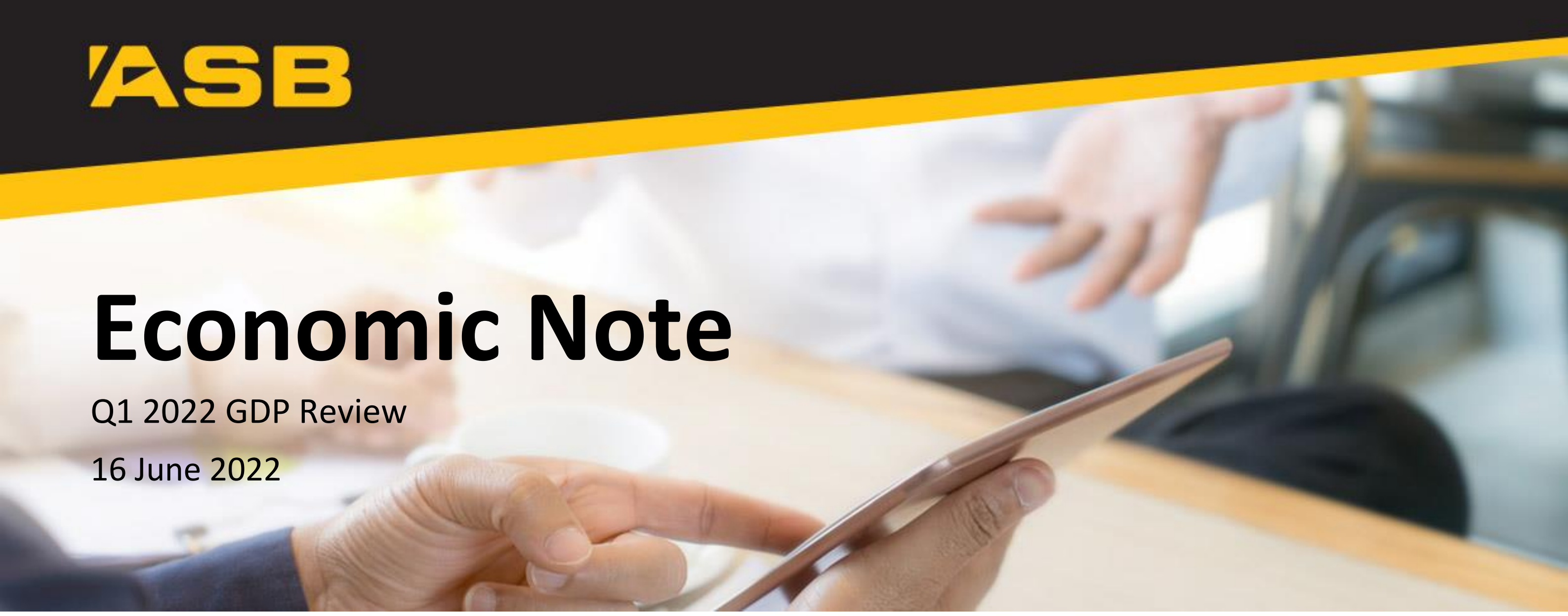

Economic Note

Q1 2022 GDP Review

16 June 2022

- NZ GDP fell 0.2% over the first quarter of 2022, wrongfooting forecasters (like us!) who expected a stronger figure
- We shouldn't obsess too much over the quarter-to-quarter shifts given how volatile GDP prints have been lately, particularly with Omicron hitting
- As we've long signalled, substantial headwinds are mounting and growth over 2022 and 2023 will be much slower

GDP - March 2022	Previous	Actual	ASB	RBNZ	Market
quarterly % growth	3.0	**-0.2**	0.6	0.7	0.6
annual % growth	3.1	**1.2**	2.4	2.5	2.4
annual average % growth	5.7	**5.1**	5.4		

NZ GDP slipped 0.2% over Q1, following on from its 3.0% post-lockdown bounce back in Q4. Today's print was quite a bit weaker than both market expectations and our own forecast (both +0.6%). But, given the wide spread of forecasts, the risk of a lower number was always a live one. Manufacturing, retail trade and transport, postal and warehousing services all look to have been weaker than we had forecast, with the bounce back in construction also a bit less than we had hoped.

It's a mistake to obsess to much about quarter-to-quarter swings. GDP prints over the past two years have been ultra-volatile and heavily impacted by periodic shifts in Alert Levels or peaks and troughs in COVID cases. This quarter we had the Omicron outbreak and all its attendant implications for worker absenteeism and household spending.

There were signs this quarter that the service sector took a substantial hit from the Omicron outbreak, with retail trade falling 1.9% – a fair bit weaker than indicators had suggested. But with the sector facing broader headwinds thanks to the hit household balance sheets are taking from higher interest rates and rising inflation, the challenge for forecasters is working out how much of that dip is temporary and how much is likely to be sustained. We suspect a bit of both, with the household sector unlikely to show the same vigour as last year.

All-up, the key takeaway is the economy is about 1% shy of its pre-Delta peak back in Q2 of 2021 and may not return to those levels until late 2022 or early 2023. Growth is set to slow this year, with a plethora of mounting headwinds descending on the economy. Higher interest rates, ongoing cost pressures, slowing construction, softer agriculture production and more cautious households will remain big themes over the remainder of 2022 and much of 2023.

We don't want to sound too pessimistic – just as recent house price falls aren't a 'bloodbath,' the economy isn't on the brink of caving-in. And we can take comfort from NZ's favourable terms of trade and the constructive outlook for our export sector. Nevertheless, we see growth slowing to circa 1-2% over 2022 and 2023 in contrast to the whopper 5.4% lift we expected last year.

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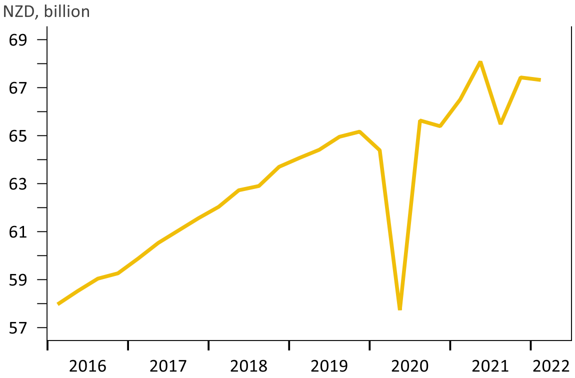
The quarterly nitty gritty and the road ahead

A few themes stand out for among the underlying production components:



- **A mixed bag for the goods sector, with manufacturing tumbling and the construction sector managing a good lift, but failing to live up to what indicators had suggested.** The former fell 1.4%, while the latter managed a 1.7% qoq lift and being one of the largest contributors to growth this quarter. Both sectors have been struggling with capacity pressures for some time and probably experienced some Omicron-related worker absenteeism this quarter, but there was clearly still a decent pipeline of construction work in the offing in the aftermath of last year's lockdown. With interest rates on the rise and the housing market cooling, we're not expecting the construction sector to be able to play the same role supporting growth that it has done over the past two years.

- **Retail trade volumes and accommodation (-1.9% qoq) were also weaker than expected, likely showing an Omicron hit on accommodation.** The expenditure data showed a strong increase in private consumption volumes (+4.6% qoq) likely on account of surging services spending as expenditure patterns returning to pre-COVID-19 norms. We expect retail activity to recover in Q2 given easing COVID-19 restrictions but for household spending to remain subpar given the surging cost of living, impact of higher interest rates and weaker household balance sheets.

- **The service sector more broadly is still patchy.** A 5.4% lift in **education & training** helped offset the declines in other sectors, but **transport, postal and warehousing** was much softer than we expected, with a 1.8% dip. Logistics activity is still a good 6% below where it was pre-lockdown, a sign that high fuel prices and the broader disruption impacting the sector remain very real.

- **Agriculture, Forestry & Fishing has slowed again, and looks likely to be slow to pick up.** Agricultural output dipped 0.2% - not as bad as we had forecast, but a sign another key economic support over recent years is having troubles of its own. Climatic conditions have been poor, labour shortages remain rife and input costs are rising just like everywhere else. We expect production to improve from here in line with tentatively favourable weather patterns, but it could be a slow recovery. **Still, with commodity prices still close to multi-year highs and NZ's terms of trade in a great position, strong net exports are one area that offers the economy real support.**

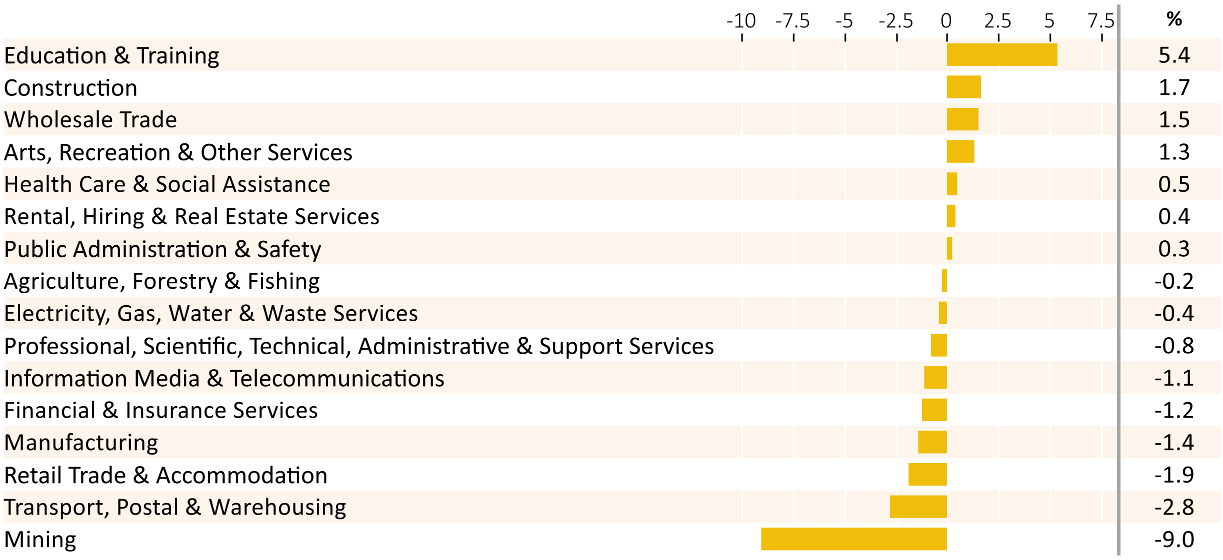
Implications

Some of this quarter's surprise decline will prove to be an Omicron-driven blip, other headwinds we've highlighted are likely to prove harder to shake off. Our pick is growth will slow to circa 1-2% over 2022 and 2023 after last year's 5.4% lift, but uncertainty is enormous in the current environment and we don't envy policymakers.

For the RBNZ, the -0.2% fall in Q1 GDP represented a close to 1% miss (they had forecast a 0.7% qoq rise in Q1 GDP). Mechanically this will flow through into a lower economic starting point (lower pressures on medium-term inflation and hence OCR settings), although the volatility of late in the figures suggest the RBNZ will be somewhat cautious.

In our view, risks to the inflation outlook remain tilted to the upside for now, and the RBNZ will want to be sure that the apparent slowdown in activity is genuine (rather than driven by statistical noise) and that this will flow through into lower capacity pressures and inflation before pausing with OCR hikes. To us the regret from not getting on top of booming inflation outweighs that from potentially driving the economy into the ground. However, the RBNZ will be closely watching activity indicators as well as those for the labour market and inflation for cues. We expect a 50bp hike in July and a 3.50% OCR peak by the end of this year, with a weak economic outlook expected to trigger OCR cuts from 2024.

NZ GDP by sector - quarterly %



Source: Macrobond, ASB

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