

NZ GDP: Q3 2024 Review

19 December 2024



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Bottom line

- The New Zealand economy contracted 1.0% q/q in Q3 on a seasonally adjusted basis, well below our forecast of -0.4% q/q and the RBNZ's November MPS forecast of -0.2% q/q. The previously reported 0.2% q/q contraction in Q2 was revised significantly lower to -1.1% q/q.
- The level of GDP was revised significantly higher, meaning the current level of GDP is not that different from expectations. However, the dramatic change in recent momentum will startle the RBNZ. The economy has experienced a deep slowdown, and how the RBNZ will weigh that against rapidly improving high-frequency data is hard to gauge. However, all else equal, putting this data into their forecasting model will reduce their estimate of inflation pressure and therefore the OCR track.
- In terms of the next OCR decision in late February, the market will now be weighing up odds of a 50bp vs 75bp cut, rather than 25bp vs 50bp. Given the rebound evident in the high-frequency data, we are comfortable at this stage with our expectation of a 50bp cut. There is still significant data to come before then: the QSBO, labour market data and the CPI. A dovish surprise in any of those could put a 75bp cut on the table, but three consecutive 50bp cuts is already pretty rapid, and the news is perhaps best cast in terms of where the OCR will ultimately end up.

The big picture and monetary policy implications

Today's Q3 GDP figures delivered a significant downside surprise that's likely to see a rethink by the RBNZ on how low the OCR will need to go this cycle.

Today's 1.0% q/q fall was significantly weaker than the RBNZ's November MPS forecast of -0.2% q/q, and alongside the revised contraction in Q2 of 1.1% q/q, the current trajectory of economic momentum is far weaker than previously thought (though the level of activity is not, courtesy of revisions). The economy has experienced the largest contraction over a six-month period since 1991, outside of the COVID disruption, which will see the RBNZ reconsider whether the OCR will need to go below neutral (ie into stimulatory territory). On the other hand, timelier activity indicators are rebounding, and for the Committee, weighing up these contrasting signals is not straightforward.

Mechanically, these data are likely to see the RBNZ revise down its near-term growth forecast, output gap, and medium-term inflation forecasts, paving the way for a much lower OCR track, and potentially more outsized cuts (assuming none of the data prints between now and the February MPS deliver significant upside surprises). However, GDP data is for a period that ended nearly three months ago, and is also prone to substantial revision, as today's data also highlighted. The timelier data is telling a very different story. In that context, a 75bp cut would be a big call, so the debate is perhaps better cast in terms of where the OCR will end up. The risk that the OCR will end up lower than our current forecast of a 3.5% trough has clearly risen.

That seems to be how the market is thinking about it: pricing is now -53bp for the February decision (from -46), still implying only a low chance of a 75bp cut. However, the implied OCR by the end of 2025 is now 3.0%, rather than 3.14% before today's market open. Next data: QSBO 14 January and CPI 22 January.

Data summary

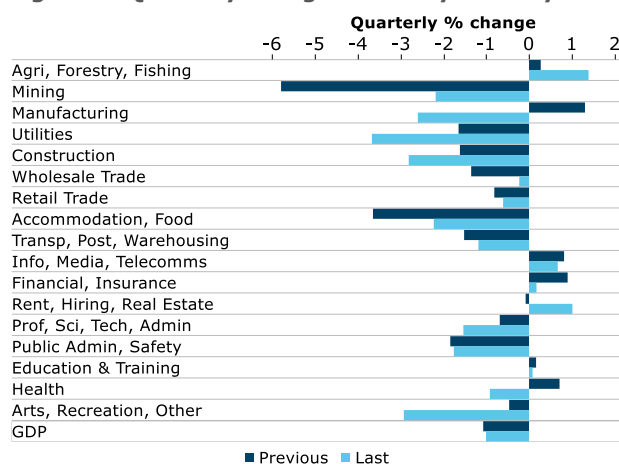
	Sep-24	Jun-24
Quarterly % change	-1.0%	-1.1%
Annual % change	-1.5%	-0.5%
Annual average % change	0.1%	0.6%

The details

However you cut it, today's GDP release was weak. In the production cut:

- **Services industries** contracted 0.5% q/q, well below our forecast of a 0.1% q/q fall. Q2's flat print was also revised significantly lower to -0.4% q/q, highlighting the slowdown is far deeper than previously estimated. Given momentum in services industries tends to be a slow ship to turn, this raises the risk that the economy will contract further in Q4 (but importantly, high-frequency data are suggesting a rebound). Compared to our forecast, weakness was broad-based, with evidence of the impacts of fiscal consolidation emerging. Public administration and safety fell 1.8% q/q, against expectations for a modest gain, while healthcare was surprisingly weak, down 0.9% q/q, compared to our expectation of a 1.3% q/q lift. The more cyclical services industries were also weak, with professional services down 1.5% q/q, and arts, recreation and other services down 2.9% q/q, much weaker than forecast. These industries tend to be more sensitive to interest rates; hence weakness in these industries will be important for the RBNZ's assessment of the extent of past monetary traction, and their assessment of how fast and how far the OCR will ultimately need to go lower.
- **Goods-producing industries** contracted 2.8% q/q, below our forecast of a 2.1% q/q fall. However, typical volatility in these industries and the impacts of temporary supply disruption mean weakness has fewer implications for the path ahead than services momentum does. As expected, electricity, gas, water and waste services fell sharply, down 3.7% q/q, reflecting disruption to electricity generation. The resulting surge in wholesale electricity prices in Q3 likely also contributed to the 2.6% q/q fall in manufacturing, which was weaker than our expectation. However, these impacts, at least in part, are expected to be temporary, with scope for a bounce-back in Q4. Construction contracted 2.8% q/q, weaker than our expectation for a 2.0% q/q fall.
- **Primary industries** expanded 1.0%, a touch above our forecast of a 0.8% q/q lift, and the one bright spot in today's release. Forestry and logging rose 5.2% q/q after last quarter's sharp contraction, while agriculture rose 1.1% q/q, buoyed by improved milk and horticultural production.
- **The unallocated tax component** can be volatile on a quarterly basis (though it does tend to follow the broader economic cycle over the long run). It contracted 1.4% q/q, detracting 0.1%pts from quarterly growth. Alongside the -0.1%pt contribution from the balancing item, these two components detracted 0.2%pts from headline growth, compared to our expectation that they would broadly offset.

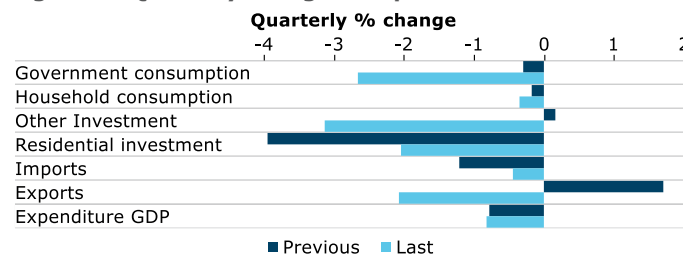
Figure 1. Quarterly change in GDP by industry



Source: Stats NZ, Macrobond, ANZ Research

On the expenditure side, headline GDP growth contracted 0.8% q/q, well below the RBNZ's forecast of -0.2% q/q. Significant volatility across the expenditure GDP components due to revisions and changes to seasonal patterns mean caution is required when comparing these components against the RBNZ's November MPS forecasts, which aren't likely to be a reliable benchmark. Private consumption fell 0.3% q/q, with Q2's previously reported expansion being revised to a 0.1% q/q contraction. Public consumption was also significantly weaker than forecast, signalling that the impacts of the Government's reductions to government spending are now emerging in the GDP data.

Figure 2. Quarterly change in expenditure GDP



Source: Stats NZ, Macrobond, ANZ Research

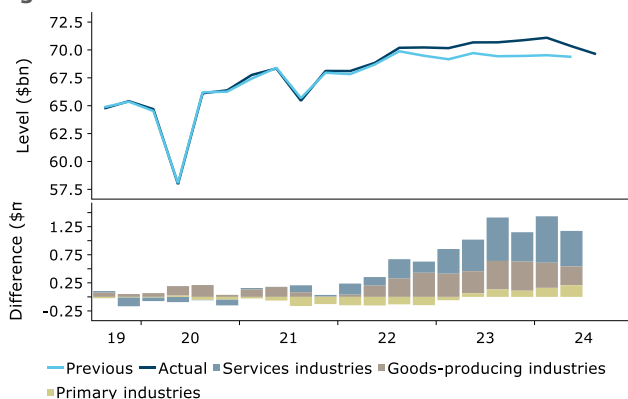
Revisions

Alongside the Q3 release, and as was signalled in advance, Stats NZ revised the level of GDP significantly higher over history, reflecting data improvements following the annual benchmarking process.

While these revisions have revised the level of GDP higher over history, given the RBNZ has already observed inflation data over history, it's likely the RBNZ will allocate these upward revisions to potential output, as opposed to a narrower output gap.

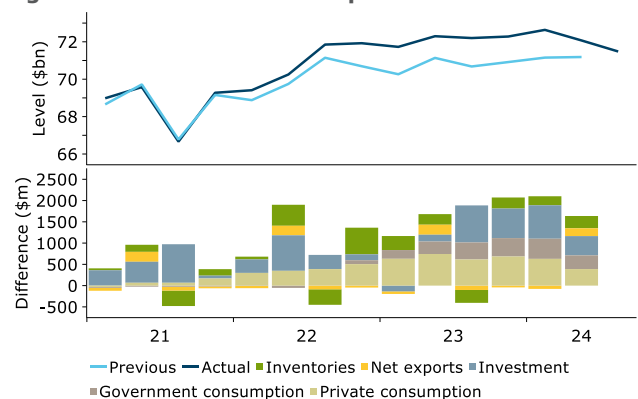
However, the changes to the recent trajectory of GDP are likely to be far more of a worry for the RBNZ, signalling the economy was in a much deeper slowdown through the middle of this year. The RBNZ's November MPS forecasts showed its output gap estimate troughing in Q3/Q4 this year. The downward revisions to GDP growth in Q2 and Q3 are likely to challenge that forecast, suggesting the output gap is still widening. NZIER's Q4 Quarterly Survey of Business Opinion, out 14 January, will be important for determining this.

Figure 3. Contributions to Production GDP revisions



Source: Stats NZ, Macrobond, ANZ Research

Figure 4. Contributions to Expenditure GDP revisions



Source: Stats NZ, Macrobond, ANZ Research

Markets

The 1-year swap moved around 10bp lower on the data release, while the NZD/USD fell from 0.5660 to 0.5625. The kiwi has had a rough morning, with an unexpectedly hawkish Federal Reserve this morning also giving it a significant knock.



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