacturing** survey showed volumes fell 2.7% q/q in Q3, as food partially retraced Q2's gain, and manufacturing ex-food continued to soften. That's consistent with weakness in the PMI.
- After adjusting for price changes, **wholesale trade** lifted slightly.

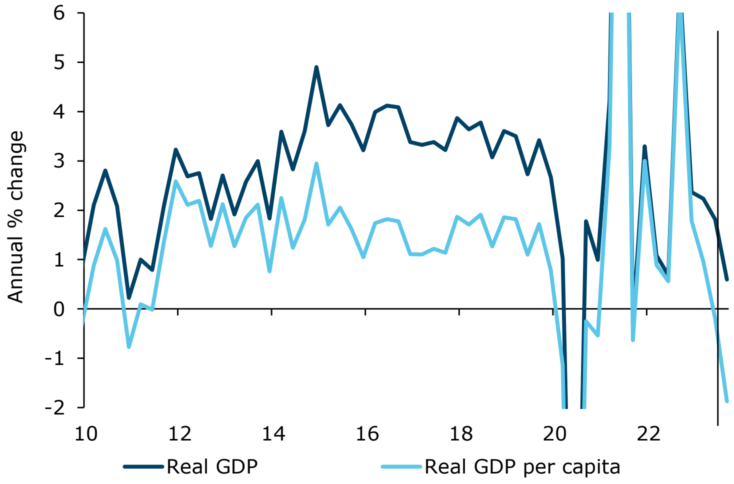
Table 1 (over) shows our industry-level forecasts. Overall, our expectation that the economy expanded 0.3% in Q3 is driven by:

- **Services industries** lifting 0.6% q/q (making a 0.4ppt contribution to headline growth). Services industries account for around two thirds of GDP, and tend to be less volatile than the both primary and goods producing industries. Growth across services industries is expected to relatively broad-based in Q3 (the main exception being retail trade excluding accommodation and food services). Compared to the goods and primary industries, momentum across the services industries has been relatively robust in the face of rising interest rates.
- **Goods-producing industries** are expected to contract 1.1% q/q (making a -0.2ppt contribution to headline growth). All the major goods industries appear to be in for a soft quarter: manufacturing, electricity, and construction. Momentum across goods-producing industries has been trending south since early 2021, reflecting the impact of higher interest rates.
- **Primary industries** are expected to expand 0.7% q/q (with its contribution to headline GDP coming in flat (0.0ppt) at one decimal place). Forestry and logging appears to be finding a floor, but agricultural production more broadly is moving sideways into possible drought conditions.

For expenditure GDP we've also pencilled in a 0.3% q/q lift. Weak goods exports are expected to be broadly offset by the ongoing recovery in services exports and softer goods and services imports. On the domestic front, weak private consumption expenditure and residential investment is expected to meet robust government consumption and very subdued growth in other investment. Changes in inventories are one of the more unpredictable components, and following Q1's -1.2ppt and Q2's -1.3ppt contributions to quarterly growth, some payback is due.

Turning to the per-capita story, growth in the population of 0.6% q/q means our expectation for headline GDP growth of 0.3% implies a per capita contraction is on the cards. Looking forward, while the economy may avoid another technical recession at the headline level, the per-capita cut of these data probably won't be so lucky. Subtract surging migration from the picture and the underlying state of the economy would be very soft indeed. And while migration is making it easier for firms to find the workers they need, the RBNZ's assessment is that net migration is a small net positive for inflation, suggesting the more migration-driven growth we get, perhaps the more pain the RBNZ will need to inflict at a per-capita level, whether that's through more hikes or just holding rates where they are for longer.

Figure 1. Headline vs per-capita GDP growth

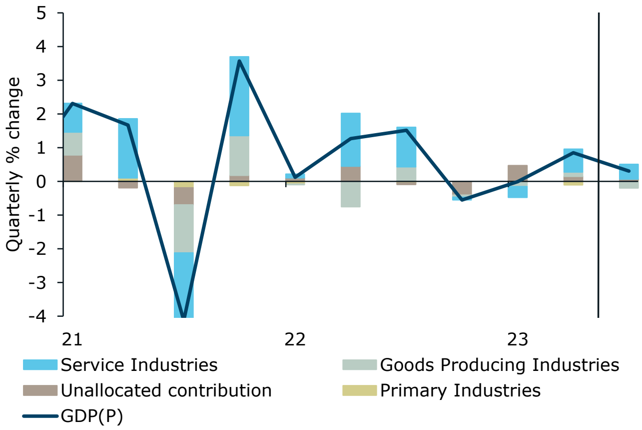


Source: Stats NZ, ANZ Research

Table 1. ANZ Q3 GDP industry-level forecast

Industry	q/q%	%pt cont.	y/y%
Agriculture, forestry, and fishing	0.8	0.04	-3.1
Mining	0.4	0.00	7.7
Manufacturing	-1.4	-0.11	-3.6
Electricity, gas, water, and waste services	-1.5	-0.04	0.7
Construction	-0.5	-0.04	0.6
Wholesale trade	0.5	0.03	-1.6
Retail trade and accommodation	0.1	0.01	-3.8
Transport, postal, and warehousing	0.5	0.02	-3.6
Information media and telecommunications	1.1	0.04	3.5
Financial and insurance services	0.5	0.03	0.3
Rental, hiring, and real estate services	0.8	0.11	2.8
Prof, scientific, technical, admin, and support	0.6	0.07	2.5
Public administration and safety	-0.2	-0.01	4.2
Education and training	0.4	0.01	1.4
Health care and social assistance	0.8	0.05	0.4
Arts, recreation, and other services	0.5	0.02	2.9
Unallocated	1.0	0.08	2.5
Balancing item	N/A	0.0	N/A
Gross domestic product	**0.3**	**0.3**	**0.6**

Figure 2. Production GDP forecast



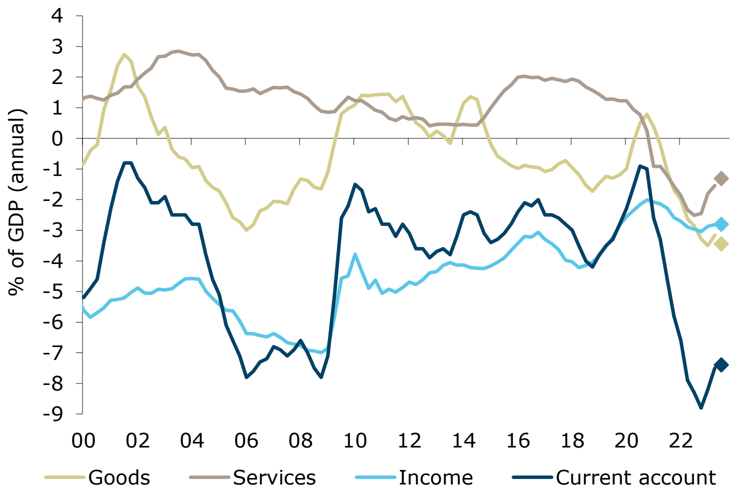
Source: Statistics NZ, ANZ Research

Turning to the Balance of Payments, we expect the annual current account deficit to narrow from 7.5% of GDP in Q2 to 7.4% (in line with our previous published forecast). But we are wary that historical revisions and quirky seasonality set the bar relatively low for a surprise.

On a quarterly seasonally adjusted basis:

- We expect the goods deficit to widen, with exports down almost 6% q/q and imports declining a little more than 4%. Weaker terms of trade will weigh on the goods balance, while weak import volumes (as domestic demand softens) only partially offset struggling export volumes.
- The services deficit is expected to narrow in the quarter as exports lift around 1% and imports remain broadly stable. However, there is still plenty of quirky seasonality impacting services exports as international tourism and education continue to recover. And that means plenty of scope for data revisions and a decent miss compared to our seasonal adjustment. In non-seasonally adjusted terms, the level of services exports is expected to remain below its Q3 2019 (pre-COVID) level.
- The income deficit (which isn't seasonally adjusted) is expected to remain broadly stable, with high global interest rates continuing to weigh on the primary deficit.

Figure 3. Current account deficit



Source: Statistics NZ, ANZ Research

Looking forward, we see the annual current account deficit narrowing from here as demand for imports softens and the recovery in travel-related exports continues. But higher global interest rates are expected to become a significant offset, keeping the income deficit under widening pressure.

Big picture: the current account deficit is still far too wide, making New Zealand vulnerable to a sovereign credit rating downgrade and suggesting there is a material risk that the transition away from this out-of-balance position involves higher-for-longer retail interest rates (as NZ picks up a wider risk premium) and a weaker NZD.

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Last updated: 18 April 2023

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