

Economic Note

Q2 2021 GDP Preview

10 September 2021

Strong momentum before the outbreak

- We expect Q2 GDP lifted 1.5% over the quarter, although uncertainty around quarterly GDP growth outcomes is higher than usual given large market median forecast errors over the past year.
- If a strong lift in Q2 is confirmed, then the NZ economy had considerable momentum prior to the current community COVID-19 outbreak, reinforcing the need for the RBNZ to start lifting the OCR once the Delta crisis has passed.
- We expect the Delta outbreak to reduce Q3 GDP by 6-7%, but for the economy to quickly bounce back as it has done in the past.

Summary & implications

We forecast the NZ economy grew 1.5% over Q2 2021, following on from a 1.6% lift in growth. If our forecast is correct, this will be an impressive performance over the first half of the year and a testament to the effectiveness of the elimination strategy. In saying that, post-COVID-19 quarterly GDP growth has become more volatile and difficult to predict, with quarterly forecast errors higher than usual. If a strong lift in Q2 is confirmed, then the NZ economy had considerable momentum prior to the current community COVID-19 outbreak.

GDP - June 2021	Previous	ASB	RBNZ
quarterly % growth	1.6	1.5	0.7
annual % growth	2.4	16.5	15.6
annual average % growth	-2.3	4.3	

Q2 GDP growth likely to be strong

Q2's GDP growth is set to be broad based, and indicators point to exceptionally strong contributions from:

- retail trade and accommodation;
- manufacturing;
- transport, postal and warehousing;
- and the services sector (including arts, recreation, and other services as well as Professional, scientific, technical, admin, and support services).

Strong growth over the first half of the year has in part been due to NZ's housing boom. A chronic housing shortage across NZ has underpinned a surge in housing construction activity. Housing construction also then creates knock-on demand for a wide range of industries for NZ, from manufacturing production to durables goods retail sales.

Further supporting NZ's economic growth has been strong household income growth, supported by a tightening labour market. Retail trade sales growth remained strong over Q3, meanwhile services indicators also point to widespread economic demand.

Transport likely received boost in Q2 due to the short-lived opening of the Trans-Tasman bubble.

Strong economic growth driving acute capacity pressures

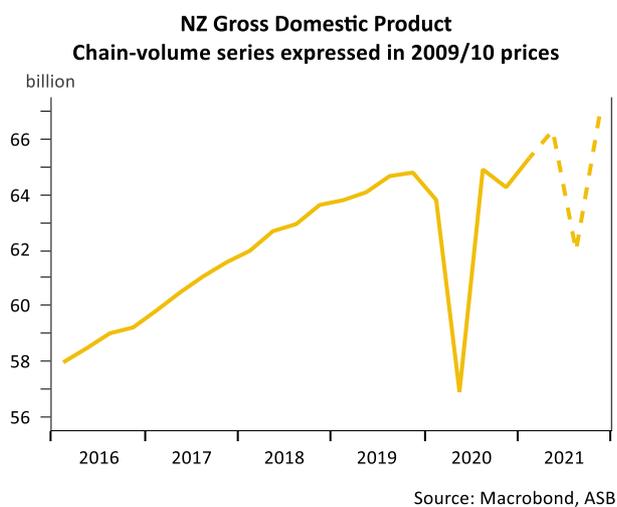
Every high-level indicator for NZ economic activity has consistently pointed to strong economic demand over the first half of 2021, but also suggest **growing pains are starting to impact the economy**. Prior to the NZ Delta COVID-19 outbreak, the NZ economy had become very capacity constrained, and this is resulting in strong inflation pressures building throughout the economy. Assuming NZ successfully deals to Delta, we expect the RBNZ will commence lifting the OCR from October. The RBNZ pencilled in a modest 0.7% lift in GDP over Q2 in the August Monetary Policy Statement – a stronger result would reinforce the need to start lifting the OCR after the Delta crisis has passed.

StatsNZ indicates upward revisions to 2020 GDP likely

StatsNZ continues to review its approach to measuring GDP during the COVID-19-affected quarters. As more data become available, StatsNZ can cross check its approach and in some areas StatsNZ has identified areas where it can improve its measurement. StatsNZ has indicated these changes are **likely to result in upward revisions to GDP over the past year**, with the largest change to the Q2 2020 quarterly growth rate. If these revisions do prove to be material, they may also change our forecasts for the likely decline in Q3 2021 GDP. For more information on StatsNZ methodology review please read [here](#).

Delta's Damage

The NZ Delta outbreak hits pause to that economic momentum, with the return of Alert Level 4 lockdown restrictions set to see the economy contract 6-7% over Q3. Job seeker claims have quickly lifted, pointing a temporary lift in unemployment. Assuming NZ is successful in crushing Delta, we expect the NZ to quickly bounce back as it has done in the past. We are assuming a strong rebound of 7.8% in Q4, which brings the level of Q4 GDP to be up 0.8% on Q2 GDP. However, it is difficult to predict the size of the rebound, or make reliable predictions of how strong NZ GDP would have been in the absence of the community outbreak. Prior to the current NZ community COVID-19 outbreak, we had pencilled in an assumption of around 0.8% quarterly GDP growth. However, over the past year, the market median quarterly GDP forecast error has been in the realm of +/- 1.0 percentage point – which is huge.



Nonetheless, we do expect the rebound to be strong. Exceptional economic momentum over the first half of the year likely carried through into July and first half of August and provides a solid foundation for the broader economy to recover. However, some smaller businesses are likely to struggle, with the most vulnerable being those located in Auckland that can't operate until Level 2. These businesses have already seen annual earnings take a significant hit from Alert Level 3 lockdowns in August last year and February this year as well. They may not have the savings buffer to survive this current lockdown given its severity and duration. Government support remains key for the resilience in the economy, in particular the wage subsidy programme has proved a useful tool in keeping people employed. Learning some lessons from the initial outbreak in March 2020, the Government support has been a bit more carefully targeted in this outbreak. But hopefully, for the most part, support is still reaching those who need it without providing an expensive lolly scramble for those who don't.

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