

Economic Note

Q1 2020 GDP Preview

12 June 2020

COVID-19 brings end to NZ's 9-year economic expansion

- We expect StatsNZ's first estimate of Q1 GDP to show a 1.1% contraction – bringing an end to 9 years of uninterrupted economic expansion in NZ.
- The impact of COVID-19 on economic growth is highly uncertain and StatsNZ has acknowledged methodology limitations will require revisions to its initial Q1 estimate.
- It's not the size of the fall that matters for policy, but the degree and timing of the recovery. We expect the economy will be slow to recover over 2020, although acknowledge recent indicators have been encouraging.

Summary & implications

We forecast that Q1 GDP contracted 1.1% qoq, however there is a higher degree of uncertainty around this estimate due to the impact of COVID-19. Nonetheless, StatsNZ Q1 GDP figures are likely to show a milder contraction in GDP than the 2.4% qoq fall the RBNZ forecast in the May Monetary Policy Statement.

Next week's Q1 GDP estimates should be taken with a huge grain of salt – as StatsNZ methodology may not pick up the full impact of the Alert Level 4 lockdown, which started during the last week of March. StatsNZ has acknowledged methodology limitations and notes that we should expect revisions to its initial estimates of Q1 and Q2 GDP growth. Furthermore, from a policy standpoint, it's not so much the size of the fall, but the size of the bounce back which really matters. As a result, it won't be until we receive the Q3 GDP estimates (not released until the end of December) that we will know how much economic recovery really took place following the lockdown and what further support the economy will need over 2021.

GDP - March 2020	Previous	ASB	RBNZ
quarterly % growth	0.5	-1.1	-2.4
annual % growth	1.8	0.2	-1.1
annual average % growth	2.3	1.6	

Q1 GDP to decline as COVID-19 ends 9-year economic expansion in NZ

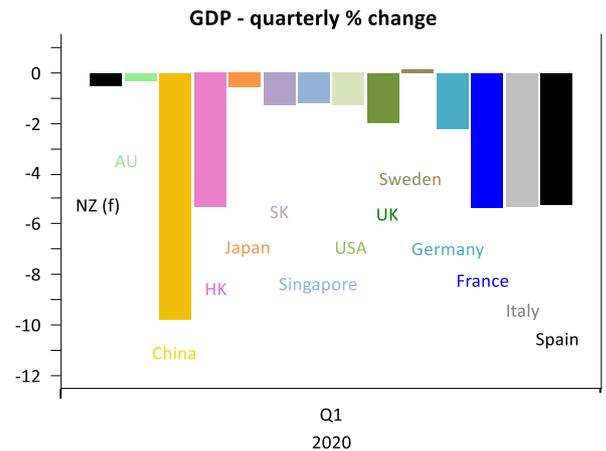
StatsNZ releases its first estimates of Q1 GDP on Thursday 18th of June. We forecast Q1 GDP contracted 1.1% qoq with annual growth falling to 0.2%, from 1.8% in Q4 2019. The contraction in GDP will be entirely due to the COVID-19 pandemic which reached NZ's shores in March and resulted in lockdown measures being put in place during the final week of March. The last 6 days of March (and last 4 working days) were spent at Alert Level 4 – which allowed only essential activity to take place. This Alert Level 4 was held in place until late April, with restrictions gradually eased over May and June. We are expecting the bulk of the economic impact to hit in Q2 – with a 17% qoq contraction pencilled in, followed by a modest recovery of 13% in Q3.

Difficult and unusual times hard for StatsNZ too

StatsNZ has acknowledged that the timing of the Alert Level 4 lockdown in NZ may impact its ability to estimate Q1 GDP. In some areas, it may impact the survey response rate and in other areas StatsNZ modelling methods may not be able to account for the shutdown without additional judgement added. While StatsNZ will make what adjustments it can in the short term, it has acknowledged that Q1 GDP may need to be revised later once it's had the opportunity to refine and improve its measurement and estimation techniques to better capture the highly unusual and unexpected circumstances of the past three months. As a result of these limitations (read more [here](#)), its possible StatsNZ's first estimate of Q1 GDP could underestimate the full impact of the lockdown on the economy.

Global Q1 Economic Contraction

Most of the developed world saw a contraction in Q1 GDP (see chart). COVID19, which was initially detected in China in late 2019, had established itself in many parts of Europe and the US by the middle of the March quarter. The timing and severity of the lockdown measures put in place have influenced the size of the Q1 GDP contraction across various countries. The virus was a bit slower to establish itself in NZ and Australia, and lockdown measures were taken relatively late the quarter. As such the Q1 GDP contractions in NZ and Australia should be comparatively mild.



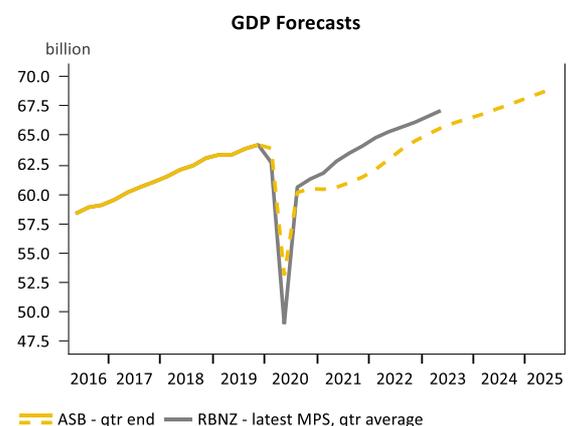
Source: Macrobond, ASB

Outlook for the rest of the year

We expect declines in Q2 GDP to be more severe. We expect a contraction of 17% qoq in Q2 – but acknowledge a high degree of uncertainty around this forecast. Our assumptions of economy-wide capacity that was able to operate under different Alert Levels – 67% at Alert Level 4, 80% at Alert Level 3 and 92% at Alert Level 2 – are broadly similar to those made by the RBNZ and Treasury, but there is a very high degree of uncertainty around them. Some of the real-time data we have monitored suggest that economic activity may have bounced back a little bit faster than expected, which is a pleasing result.

NZ's "hard and early" approach to managing COVID-19 turned out to be unexpectedly successful in terms of eliminating the virus, which means a stronger economy over H2 than we (and other forecasters, such as the RBNZ and Treasury) initially expected. It is still early days, but NZ looks to have materially reduced its risk of a second wave of infections requiring a reinstatement of lockdowns. This improves certainty for businesses for the rest of the year and will support employment and investment.

In saying that, we do not expect NZ to complete a full economic recovery this year – in large part because it's impossible to replace the roughly 5% of expenditure generated by international tourism in that time frame. Sure, there is potential for some offset by more NZers taking holidays at home this year – NZ households certainly spent a lot overseas last year, but it was less than half of what was spent in NZ by overseas visitors. Furthermore, with unemployment set to rise and job security concerns weighing, many households will be more cautious on spending over the coming year. Plans for holidays or upgrades to cars and homes are likely to be put on hold for many. The fate of the labour market will be the key factor influencing the timing and strength of the recovery. We expect Q4 GDP will be 6% below that of the previous year's level, which compares to the RBNZ's May MPS forecast of a 4.5% contraction. The fall in H1 GDP may not be as steep as the RBNZ forecast, but the degree bounce back over the rest of the year may be a little slower than what the RBNZ predicted in May.



Source: Macrobond, ASB

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