Economic Note

Q4 2020 GDP Preview

12 March 2021

Take a breather

- We expect Q4 GDP declined 0.1% qoq, as the NZ economy caught its breath following the stunning recovery over Q3.
- NZ GDP will still be above pre-pandemic levels in Q4 and one of the strongest economic performers among our key trading partners.
- GDP activity looking flat over summer, but the 2022 outlook is now looking brighter.

Summary & implications

Q4 GDP is likely to be weaker than we originally expected and weaker than suggested by high-level indicators, such as business confidence surveys. We now expect Q4 GDP contracted by 0.1% over Q4, with the quarter's GDP just 0.1% above year-ago and pre-pandemic levels (Q4 GDP is released on Thursday 18th of March at 10.45 am). Such an outcome would mean annual growth slowed from 0.4% in Q3 to 0.1% in Q4. Our forecast is only marginally softer than the RBNZ's February Monetary Policy Statement (MPS) forecast of zero Q4 GDP growth.

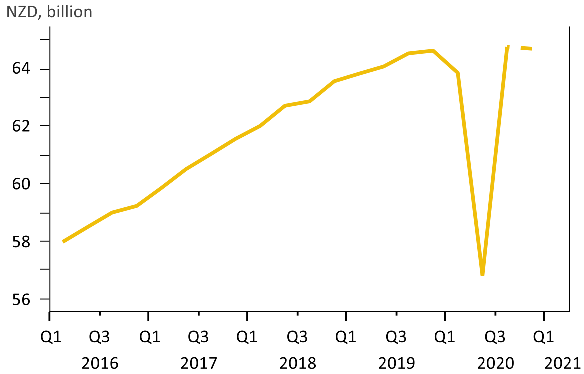
NZ economic performance appears to have been subdued over summer. Nonetheless, compared to our key trading partners, NZ's economic performance is still a strong one. Furthermore, prospects for 2022 have improved in large part due to the early signs of success in global vaccinations to date and clarity around NZ's own vaccination timetable. From this point on, businesses should become more confident on the outlook and look to take action on employment and investment plans over the coming year.

GDP - Dec 2020	Previous	ASB	RBNZ
quarterly % growth	14.0	-0.1	0.0
annual % growth	0.4	0.1	0.3
annual average % growth	-2.3	-2.7	

Q4 GDP may have declined

It appears NZ GDP growth may have stalled over Q4, after an impressively-strong rebound in Q3 which saw NZ GDP recover to its pre-pandemic level in just one quarter. We now expect Q4 GDP contracted by 0.1%, with the quarter's GDP just 0.1% above year-ago and pre-pandemic levels. That would mean annual growth slowed from 0.4% in Q3 to 0.1% in Q4. Our forecast is only slightly softer than the RBNZ's February MPS forecast of zero Q4 growth.

NZ Gross Domestic Product
Chain-volume series expressed in 2009/10 prices



Source: Macrobond, ASB

Q4 GDP growth is likely to be weaker than we originally expected (a few weeks ago we had a relatively optimistic 0.5% growth pencilled in), and **weaker than suggested by high-level indicators**

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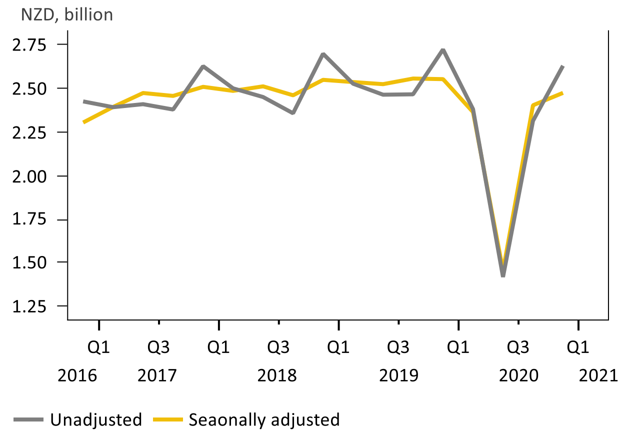
(such as business confidence surveys). However, as a range of early Q4 partial data rolled in consistently below our expectations, we had to take a hard look at our forecast and ended up scaling back our view of GDP growth. We now expect that GDP remained broadly flat over Q4 and Q1.

Some of Q4 dip was expected – for example a fall in manufacturing output over Q4 largely reflects a return to normal levels of production after what appeared to be overtime in Q3 (to catch up from missed production in Q2). The weak retail sales report was also anticipated to some degree, given the absence of international tourists meant accommodation sales failed to lift in line with its usual seasonal pick-up. However, there were also pockets of weakness that surprised us, for example the fall in non-residential construction output and soft indicators for business services and transport, postal and warehouse activity. All these sectors had not seen output return to pre-pandemic levels of GDP in Q3, and we had seen scope for more recovery than now appears the case.

Key December quarter industry movements:

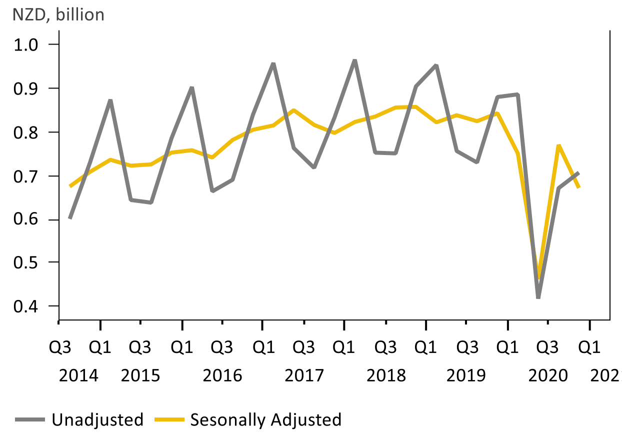
- **Retail sales** volumes declined 2.7% qoq, payback from the previous quarter's outsized lift – though still leaving volumes 5% higher than year-ago levels. Fortunes of the hospitality sector were mixed, as fewer overseas visitors weighed but strong NZ domestic spending at restaurant and bars provided some offset. Food and beverage spending held up well, up 3% over the quarter but accommodation spending fell 13%.
- Previously-released data point to declines in **wholesale trade** and **manufacturing** over Q4.
- We expect **construction activity** to show a 0.8% fall, largely due to an unexpected decline in non-residential construction activity (down 4.9%). Given the strength in building consents over the second half of 2020, we expect some catch-up next quarter.
- We expect **transport activity** to recover a bit more from Q3, although to remain well down on year-ago levels (-32% yoy). The airline industry has been hard hit by border closures, with international flights still well down on year-ago levels. However, over Q4 there should be a pick-up in transport activity led by an increase in domestic flights (in large part as there was no Alert Level 3 over Q4, in contrast to Q3). However, indicator data suggest that the lift in Q4 may be less than we had earlier hoped.
- **Services activity** is likely to be mixed. Indicators for some services components were impressively strong, such as personal care and repairs & maintenance. The hot housing market likely supported real-estate services and financial services. Meanwhile, indicators for business services (Professional, scientific, and technical services) were a bit softer than we'd hoped for given the lacklustre recovery in this sector over Q3.

Retail Trade - Food and Beverage Services



Source: Macrobond, ASB

Retail Trade - Accomodation

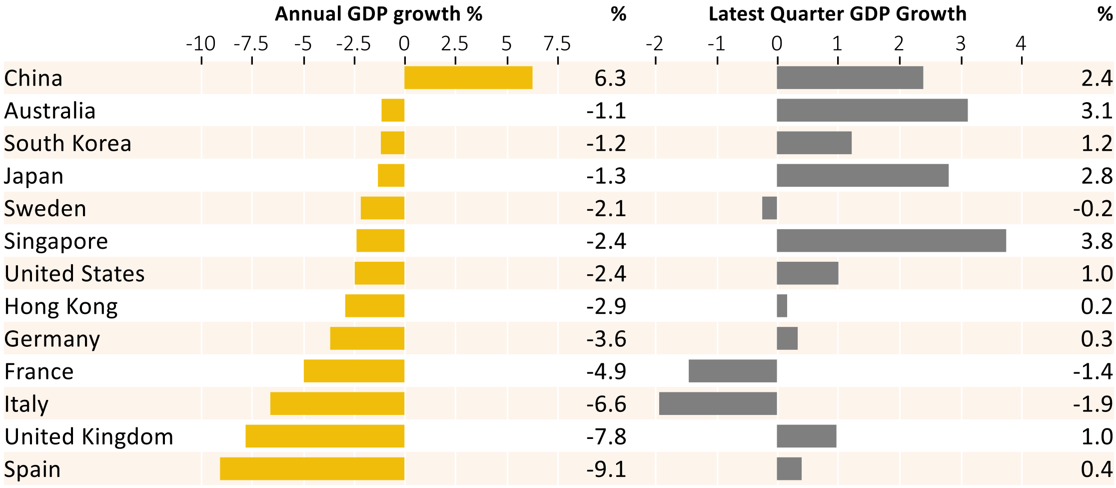


Source: Macrobond, ASB

The uncertainty around this quarter's GDP outcome remains higher than normal, although somewhat less than the extreme levels of uncertainty around the previous two quarter's outcomes. Given the unprecedented nature of the pandemic and the impact it had on data collection and statistical estimation, there could still be sizable revisions to StatsNZ estimates of GDP in previous quarters. An altered starting point could still materially impact our overall assessment of the underlying strength of the NZ economy.

Nonetheless, in the context of the global pandemic, NZ's economic performance is still a strong one. Even zero GDP growth over the past year holds up well compared to many of our trading partners (see table on the next page). Australia's Q4 GDP remained 1.1% below year-ago levels – and even that stacks up well compared to the economic performance of Europe, the UK and the US.

Annual GDP Growth - Q4 2020



Source: Macrobond, ASB

Outlook

NZ economic growth likely remained subdued over summer. A key reason for weaker growth is the absence of the usual number of overseas visitors, meaning accommodation and hospitality spending did not enjoy its usual seasonal lift. In saying that, there are still a few international visitors lurking about in NZ. There are those who chose not to leave during the pandemic. And there is the large share of arrivals into NZ via MIQ who indicate they do not intend to stay in NZ for more than a year, and therefore are not counted as permanent migrants. In addition, there has been some offset: domestic spending by households has been quite strong, particularly over the holiday periods (i.e. the Christmas and New Year's Day break, and Waitangi Day). Also providing offset for the economy is that the construction sector is absolutely booming. The housing market remains chronically undersupplied, and low interest rates and strong housing demand have stimulated housing construction appetites. Consents for non-residential activity have also remained very strong – so we expect the Q4 dip to be quickly reversed in Q1.

The overall picture for 2021 remains one of muted growth, but prospects for 2022 have improved. The labour market and household income growth have held up relatively well and that's a key positive for the NZ economy this year. But a lot of NZ's GDP growth over recent years has come from population growth (net migration) and, with borders closed until the end of the year, weak population growth will limit the degree of economic recovery. Nonetheless, the end is in sight. Vaccination is underway in those countries most acutely impacted and early data on the efficacy of vaccines has been promising. For NZ, just this past week we have received clarity on NZ's vaccination plan (with general population to get vaccines from July!). Furthermore, with vaccination of border workers in progress the risk of further COVID-19 border breaches has been materially reduced. From this point on, businesses should become more confident on the outlook and look to take action on employment and investment plans over the coming year.

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