16 March 2023

Drop in Q4 GDP Teases at Recession to Come

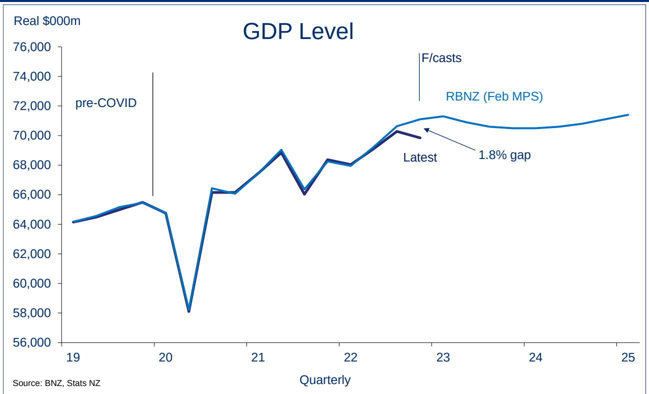
- **Q4 GDP drops 0.6%, carving annual growth to 2.2%**
- **Downward revisions too, netting to around -0.5%**
- **GDP undershoot to RBNZ/Feb MPS totals 1.8%**
- **Causing a reassessment of potential growth assumptions?**
- **Still, Q4 GDP hints our recession call for 2023 on track**
- **We maintain our OCR view, but now seems a maximum**
- **Market OCR pricing presently reflects the risks we see**

Most analysts were anticipating a fall in this morning's Q4 GDP. We certainly were. Nevertheless, the reported drop, of 0.6%, turned out to be bigger than the market's expectation of a 0.2% decline. The alternate expenditure measure of GDP, for the record, dipped 0.8%.

There were also historical revisions to the downside. While Stats NZ hinted at this likelihood in a paper a couple of weeks ago, confirmation of the direction, and degree (about -0.5%), was still good to know about.

More to the point, all considered, the latest GDP result represents a major starting point shock for the RBNZ. In the order of 1.8%, we estimate. The Bank, in its February Monetary Policy Statement (MPS), had picked Q4 GDP to expand 0.7%.

A Big Miss, But How Significant?



All other things being equal, this would push the Reserve Bank towards a softer stance than it was otherwise contemplating.

But all things aren't equal. If inflation and employment indicators remain excessively tight, the RBNZ will stick to its knitting and push ahead with further rate increases.

Industry	qtr % chg prev qtr	% pt cont to chg	ann % chg	ann avg % chg
Gross domestic product by industry – December 2022 quarter				
Agriculture, forestry, and fishing	-1.6	-0.1	-4.0	-2.1
Mining	2.0	0.0	-8.5	-7.1
Manufacturing	-1.9	-0.2	-5.3	-9.1
Electricity, gas, w ater, and w aste services	-0.4	0.0	2.1	2.8
Construction	1.6	0.1	2.3	4.7
Wholesale trade	-1.0	-0.1	5.9	2.3
Retail trade and accommodation	-1.9	-0.1	0.2	-1.3
Transport, postal, and w arehousing	-3.0	-0.1	12.1	15.0
Information media and telecommunications	-0.7	0.0	1.0	1.0
Financial and insurance services	0.3	0.0	0.2	1.4
Rental, hiring, and real estate services	0.3	0.0	1.9	1.7
Prof, scientific, technical, admin, and suppoı	3.3	0.4	8.5	6.6
Public administration and safety	0.0	0.0	2.4	0.9
Education and training	0.9	0.0	-0.9	3.9
Health care and social assistance	-1.2	-0.1	9.5	7.6
Arts, recreation, and other services	-4.2	-0.1	2.2	6.6
Unallocated(2)	-0.4	0.0	2.7	3.4
Balancing item(3)		..	..	..
Gross domestic product	**-0.6**	**-0.6**	**2.4**	**2.2**

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

Component	qtr % chg prev qtr	% pt cont to chg	ann % chg	ann avg % chg
Expenditure on gross domestic product – December 2022 quarter				
Final consumption expenditure				
Private	0.0	0.0	2.9	2.1
General government	-2.4	-0.5	4.5	-1.5
Gross fixed capital formation				
Residential buildings	-2.2	-0.2	0.4	0.7
Other fixed assets	-1.5	-0.3	4.9	-3.4
Exports of goods and services	-2.2	-0.5	-1.0	5.7
Imports of goods and services	0.6	-0.2	4.4	1.6
Change in inventories and balancing item(2)	..	..	..	..
Expenditure on gross domestic product	**-0.8**	**-0.8**	**2.2**	**2.5**

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

On the one hand, the downside shock to GDP implies a weaker economy than had been thought. On the other it suggests that the economy has created strong inflation despite softer growth. In other words, potential growth is probably lower than the Reserve Bank previously believed.

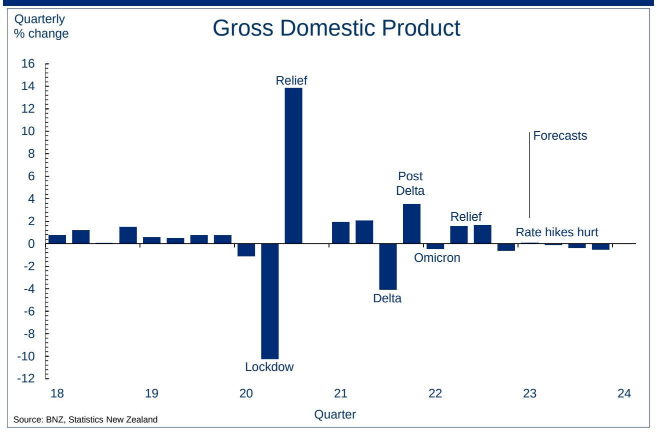
To the extent the RBNZ does downgrade its view on supply-side growth – in recent history and carrying over into the period ahead – it will reinforce inflation pressure, all else equal. After all, the Bank did exactly the opposite, after the significant upside surprise that came through on Q3 GDP (along with historical upward revisions), in order to reconcile back to the inflation that it was seeing.

We certainly thought this was a bold thing for the RBNZ to be doing, when potential growth was still under serious question, and the Bank was facing into a lot of core inflation. So, to revise down estimates and forecasts of potential growth would provide a more realistic basis for thinking about inflation, in our opinion.

But is the latest GDP outcome the start of the recession we have been forecasting since last May, in any case? Possibly.

However, we also caution that changes in seasonal patterns continue to create havoc with the data. Hence the ridiculous volatility in the last four quarters' data of -0.5%, +1.6%, +1.7%, -0.6%!!

Noisy But Slowing



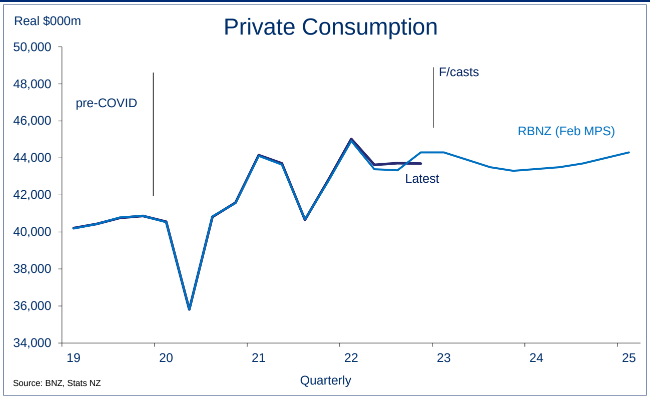
So, who knows what the next quarter looks like? For the record, we have a fractional increase on the board for Q1 GDP, conscious of the impacts of the severe weather that hit the country in January and February.

The RBNZ, in its February MPS, predicted a gain of 0.2% - before a string of falls in Q2, Q3 and Q4 of 0.5%, 0.4% and 0.2% respectively. This is a reminder the Bank was already forecasting a recession for 2023, as we started doing back in May 2022.

But that's for the future. Even with the weaker than expected Q4 2022 result, we note NZ GDP still logged annual growth of 2.2%. That's hardly weak.

And while private consumption expenditure went flat in Q4, it was still up 2.1% in annual terms, and, for broader perspective, was almost 5% higher than pre-COVID levels in per capita terms. The latter speaks to the still-strong force of consumer spending, even though it has obviously started to struggle in a growth sense.

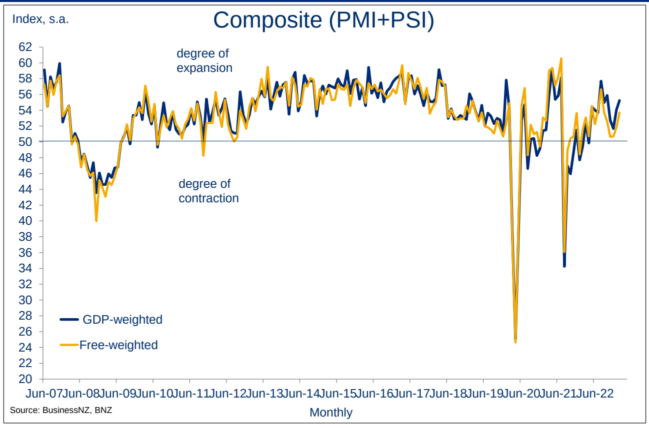
Overs and Unders



That the economy is not faltering into weak state, right now, has certainly been the message from the Performance of Services Index (PSI). Its seasonally adjusted reading of 55.8, was higher than January's 54.7, which meant it compared even more favourably to its long-term average, of 53.6.

This, along with the recovered tone of the PMI over January and February, suggests economic growth slowed a lot toward the end of 2022 – from a mid-year burst of speed – but has managed a decent pace into the early stages of 2023.

Not Recessionary, Not Yet



Nonetheless, we still believe the economy will enter recession this year and today's latest array of GDP data are not inconsistent with this.

For now, we maintain our view that the RBNZ will push through two more 25-point hikes, delivering a peak of 5.25%. Until recently, this was a non-consensus view. If anything, the balance of risk is starting to shift to an even lesser peak. The recent warning signs from the international financial sector play to this – to the extent they suggest lower inflation pressure ahead, that is.

As for the market's interpretation to todays' GDP figures, it was most evident in the 2-year swap, which dipped an immediate 10bps or so, before recovering about 5bps of that. The longer-end swaps were relatively stable by comparison. Shorter-term OCR pricing was not much moved, in the end. This infers an OCR of around 4.90% for the RBNZ meeting on 5 April, and a peak of about 5.10% by July.

The bigger re-pricings in the NZ OCR had already occurred pre the NZ Q4 GDP release, of course, in response to the global bank-related news of recent days.

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