Economic Note

Q2 2020 GDP Preview

11 September 2020

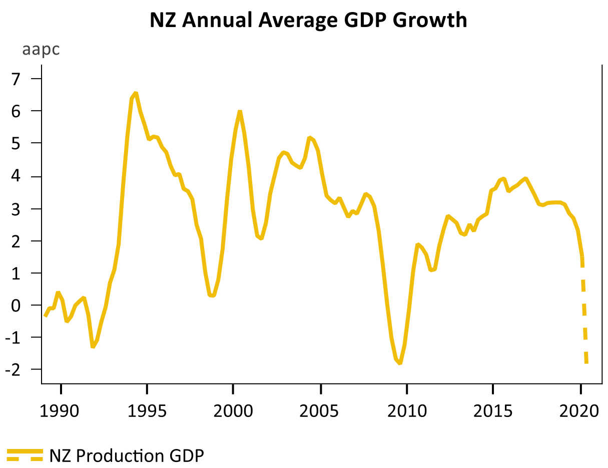
When the crystal ball cracks

- We expect StatsNZ's first estimate of Q2 GDP to show an 11% contraction – adding to the 1.6% decline in Q1 GDP.
- Initial Q2 data have been consistently stronger (i.e. less weak) than expected, suggesting the fall in Q2 GDP is likely to be less than many initially feared.
- The impact of COVID-19 on economic growth is highly uncertain and StatsNZ has acknowledged methodology limitations will require revisions to its initial Q2 estimate.

Summary & implications

We expect Q2 GDP contracted by 11%, adding to the 1.6% contraction in Q1 as a result of the COVID-19 pandemic. StatsNZ will release its first estimate of Q2 GDP on Thursday 17th of September at 10.45 am. Data released to date suggest Q2 GDP held up much better than our earlier assumptions, with many sectors able to produce more output over Alert Level 3 and Level 2 than we assumed. Nonetheless, the uncertainty around our forecast is very high. StatsNZ has already highlighted the many difficulties it faces in modelling Q2 activity based off the data available on a quarterly basis. We strongly urge readers to take this first estimate as indicative only – this estimate will continue to be revised as StatsNZ gleans additional and more complete information over time.

GDP - June 2020	Previous	ASB	RBNZ
quarterly % growth	-1.6	-10.8	-14.2
annual % growth	-0.2	-11.1	-14.5
annual average % growth	1.5	-1.8	



Source: Macrobond, ASB

Lockdown drives unprecedented GDP fall

We expect Q2 GDP contracted by 11%, adding to the 1.6% contraction in Q1 as a result of the COVID-19 pandemic. In the August Monetary Policy Statement, the RBNZ assumed a fall in Q2 GDP of 14% – at the time we had a very similar forecast which suggests, like us, the RBNZ may have been pleasantly surprised by recent Q2 economic data.

There are limited policy implications from the Q2 GDP release, as the RBNZ and fiscal policy have already responded to the lockdown with a range of measures. Going forward, further policy moves will be dictated by developments over the rest of the year and 2021. Like many others, we expect growth to rebound strongly, particularly over Q3. By Q4, we expect annual GDP growth to be down only 5% – although we see the risks now skewed to an even stronger H2 2020 recovery. Nonetheless, with unemployment rising and the borders to remain closed, we continue to believe the RBNZ's 2021 GDP growth forecasts are on the optimistic

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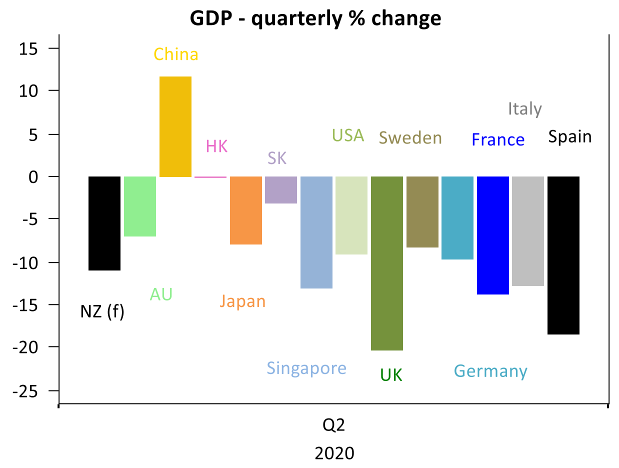
side and expect the OCR to be cut to negative territory in April next year.



Source: Macrobond, ASB

StatsNZ faces a challenging job

StatsNZ faces an incredibly challenging job in estimating the impact of lockdown on Q2 GDP. The pandemic and the policy responses are unprecedented, and StatsNZ's usual modelling techniques for quarterly GDP estimates are not designed to account for this type of extraordinary economic disruption. StatsNZ will likely have to wait until more comprehensive annual surveys are completed before being able to accurately estimate economic activity over 2020. StatsNZ is already aware of its data limitations and has released a paper addressing these. Where possible StatsNZ will use alternative data sources and experimental data to cross check its estimate. For example, StatsNZ uses employment data, such as hours paid, as indicators for activity in some sectors – but due to the wage subsidy, these indicators have held up relative to production. This is an area where StatsNZ is likely to query the result and look to alternative data for an estimate.

There are some areas where StatsNZ will have a good feel on the economic impact of COVID-19: the Economic Survey of Manufacturing and the Building Work Put in Place survey are examples of relatively comprehensive quarterly surveys. However, the greatest uncertainty will be for the services sector (in particular, where there are a large number of small businesses) as here the information is more difficult to capture on a quarterly basis – and the services sector is most heavily impacted by COVID-19 social distancing restrictions. As a result, the initial Q2 estimate will likely be subject to heavy revision over time.

Initial Q2 data consistently stronger than expected

Over the recent weeks as sector survey data for Q2 has been released, we have found that economy activity appears to have held up better than expected in many sectors - which is a pleasing result. The COVID-19 pandemic, and the policy response was unprecedented, with no examples from recent history to share insight as to how the economy might fare from the lockdown. There was an incredibly high degree of uncertainty around how much economic activity could take place under the Alert Level restrictions. Based off some of the various data outcomes so far, our initial assessment is that seems more activity was able to take place over Alert Level 3 and Alert Level 2 than we had assumed. Going forward, this suggests the economic impact from using Alert Level restrictions to manage outbreaks may be less than previously estimated – although it is still substantial.

Forecast detail

Retail trade volumes fell 15% over Q2. Most areas of retail spending were down over the quarter, except for supermarket and grocery retail spending and electronic goods retail spending (the latter likely boosted by the sudden surge in working from home requirements). Retail spending for many goods appears to have recovered relatively quickly under Alert Levels 2 & 3, as most goods could be purchased online. However, given the tighter restrictions on eating out and border closures, **accommodation, food and beverage services were more severely hit, both down 38%.**

We expect **construction fell 20%,** with Building Work Put in Place survey showing a 20% decline in residential construction and a 26% fall in non-residential construction. We were surprised by how well residential construction held up, which suggests output for less complex building projects was less impeded by social distancing requirements.

We expect **wholesale trade fell 11%,** while **manufacturing production fell 13%**. Survey data suggest activity in both these sectors appears to have declined by less than we initially expected. Wholesale trade remained supported by strong supermarket spending and NZ's agricultural production, with export activity remaining firm during the lockdown. Meanwhile, manufacturing production was mixed, with data from the manufacturing survey suggesting some sectors saw much smaller declines than we had expected.

We lack reliable indicators for the transport, postal, and warehousing component of GDP. However, **air transport activity plummeted** during the quarter, so we expect to see a sizable decline. For example, the average number of flights per day at Auckland Airport over Q2 was down 76% on year-ago levels for domestic and down 78% for international. Strong demand for **online shopping during Alert Level 3 may boost postal activity**. Meanwhile, **warehousing** activity likely fell in line with reduced output in key areas of goods production.

Services remain a key area of uncertainty, and this is the area with the least indicators available prior to the release of GDP and the area where StatsNZ will face the largest challenges in estimating GDP. The professional, scientific, and technical services sector is a key area of the services sector and data from the selected services survey suggests a 12% decline in price-adjusted output for many of the professions surveyed in this sector. Meanwhile, we expect Arts and Recreational services to be one of the sectors more heavily impacted by Alert Level restrictions. Price-adjusted output from the selected services survey points to a 31% fall in personal care, funeral, other services, and a 21% fall in repairs and maintenance.

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