ASB

Economic Note

Q1 2020 GDP Review

18 June 2020

Q1 GDP fall is just the beginning

- Q1 GDP fell 1.6% qoq, a larger contraction than ourselves and the market expected, but less severe than the RBNZ May MPS forecast.
- There remains a wide range of uncertainty around the Q1 estimate and revisions are likely in future.
- We expect the bulk of the COVID-19 impact to hit Q2 GDP, and forecast a 17% decline, followed by a modest 13% recovery in Q3.
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GDP - March 2020	Previous	Actual	ASB	RBNZ	Market
quarterly % growth	0.5	**-1.6**	-1.1	-2.4	-1.0
annual % growth	1.8	**-0.2**	0.2	-1.1	0.3
annual average % growth	2.3	**1.5**	1.6		

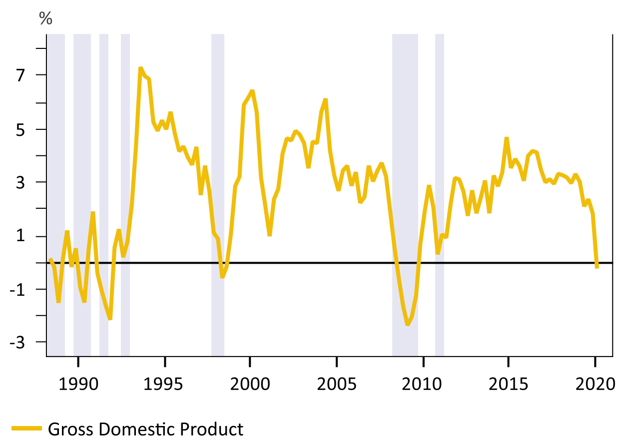
Summary and implications

Q1 GDP contracted by 1.6% due to the COVID-19 pandemic. The fall was larger than ourselves and the market expected, but less severe than the 2.4% decline forecast by the RBNZ at the May Monetary Policy Statement. Given the wide degree of uncertainty around the Q1 GDP estimate, the fall of 1.6% was well within the range of plausible outcomes. Ahead of the release StatsNZ had noted some of the limitations in estimating Q1 GDP and that it would be subject to revision going forward.

The 1.6% decline in Q1 sees annual growth slump, falling from annual growth of 1.8% in Q4 2019, to -0.2% in Q1 2020. The Q1 contraction brings an end to 9 years of uninterrupted GDP growth – in Q1 NZ started tipping into a deep recession.

COVID-19 reached NZ somewhat later than many of our key trading partners, with NZ only entering a strict lockdown late in March. This impacted the last 4 business days of March, and 7% of all days in the quarter. Under Alert Level 4, only essential activity could take place: we have assumed that only 67% of normal economic activity was able to occur. Alert Level 4 remained in place until late April, and the Alert Level was gradually relaxed 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.

NZ Annual GDP Growth and Previous Recessions



Source: Macrobond, ASB

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COVID-19 disrupts activity from March

In Q1, there were large declines in transport, postal and warehousing, down 5.2% in the quarter (with transport particularly hard hit by the lockdown and travel restrictions). Also unsurprising was the large fall in retail trade and accommodation: recall that all visitors from the Chinese mainland were not allowed to enter NZ from early February, with Chinese tourists normally making up around 10% of annual visitor numbers. Other services saw large declines, included finance & insurance services and education & training. StatsNZ noted that the closure of early childhood centres and reduced international students likely weighed on education services. All up, services fell 1.1% during Q1.

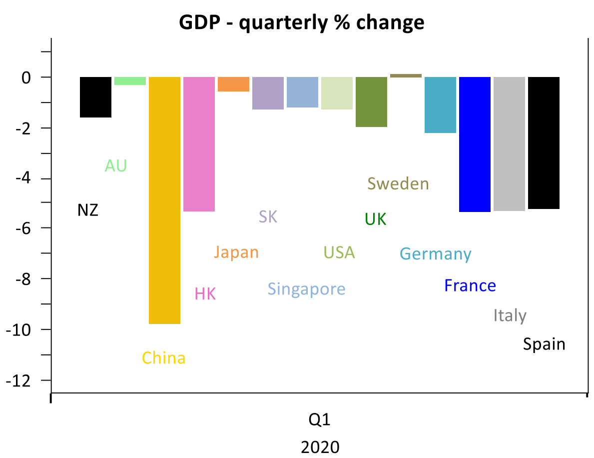
The goods-producing sector felt the brunt of the lockdown impact, with manufacturing down 2.4% and construction activity down 4.1%.

Meanwhile, the fall in the primary sector was limited to 1%, with strong mining output offsetting falls in agriculture, forestry and fishing. International forestry demand had already slumped in late 2019, ahead of the COVID-19 outbreak. Meanwhile, StatsNZ noted that the dairy sector was impacted by drought conditions.

Looking at the expenditure GDP estimates, household spending fell 0.3%, with a decline in eating out and vehicle sales weighing. Investment spending fell, led lower by the fall in construction activity (i.e. residential and non-residential investment). Plant and Machinery investment held up better than we expected in Q1 which suggests underlying investment demand was quite strong prior to the pandemic. However, we expect this type of investment to fall over Q2 and Q3 as the economic uncertainty caused by the pandemic sees businesses delay or reconsider investment plans for the coming year. Both exports and imports of services fell sharply (-7.6% and -8.1%, respectively) as travel restrictions were implemented in NZ and abroad as the pandemic rapidly spread across the world during February and March.

Outlook

We expect the decline in Q2 GDP to be more severe, and currently forecast a contraction of 17% qoq – 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. 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. Along with the disruption to international tourism, the labour market is set to deteriorate markedly with unemployment set to rise above 8%. The weaker labour market and job security concerns will likely result in many households becoming more cautious about spending over the coming year.



Source: Macrobond, ASB

RBNZ implications

The fall in Q1 GDP was less severe than the RBNZ expected at the May MPS. We also expect the RBNZ will be revising its GDP forecast for Q2 higher as well, particularly given that NZ has transitioned into Alert Level 1 faster than expected and recent economic indicators have been very encouraging.

We expect 2020Q4 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.

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