Economic Note

Q2 2020 GDP Review

17 September 2020

Q2 GDP registers largest fall in recorded history

- StatsNZ estimates that GDP shrank 12.2% over Q2, relatively close to ASB and market expectations (of -11% and -13%, respectively).
- As expected, the fall in economic output was largest in areas of the economy that were most impacted by the border closure or the inability to operate during Alert Level restrictions. Activity that was deemed essential or could be completed remotely from home saw smaller declines.
- It's not the size of the fall that matters, but the size of the rebound and like many, we expect to see a strong bounce back in activity over Q3.

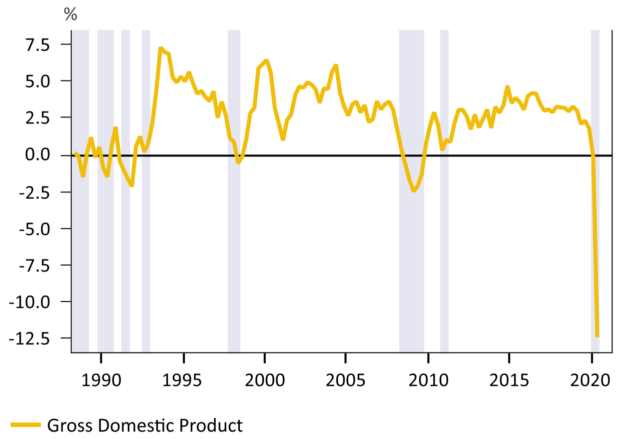
GDP - June 2020	Previous	Actual	ASB	RBNZ	Market
quarterly % growth	-1.4	**-12.2**	-10.8	-14.2	-13.0
annual % growth	-0.1	**-12.4**	-11.1	-14.5	-13.3
annual average % growth	1.5	**-2.1**	-1.8		

Summary and implications

Q2 GDP declined 12.2%, relatively close to our own and market expectations (-11% and -13%, respectively). Despite the elevated level of uncertainty heading into the release, there were no material surprises from our perspective. The falls were largest in industries most exposed to border closures or unable to operate under Alert Level restrictions. Essential activities and activities which could be completed remotely saw smaller-than-average declines.

In terms of economic and policy implications – it's not so much the size of the decline, but the size of the recovery which matters. Q2 GDP has fallen by less than earlier estimates – in large part due to activity recovering faster and stronger during Alert Level 2 and 1 over the second half of the quarter. We expect these trends to continue and – despite the setback of the August outbreak – we expect to see a firm rebound in Q3 GDP. In light of strong business confidence and today's GDP data, we will review our H2 GDP forecasts over the coming days.

NZ Annual GDP Growth and Previous Recessions



Source: Macrobond, ASB

NZ in recession

Q2 GDP declined 12.2%, compared to ASB's forecast of a 11% fall, a median market expectation of a 13% decline, and the RBNZ's August MPS forecast of a 14% fall. StatsNZ confirmed this was the largest quarterly fall in GDP in

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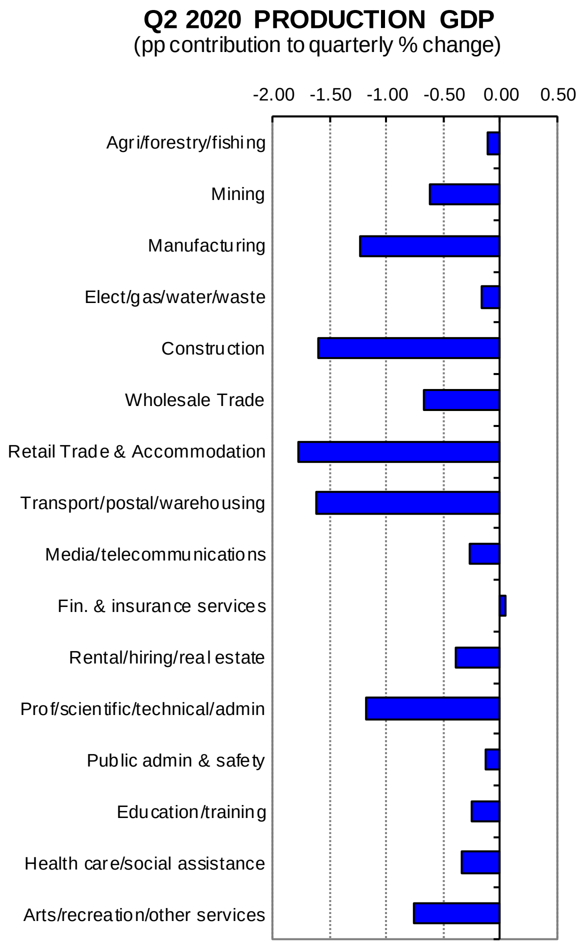
recorded history. Ahead of the Q2 GDP release, uncertainty was much higher than usual given the unprecedented economic disruption caused by the COVID-19 pandemic. Given the uncertainty, StatsNZ's estimate of Q2 GDP was fairly close to economist expectations and unlikely to be considered a material surprise by financial markets or policy makers.

StatsNZ revised its Q1 GDP estimate, and now estimate a slightly smaller fall of 1.4%, compared to the 1.6% decline initially published.

COVID-19 pandemic response drives economic impacts

Industries with the largest negative contribution to Q2 GDP were largely as expected, represented by those industries most exposed to reduced international visitor numbers due to border closures or those industries unable to work from home or open for business due to Alert Level restrictions. Retail trade and accommodation fell 25%, led by a near 50% decline in accommodation and food services. Transport, postal and warehousing output slumped by 39% over the quarter – impacted by dramatic falls in air transport. Construction output fell 25% over the quarter – as largely foreshadowed by the earlier release of the Building Work Put in Place Survey. Professional, scientific, technical, administration and support services 'only' fell by 11%, but given its large weight within value-added GDP it was a key drag on total output. Likewise, manufacturing fell 13%, but given its large weight in value-added GDP it was a key area of drag. Meanwhile, arts, recreation and other services fell by 25% – largely in line with earlier indicators.



Industries that registered smaller declines (or in one case, a small increase) were economic activities most likely to be classified as essential (i.e. food production, electricity generation, health care and essential public services etc.) or were the types of activity which could be completed remotely at home (financial services recorded an increase of 0.7%, while information, media and telecommunications recorded a smaller-than-average decline of 7.4%).

From an expenditure perspective, GDP 'only' contracted 10%, with household consumption down 12% due to reduced spending on restaurant meals, ready-to-eat food, domestic air passenger services, and recreation and cultural activities. Durable goods spending fell 14%, due to reduced car sales. The fall in spending reflects consumers' inability to go about usual patterns of spending during lockdown. **The most remarkable feature of the lockdown, from an economist's perspective, is the speed at which households resumed typical spending patterns once Alert Level restrictions were eased.** We had expected a fall in consumer confidence would have seen a more cautious return to the shops.

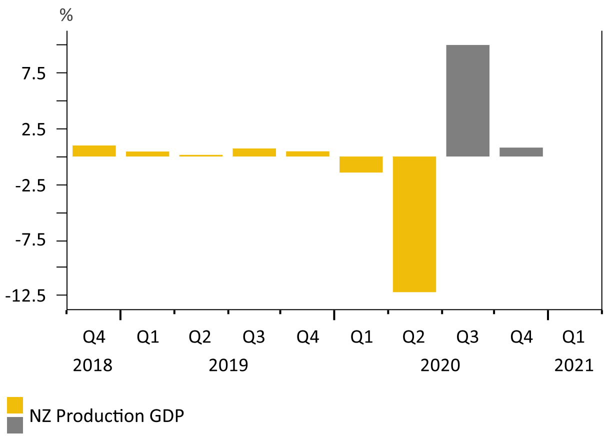
Uncertainty around Q2 higher than usual, given extraordinary circumstance

As we noted in our GDP preview, there was an exceptional level of uncertainty heading into the release of Q2 GDP – and increased pressure on StatsNZ who, at times, had to look to alternative measures to estimate activity. The greatest level of uncertainty was for the services sector as here the information is more difficult to capture on a quarterly basis. Also, the services sector is most heavily impacted by COVID-19 social distancing restrictions. We think StatsNZ did a good job at estimating Q2 GDP – delivering a number close to economist estimates and one that feels intuitively right. Nonetheless, the initial Q2 estimate will likely be subject to heavy revision over time. The pandemic and the policy responses are unprecedented, and StatsNZ's usual modelling techniques for quarterly GDP estimates are not designed to account for this type of extraordinary economic disruption. StatsNZ will likely have to wait until more comprehensive annual surveys are completed before being able to accurately estimate economic activity over 2020

Outlook and Implications

In the August Monetary Policy Statement, the RBNZ assumed a fall in Q2 GDP of 14% – at the time we had a very similar forecast which suggests, like us, the RBNZ may have been pleasantly surprised by recent Q2 economic data. **There are limited policy implications from the Q2 GDP** release, as the RBNZ and fiscal policy have already responded to the lockdown with a range of measures. Going forward, further policy moves will be dictated by developments over the rest of the year and 2021.

NZ Quarterly GDP Growth



Source: Macrobond, ASB

Like many others, we expect growth to rebound strongly, particularly over Q3. We currently have a 10% bounce-back pencilled in for Q3, but will review our H2 GDP forecasts closely over the coming days in light of the Q2 GDP figures (and the implication that more activity can take place under Level 3 and Level 2 than we had previously assumed), strong business confidence and other timely indicators such as card spending and transport volumes.

However, looking beyond the strong recovery over H2 2020, we remain somewhat cautious on the 2021 growth outlook. Given the rising unemployment rate, ongoing border closures and weak global growth backdrop, we see many headwinds to further growth over 2021. We continue to believe the RBNZ's 2021 GDP growth forecasts are on the optimistic side and expect the OCR to be cut to negative territory in April next year.

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