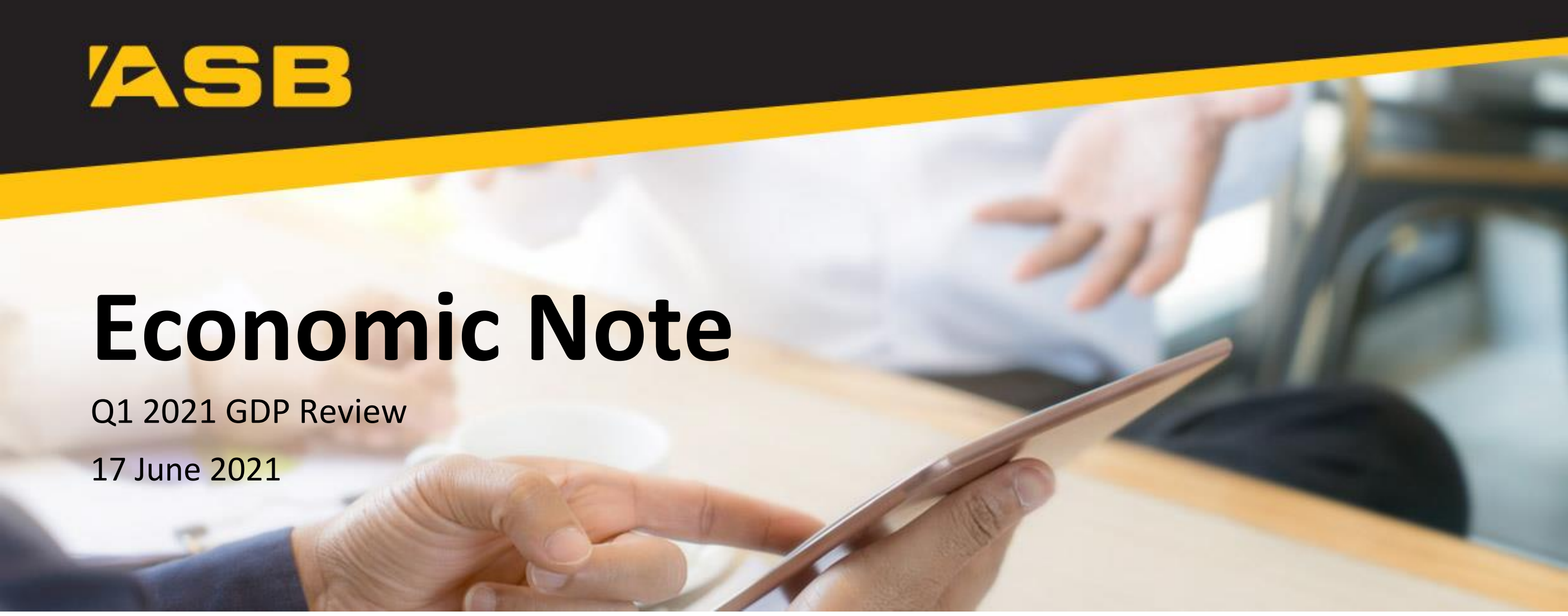


Economic Note

Q1 2021 GDP Review

17 June 2021

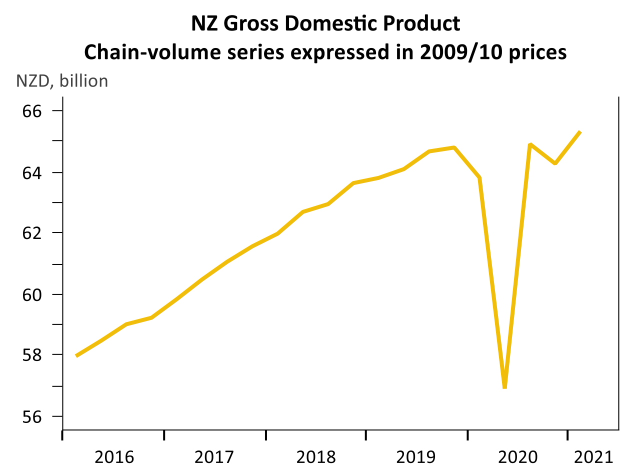
NZ economy sizzles through summer

- Q1 GDP lifted by more than expected, up at whopping 1.6% over the quarter, compared to market expectations centred on a 0.5% lift.
- The strength in Q1 was broad-based across domestic demand, with strong lifts in household spending, business investment and Government spending.
- Stronger than expected domestic demand, coupled with growing cost pressures, are a potent mix for inflation pressures. We currently expect the RBNZ to start normalising interest rates in May 2022, but risks are now very firmly skewed to an earlier move.

GDP - March 2021	Previous	Actual	ASB	RBNZ	Market
quarterly % growth	-1.0	**1.6**	0.8	-0.6	0.5
annual % growth	-0.8	**2.4**	1.1	-0.3	0.9
annual average % growth	-2.9	**-2.3**	-2.7		

Implications

Q1 GDP was much stronger than expected, rising a massive 1.6% qoq – compared to ASB's relatively strong forecast of 0.8%, the market expectation of 0.5% and the RBNZ's May Monetary Policy Statement (MPS) forecast of a 0.6% *decline*. Quarterly GDP has become more volatile and difficult to forecast in the wake of the pandemic. The strength of the Q1 figures will likely see us lower our growth expectations for coming quarters. Nonetheless, the sheer unexpected strength of Q1 GDP growth adds to the weight of evidence that the NZ economy is on very firm footing despite the global pandemic. With domestic demand (both household and business) proving even stronger than we believed, coupled with cost and inflation pressures, there is a growing need to normalise interest rates or risk overstimulating the economy. Globally, central banks are increasingly waking up to surprisingly-quick rebounds in capacity and inflation pressures. In NZ, these pressures are being compounded by the lack of immigration to fill gaps in labour shortages.



Source: Macrobond, ASB

We currently expect the RBNZ to start lifting the OCR in May 2022 – but strong economic data now skew the risk to an even earlier move than that. Many interest rates (such as the 1- and 2-year swap rates) are likely to lift over the rest of this year in anticipation of higher cash rate going forward.

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Details

Q1 2021 lifted 1.6%, much stronger than expected, with growth of 2.4% in the goods-producing sector and growth of 1.1% in the services sector.

Construction activity came roaring back in Q1, after an unexpected contraction in Q4. The massive 6.6% lift in construction output suggests the sector may not be as capacity-constrained as previously feared.

Wholesale trade activity lifted strongly, supported by strong retail and investment activity, as foreshadowed in the earlier data. It's possible that the delayed arrival of international cargo shifted economic activity from Q4 into Q1.

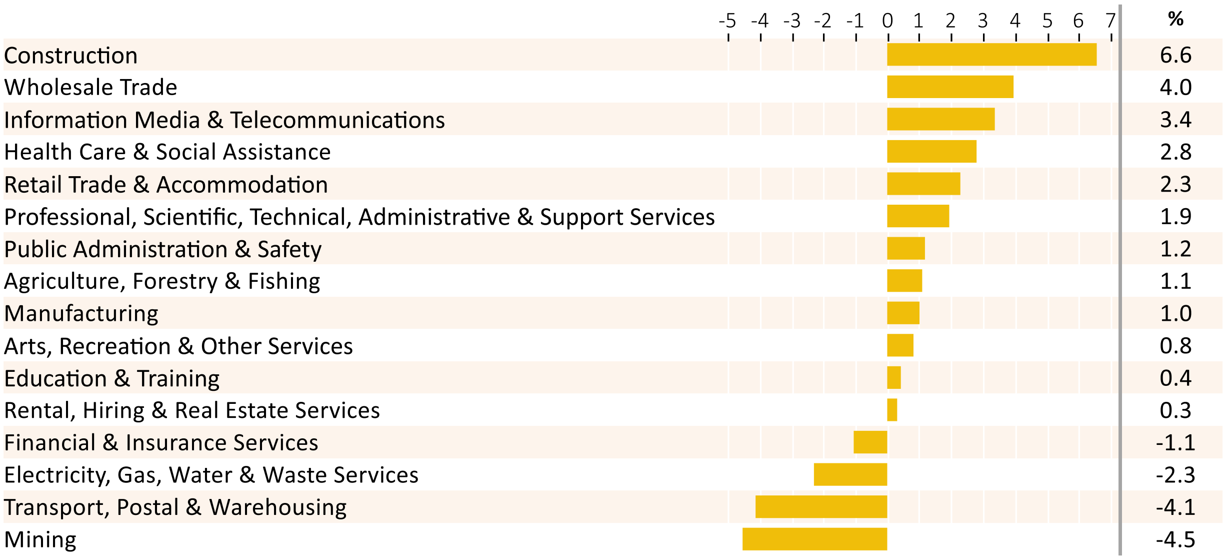
Services sector activity was much stronger than we had pencilled in, with strong increases recorded across most sectors. The 3.4% lift in information media and telecommunications stood out as an unexpected source of strength. Business services proved robust, up 1.9%. Government-dominated sectors also lifted strongly, with public administration and safety up 1.2% and healthcare and social assistance up 2.8%.

From an expenditure perspective, the strong lift in GDP was supported by a very strong lift in domestic demand. The lack of international tourists and students still weighed on GDP, with exports of services declining 20% (largely in line with expectations). However, this fall was more than offset by surprisingly strong spending by NZ households over the quarter. Household spending lifted 5.4% over summer with NZers spending more on accommodation, eating out and major household assets, such as furniture, cars and AV equipment. Furthermore, the outlook for NZ household spending is supportive, with a stronger labour market to support income growth and strong housing construction to support spending on household durables.

Investment was also stronger than we had expected, an encouraging sign that businesses are acting on improved business confidence and investment intentions. Stronger plant and machinery equipment investment also increases NZ's production potential, paving the way for further growth over the coming year.

There were revisions to GDP extending back to Q3 2019, the balance of these revisions put the level of GDP slightly higher, with Q4 2020 0.2% higher than previously published. In Q1 2021, GDP was 0.8% above pre-pandemic levels (December 2019).

NZ GDP by sector - quarterly %



Source: Macrobond, ASB

Outlook

Offshore, the global outlook continues to improve, with the number of COVID-19 infections slowing, particularly in the

US and UK – in large part due to vaccination efforts. But the pandemic is not over yet – the new Delta variant poses risks that could undermine vaccination efforts. Furthermore, recent outbreaks in Taiwan, Melbourne and Fiji highlight the ongoing risk COVID-19 presents to NZ. Nonetheless, over the past year the NZ economy has performed exceptionally well. Despite the constraint of a closed international border, NZ's economic demand has grown beyond expectations. Business confidence continues to steadily increase, and this has led to an increase in employment and investment over early 2021. Strong domestic demand coupled with rising cost pressures are a potent combination for stronger consumer price inflation over the coming year. Strong economic demand will also filter through to stronger employment demand. But, with the labour supply constrained by a closed border, a tighter labour market will see wage inflation pressures also pick up over the coming year. The time for the RBNZ to normalise interest rates is fast approaching. We currently expect the RBNZ to start lifting the OCR in May 2022 but the risks are now skewed to an earlier move. Borrowers should brace for the end of record-low interest rates.

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