ANZ Research

NZ GDP: Q1 2022 Review

16 June 2022

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Contact

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More COVID noise

Bottom line

- Economic activity fell 0.2% q/q in the first quarter of 2022, weaker than the 0.0% we had pencilled in and significantly below the May MPS forecast of 0.7%. When the May MPS was released we were at 0.6% q/q.
- We don't see a lot in today's data to push our OCR call one way or the other. Right now, the OCR outlook is pinned more on inflation and labour market indicators, which, if anything, present upside risks our OCR call.
- Bottom line: the GDP data are still noisy in the wake of COVID, and for the RBNZ a slowdown caused by supply-side issues (ie people self-isolating) only helps explain why inflation pressures are so intense. We now need to factor in a little more COVID noise into our GDP forecasts, which all else equal suggests Q2 growth might need a small upgrade.

Summary

Q1 saw the impacts of Government-imposed Alert Level restrictions give way to traffic lights and self-imposed home isolation as Omicron cases surged. And while the economic impacts of the latter appear significantly smaller than the former (particularly compared to Alert Level 4), they are still adding considerable volatility to these data, making it difficult to diagnose activity relative to its "potential level".

For inflation pressure, and therefore the RBNZ's reaction to these data, it's economic activity relative to potential that really matters, and we don't see a lot here to push the RBNZ away from its current strategy of front-loading OCR hikes. Indeed, the Omicron outbreak meant there was less economic resource (ie labour) available in the economy to produce goods and services in Q1, suggesting weak activity in Q1 is more about constraints on supply than demand. For a central bank, that's an extremely important distinction. Negative supply shocks add to inflation (all else equal).

Thanks to data volatility, economic uncertainty, very defensible least-regrets strategies, and, in hindsight, too much monetary and fiscal stimulus for this particular crisis, central banks the world over no longer have the luxury of setting interest rates based on risks to the near-term growth outlook. Any economy bumping into capacity constraints is going to struggle to grow, meaning a small slowdown doesn't necessarily mean 'job done' on the inflation front. And with labour market and inflation indicators where they currently are, the RBNZ will need to keep going. Indeed, despite these data, we are seeing clear upside risks to our call that the RBNZ will feel comfortable by August reverting to a more normal pace of hiking.

Clearly, the GDP data are still riddled with COVID-related noise, but underneath that we think domestic economic momentum is starting to slip. Interest rates are lifting, house prices are falling, inflation is eroding household incomes, migration is negative, and consumer confidence has tanked. However, we are unlikely to see these impacts in the headline GDP data until later in the year (after the Q2 release in September). And even then, the RBNZ will need to ask if this slowdown is sufficient to take the heat out of pipeline core inflation pressures.

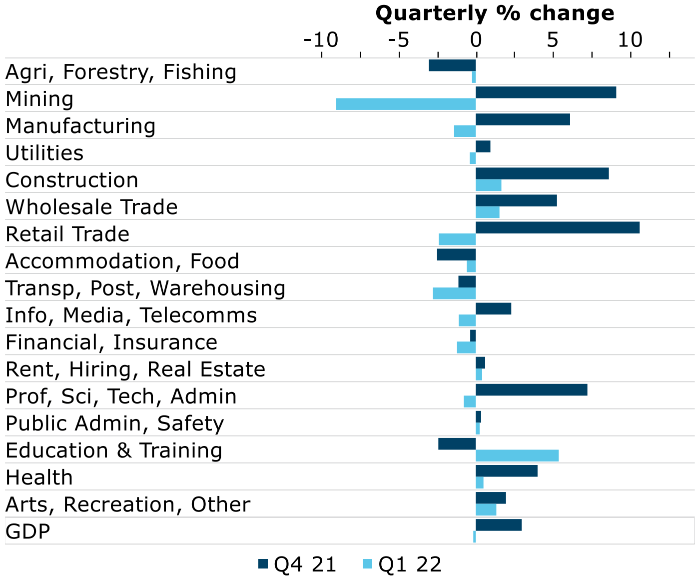
Data summary

	Latest	Prev
Quarterly % change	-0.2%	3.0%
Annual % change	1.2%	3.1%
Annual average % change	5.1%	5.7%

Production GDP fell 0.2% in Q1

Turning to the details of the Q1 release, it's still a very mixed picture by industry. Primary industries fell 1.2% q/q on a seasonally adjusted basis, its third consecutive decline – that's a combo of bad weather, difficulty finding labour, and continued global shipping disruptions. Goods production fell 0.1% as manufacturing slipped 1.4% q/q. Services industries were flat (0.0% q/q), and given this is almost two thirds of the economy, headline GDP didn't stand a chance. All up, it's a weaker read than we were expecting, but that appears to be driven by higher volatility at the industry level than we had factored in.

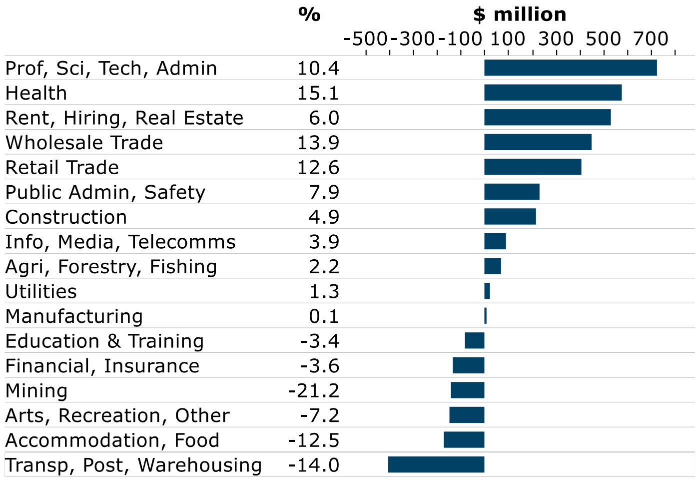
Figure 1. Quarterly change in GDP by industry



Source: Stats NZ, Macrobond, ANZ Research

Comparing Q1 2022 activity to that recorded in Q4 2019 (pre-pandemic) provides a sense of how different industries are preforming relative to the good old days before COVID-19 (of course this ignores the lockdown-induced holes in between these two points in time, which varied a lot by industry). Broadly, there isn't a lot of new news here. Industries more dependent on foot traffic and international tourists continue to underperform, while industries benefiting from the very sizable macroeconomic stimulus over the past couple of years are the out-performers.

Figure 2. Activity in Q1 2022 vs Q4 2019

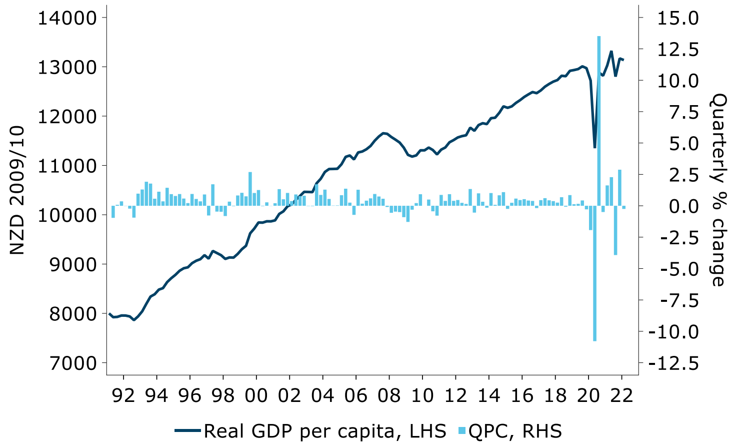


Source: Stats NZ, Macrobond, ANZ Research

GDP per capita fell with headline

Net migration is now drifting negative, and all else equal will be a very small drag on headline GDP. However, the GDP per capita story isn't all that different to headline, with GDP per capita also down 0.2% q/q.

Figure 3. Per capita GDP

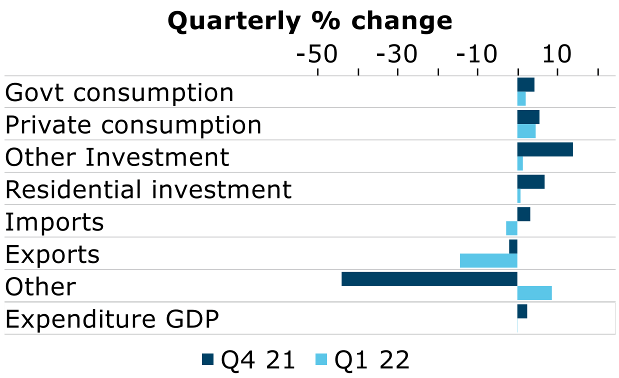


Source: Stats NZ, Macrobond, ANZ Research

Expenditure GDP fell 0.1%

Expenditure GDP is volatile right now too. This measure fell 0.1% q/q, led by a 14.3% decline in total exports – closed borders are hurting international tourism and headline GDP. It was another big quarter for Government consumption (up 2.0%), suggesting Government demand continues to directly or indirectly support demand, but also crowd out private sector activity (given widespread capacity constraints). Investment is holding its own for now, but that's unlikely to remain the case as rates continue lifting.

Figure 4. Expenditure GDP growth

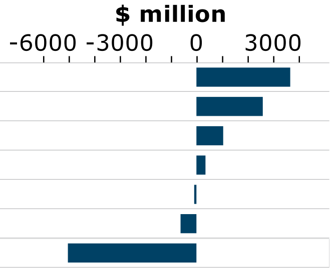


Source: Stats NZ, Macrobond, ANZ Research

Overall, the post pandemic story is still pretty clear in the expenditure data. Exports have taken a big hit thanks to the closed border and missing international tourists, but Government spending (and debt) has filled a lot of that hole in aggregate (figure 5, over page). Meanwhile, private consumption has responded strongly to macroeconomic stimulus, but that's also pushed up demand for goods imports, causing New Zealand's goods trade deficit to widen despite the rising terms of trade.

Figure 5. Real expenditure GDP vs Q4 2019

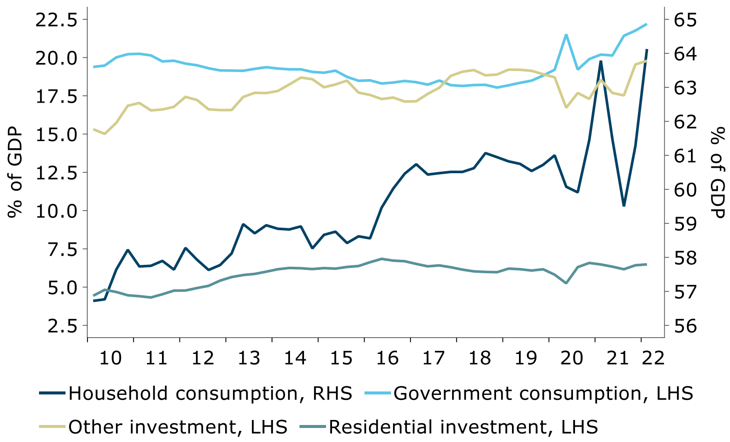
	%
Private Consumption	9.1
Central Govt	23.8
Other investment	8.4
Residential Investment	8.7
Other	-3.4
Imports	-2.8
Exports	-27.1



Source: Stats NZ, Macrobond, ANZ Research

As interest rates rise, the composition of growth is expected to change. That means it's worth keeping an eye on the expenditure GDP components as a share of total GDP over coming quarters. At well over 60% of GDP in Q1, household consumption has a lot of say when it comes to the direction of travel for the economy, and rising debt-servicing costs and high inflation (pushing real household incomes backwards) suggest we're in for a period of belt tightening ahead. That's not visible in the data yet (private consumption lifted 4.6% q/q in Q1), but we think it will be by year end.

Figure 6. Domestic components share of total



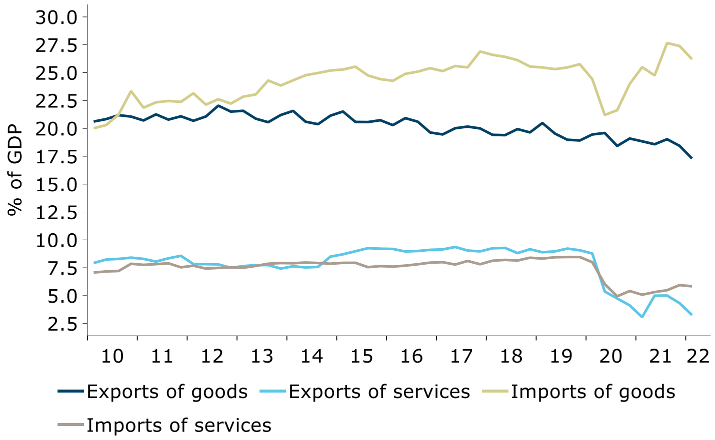
Source: Stats NZ, Macrobond, ANZ Research

Meanwhile, record levels of fiscal stimulus have seen government consumption as a share of GDP trend higher. But this upwards shift will have to come to an end if the Government wants to achieve an operating surplus any time soon. Both residential and other investment will have elements of Government investment underpinning them, but private sector activity accounts for the lion's share here and will determine the overall path going forward. We know from the consents data that there is a very healthy pipeline of residential construction activity, but we'd be surprised to see actual activity perform as strongly as consents suggest, given cost blow outs, sharply lifting interest rates and increasingly uncertain demand. Some projects are likely to get scrapped. Other investment (chiefly business investment) is also likely to struggle as interest rates rise. However, skills shortages provide some ongoing incentive to invest in labour-saving capital (provided businesses aren't too worried about pipeline demand – a big if).

Looking at the external picture (exports and imports), goods imports have recovered very strongly as fiscal and monetary policy added plenty of domestic stimulus. Households have also had a more concentrated consumption basket, with no ability to travel overseas, and that's given spending on imported goods an additional bump. Goods exports, on the other hand, have struggled to outperform, as shipping and capacity woes bite.

On the services side, extremely restricted international travel has hit both sides hard. However, exports are unfortunately a little more dependent on travel (ie tourism) than imports, so have underperformed. All going well, the return of international tourism will put exports back on top again, but if typical seasonality is anything to go by, services exports won't be on a strong path to recovery until the 2022/23 summer (at the earliest). Travel-related imports are likely to lift earlier than that as Kiwis look to escape the colder months ahead.

Figure 7. External sector components share of total



Source: Stats NZ, Macrobond, ANZ Research

All up, the GDP data are still noisy in the wake of COVID, and for the RBNZ, a slowdown caused by supply side problems (ie labour shortages) only helps explain why inflation pressures are so intense. It doesn't provide any evidence that they are set to wane. For now, indicators of labour market tightness and inflation are top of the pops. And unless supply capacity increases, the RBNZ will need to see economic demand slip over the coming quarters in order to achieve its targets.

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