Economic Note

Q2 2021 GDP Review

16 September 2021

Strong NZ growth momentum prior to lockdown

- NZ real GDP expanded at a robust 2.8% qoq pace over Q2, confirming the NZ economy had considerable momentum prior to the more recent community COVID-19 outbreak. There were positive revisions to the level of GDP, with the magnitude of the 2020 Q2 dip and Q3 rebound revised a touch lower.
- The Q2 figures look increasingly dated given more recent events. The most recent lockdown is set to add further volatility to GDP figures through the remainder of the year. Uncertainty is high, but we expect the sharp Q3 dip to be short-lived and followed by a strong Q4 rebound.
- We expect the RBNZ to 'look through' near-term volatility and reduce monetary stimulus, with a series of 25bp hikes starting from next month. We envisage a gradual path of OCR hikes and a low 1.50% OCR endpoint.

Summary & implications

NZ Q2 GDP managed a massive 2.8% climb in Q2, suggesting that the heady pace of momentum had strengthened prior to the current community COVID-19 outbreak and the economy was on the cusp of overheating if it was not already doing so. The opening of the trans-Tasman bubble looks to have provided a sizeable boost to the Q2 readings on a number of fronts. The Q2 figures now look increasingly dated in light of subsequent events and a near-term hit to Q3 GDP looms. Uncertainty remains, but it is our hope that the NZ economy will quickly bounce back after the community outbreak is brought under control and restrictions eased, with a Q4 rebound looming. In our view the RBNZ will look through the near-term disruption caused by the outbreak and the path of least regrets still necessitates some removal of monetary stimulus. A gradual series of 25bp OCR hikes beckon, starting from October.

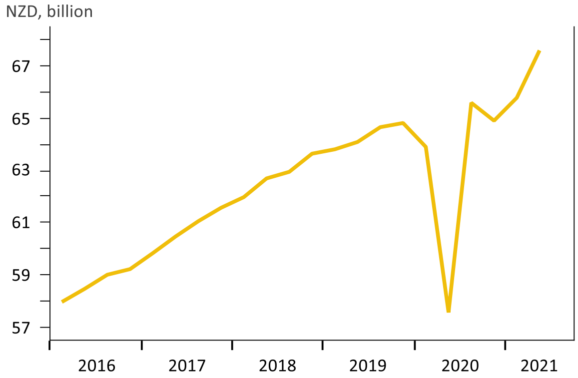
GDP - June 2021	Previous	Actual	ASB	RBNZ	Market
quarterly % growth	1.4	**2.8**	1.5	0.7	1.1
annual % growth	2.9	**17.4**	16.5	15.6	16.1
annual average % growth	-1.4	**5.1**	4.3		

Stonker Q2 GDP reading

NZ real production-based GDP rose a seasonally-adjusted 2.8% in Q2 (+17.4% yoy), much stronger than ASB (+1.5% qoq) and market expectations (+1.1% qoq) and a considerable distance above the 0.7% qoq RBNZ pick. The jump followed the strong 1.4% Q1 climb and took the level of real GDP to a record high and 4.3% above pre-COVID-19 levels.

The GDP figures contained historical revisions, as alternative methods were utilised to capture economic activity through the disruptive post-COVID period. These changes have boosted the

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



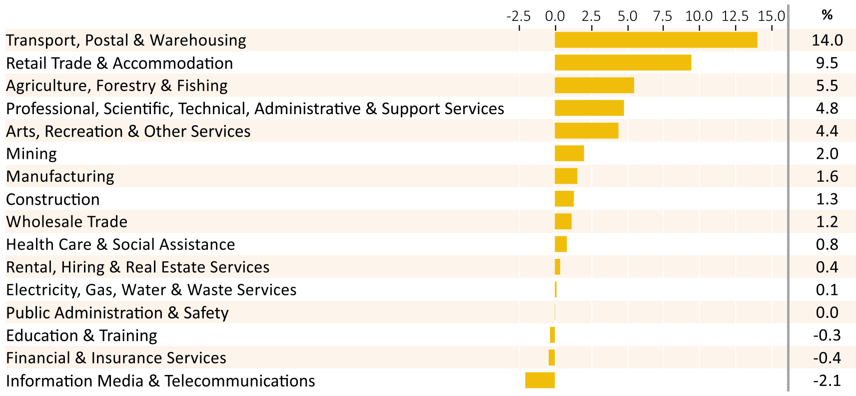
Source: Macrobond, ASB

Mark Smith – Senior Economist (027) 578 5635 mark.smith4@asb.co.nz

level of outright GDP (the level of real GDP was 0.7% higher by 2021 Q1 than previously estimated) and slightly reduced quarter-to-quarter volatility over 2020. The revisions were primarily for services (+0.9%) and primary sector GDP (+2.0%).

The Q2 lift in GDP was driven by a sizeable 2.8% qoq climb in services GDP, with sizeable rises for transportation (+14% qoq), and retail trade & accommodation (+9.5% qoq) showing the growth enhancing impact of the reopening of the trans-Tasman bubble. These are set to unwind in Q3. Activity in professional, scientific and support services (4.8% qoq) and arts and recreation (+4.4% qoq) was also strong. Increasing capacity constraints look to be behind slower Q2 growth in the construction sector (1.3% qoq) and the goods sector overall (1.3% qoq), with a more modest than expected 1.6% qoq climb in manufacturing sector value added. Moreover, strong agricultural production boosted primary GDP by 5.0%.

NZ GDP by sector - quarterly %



Source: Macrobond, ASB

Expenditure GDP posted a strong 2.7% quarterly bounce (17% yoy). Driving the increase was a 17% surge in export volumes, with the opening of the trans-Tasman bubble boosting services exports by close to two-thirds, albeit off a low base with volumes still more than 40% below pre-COVID-19 levels. Much of the strength in retail activity was deemed to be export-led with private consumption volumes contracting 1.4% in Q2 after growing 5.6% in Q1, although they remain 9% above pre-pandemic levels. **Disappointingly for future supply-side capacity, plant & machinery investment (-6.7% qoq) failed to build on a positive start to 2021 to be back slightly below pre-pandemic levels.** With labour shortages unlikely to go away any time soon, firms will have to increasingly look at both capacity enhancing and labour-saving investment.

Second half of 2021 will be bumpier but hopefully clearer skies ahead

The Q2 figures now look increasingly dated in light of subsequent events but they certainly add conviction to our view that the NZ economy had run up a strong head of steam heading to the mid-August lockdown. Nevertheless, a sizeable Q3 contraction to overall GDP looms (in the region of -7½ %qoq), although fiscal support will help mitigate this. Statistics NZ will also be adding benchmark revisions to the Q3 figures that are likely to be lost in the wash. Uncertainty is pronounced but we are hoping that the current community outbreak in Auckland is contained, setting the scene for a swift Q4 bounce in GDP (close to +9% qoq in Q4), given pent-up demand, and the ingenuity and resilience displayed by households and firms. All thing going well, activity in the NZ economy will hit record highs by the end of 2021/early 2022.

Further ahead, there remain a decent number of supports to NZ economic activity. However, border restrictions are likely to remain around for a while yet, providing a decent headwind to tourism and services exports and well as net immigration. In the absence of an uplift in productive investment, capacity constraints look set to become increasingly widespread as the economy rebounds. Moreover, cost pressures are intense, and consumers look more resigned to accepting price increases. The delta variant of COVID-19 is a difficult nut to crack and periodic stop-start episodes and a period of pronounced volatility remain likely.

RBNZ to look through near-term volatility and hike the OCR

What will the RBNZ do? **The Q2 GDP outturn was much, much stronger than the 0.7% qoq August MPS pick, which will boost RBNZ estimates of starting-point capacity pressures. In our view the RBNZ will look through the near-term disruption caused by the outbreak** and focus on the degree of inflationary pressures and the state of the labour market beyond then. Both were showing signs of overheating prior to the lockdowns, hence the earlier hawkish rhetoric by the RBNZ. In our view the lockdowns will temporarily dent overall employment, with a larger fallout for exposed sectors, but the labour market will subsequently tighten. Moreover, the lockdowns have done little to extinguish simmering cost and inflationary pressures that could well persist well into 2022.

As such, the path of least regrets for the RBNZ still necessitates some prompt removal of monetary stimulus. The OCR at current levels is roughly 150bps lower than neutral settings and, while there will be a temptation to quickly remove stimulus (in 50bp steps rather than 25bps), we envisage that the RBNZ will tread carefully. We have pencilled in a series of gradual 25bp hikes in October, November and February 2020 that will take the OCR back to pre-pandemic levels (1%). Beyond that we envisage the OCR peaking at a historically low 1.50% from the end of next year. The path of the OCR is uncertain and largely depends on how the NZ economy fares.

ASB Economics & Research			Phone
Chief Economist	Nick Tuffley	nick.tuffley@asb.co.nz	(649) 301 5659
Senior Economist	Jane Turner	Jane.turner@asb.co.nz	(649) 301 5957
Senior Economist	Mark Smith	mark.smith4@asb.co.nz	(649) 301 5657
Senior Economist	Mike Jones	mike.jones@asb.co.nz	(649) 301 5661
Senior Economist, Wealth	Chris Tennent-Brown	chris.tennent-brown@asb.co.nz	(649) 301 5915
Economist	Nat Keall	nathaniel.keall@asb.co.nz	(649) 301 5720

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