16 December 2021

Yes, Q3 GDP Drop Buttresses RBNZ Hiking Bias

- **3.7% fall in Q3 GDP close to market**
- **Not nearly as weak as RBNZ anticipated**
- **But its rebound expectations accordingly too strong**
- **Anyway it's the labour market and CPI that dictate**
- **Investment holds up in Q3, inventory rebounds**
- **GDP "deflator" broadly inflating**

If you thought yesterday's HYEFU had a perplexing mix of (positive) news, try the following on for size. Today's Q3 GDP report – which registered a quarterly drop in activity of 3.7% – reinforces the case for the Reserve Bank to keep removing OCR stimulus.

How so? Well, the overarching thing to point out, which we already knew, is that the September quarter of 2021 also logged 1) a plunge in the unemployment rate to 3.4%, from 4.0% in Q2, and 2) a surge in annual CPI inflation to 4.9%, from 3.3%. And it's these things that drive monetary policy, not GDP per se.

We also know that the economy was severely impacted by the COVID-lockdowns that began mid-August. [That said, Q3 GDP cannot be taken as a clean read on the degree of the hit. Given the first half of Q3 was "COVID free", the drop in GDP over the second half of the quarter could easily have been double the 3.7% drop reported for the quarter overall. Of course, there is no breakdown of this sort that Stats NZ can provide.]

With the graduated relaxation of COVID-restrictions since August, there is clear cause to expect economic activity to rebound, from the drop in posted in Q3. The question is though, by how much?

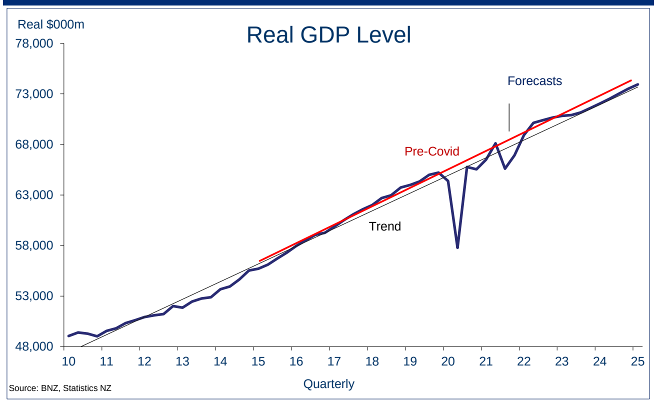
This alludes to another point. That is, we should also not make too much of the fact Q3 GDP didn't drop nearly as much as the Reserve Bank (and the Treasury) anticipated. Not even close. In its November Monetary Policy Statement (MPS) the RBNZ estimated a 7% decline in Q3 GDP (and the Treasury, in its HYEFU, factored in a 6% fall). But these forecasts were finalised well before the GDP partials came to light – partials that had us, like the market, making our Q3 GDP picks much less negative than they were.

The November MPS forecast a 5.8% jump in Q4 GDP followed by a gain of 2.6% in Q1. These now look far too ambitious – given the starting point we now have for Q3, along with the local indicators on activity, which have become a bit more mixed of late.

For instance, while electronic card transactions were rebounding strongly in November, the PMI for the month was roughly flat while the PSI was still contracting. And while there is no hard evidence of a housing correction just yet, consumer confidence is starting to look a bit iffy. Note: there are updates on consumer confidence next week in the form of Monday's Westpac McDermott Miller report for Q4 and Wednesday's (delayed) ANZ Roy Morgan version for December.

By way of comparison to the November MPS, we forecast a relatively mild 2.0% rebound in Q4 GDP and a 3.0% expansion for Q1 – now that we have Q3 under our belt. Note: results of this order would bring GDP back close to November MPS baselines.

In perspective

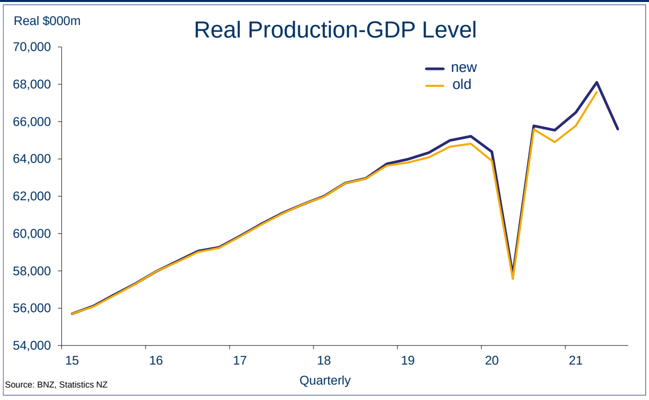


Still, at the margin, today's Q3 GDP report buttresses the idea that the Bank will need to keep removing monetary stimulus. Pressure remains upward. Like yesterday's HYEFU emphasised.

Today's historical revisions reinforced the case. Granted, the increase in Q2 GDP was toned down to 2.4%, from the initially published 2.8%. However, annual GDP growth in Q3 came in at -0.3%, compared to market expectations of -1.4%. This inferred net-positive revisions to GDP over the trailing few quarters, considering the market's median expectation for Q3 GDP was that it would ease 4.1% (we expected -4.0%).

In addition to this, the annual-cycle revisions bumped up the trajectory of real GDP over recent years. This painted a picture of the economy being stronger going into the pandemic, tracing a very similar down and up during last year's lockdowns, but then achieving a better overall growth recovery since – compared to the NZ GDP track pre-revisions. This had the level of GDP about 0.8% stronger at Q2 2021, than previously estimated.

A stronger historical profile



The composition of today's Q3 GDP also had some undercurrents of positivity running through it. Notably, business investment appeared to be looking through the Q3 disruption (and to currently extreme capacity constraints?), with expenditure on plant, machinery and equipment up 2.0% and on transport goods down just 1.6%. We expected weaker results than these.

Inventories also turned out more solid than we anticipated for Q3. Indeed, they jumped a fair bit, in historical context. Of course, it's hard to know if this is a deliberate or unintended build up. However, the bounce in stocks, like the resilience in business investment, certainly accounted for the strength in imports that we already knew about, filling important gaps in our calculations of Q3 expenditure GDP in the process.

Counterbalancing this, private consumption (-7.5%) fell more than we anticipated (as did the retail & accommodation component of production-based GDP). This is surely sheeted directly to the lockdowns rather than signalling a genuine wobble. The exports and imports results in Q3 GDP, for the record, were relatively close to what we thought.

It's also worth mentioning that the inflation measures in today's GDP report were widely robust. Whether for consumer goods, investment goods, exports or imports, prices were rising strongly in Q3. The GDP "deflator" increased 1.8% in the quarter, after expanding 1.5% in Q2. While none of this was a revelation to us, it underscores the fact that inflation pressures are about far more than the CPI.

From here then, it's a matter of gauging how well (or otherwise?) economic activity will recover. This will be complicated by the economy transitioning to "living with the virus", including its ever-changing variants. There are positives and negatives to this. The other unknown is how the economy will be affected by decisions around the international border (in due course, as it remains substantively shut to arrivals until at least mid-January).

However, in thinking about monetary policy, marking the level of economic activity (GDP) will get us only so far. Through all the (ongoing) disruption, we need to keep a sharp eye on the path of the labour market and the trends in inflation, including expectations thereof.

Industry	qtr % chg prev qtr	% pt cont to chg	ann % chg	ann avg % chg
Gross domestic product by industry – September 2021 quarter				
Agriculture, forestry, and fishing	-2.8	-0.2	5.6	-0.4
Mining	-5.3	0.0	3.5	-3.9
Manufacturing	-7.6	-0.7	4.4	-6.1
Electricity, gas, w ater, & w aste services	0.0	0.0	1.2	1.8
Construction	-9.6	-0.7	8.0	-11.1
Wholesale trade	-1.1	-0.1	8.3	2.9
Retail trade and accommodation	-13.3	-1.0	11.0	-7.8
Transport, postal, and w arehousing	-3.3	-0.1	1.9	15.8
Information media and telecommunications	-1.7	0.0	3.7	-0.2
Financial and insurance services	0.8	0.0	-1.7	-2.0
Rental, hiring, and real estate services	0.4	0.1	4.1	2.1
Prof, scientific, technical, admin, & support	-1.2	-0.1	5.2	6.5
Public administration and safety	1.7	0.1	5.0	3.7
Education and training	-4.2	-0.2	-0.4	-3.9
Health care and social assistance	-1.7	-0.1	6.7	4.2
Arts, recreation, and other services	-11.9	-0.4	7.1	-3.7
Unallocated(2)	-5.2	-0.4	4.6	-0.6
Balancing item(3)	..	0.2	..	..
Gross domestic product	**-3.7**	**-3.7**	**4.9**	**-0.3**

1. Percentage point contributions to change may not sum to gross domestic product due to rounding.

2. Includes unallocated taxes on production and imports.

3. The seasonal adjustment balancing item.

4. Contribution to change estimates should be treated w ith caution. Larger than normal variations in trend and seasonal pattern have affected the ability to reconcile the seasonally adjusted contribution of some components to the seasonally adjusted aggregate.

Component	qtr % chg prev qtr	% pt cont to chg	ann % chg	ann avg % chg
Expenditure on gross domestic product – September 2021 quarter				
Final consumption expenditure				
Private	-7.6	-4.4	6.4	-2.4
General government	1.8	0.4	9.0	9.8
Gross fixed capital formation				
Residential buildings	-6.1	-0.5	13.8	-2.7
Other fixed assets	-4.8	-0.7	3.3	-2.5
Exports of goods and services	-4.8	-1.1	-7.2	2.7
Imports of goods and services	5.4	-1.3	6.8	23.3
Change in inventories and balancing item(2)	..	..	..	..
Expenditure on gross domestic produc	**-4.7**	**-4.7**	**4.8**	**-1.7**

1. Percentage point contributions to change may not sum to expenditure on gross domestic product due to rounding.

2. Includes the change in inventories and the seasonal adjustment balancing item.

3. Contribution to change estimates should be treated w ith caution. Larger than normal variations in trend and seasonal pattern have affected the ability to reconcile the seasonally adjusted contribution of some components to the seasonally adjusted aggregate.

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