Research

Economy Watch

21 September 2023

Recession rounded away

- **Q2 GDP surprisingly strong**
- **But plenty of noise in the data**
- **Economy bouncing along the bottom**
- **No concern for RBNZ, yet**
- **And, by the way, we've still had a recession**

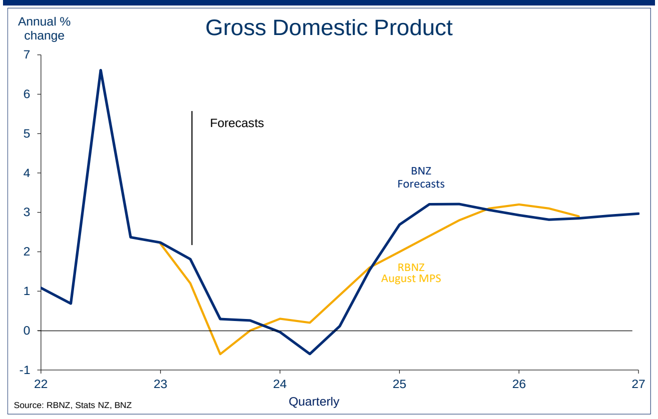
It was all so predictable. Q2 GDP printed very solid. Indeed, more solid than expected resulting in plenty of back patting that the recession is now over. To cap things off, enthusiasm for New Zealand's achievements grew with the news that, apparently, there was no contraction in Q1 anyway so there was no recession in the first place.

All this goes to show how fickle we can be. The only reason there wasn't a recession was that Statistics New Zealand rounds its numbers to one decimal point. Had it published to two decimal places -0.01% then all those headlines would have to be rewritten. And, by the way, the expenditure measure of GDP still reported a clear cut second quarter of decline in Q1.

As for the surge in activity. There is no avoiding the fact that the 0.9% increase in Q2 GDP was well above our expectation of 0.6% and the RBNZ's 0.5% pick. But there was nothing in the surprise to suggest that an increase anywhere near this magnitude will be repeated at any time in the next year or so. This economy is still slowing down on a trend basis, and this will become glaringly obvious when the Q3 data are published.

As things stand, annual growth in GDP has fallen to 1.8%. If we ignore all the COVID noise this is the weakest performance by this economy since Q2, 2011.

RBNZ surprised?



Industry	qtr % chg prev qtr	% pt cont to chg	ann % chg	ann avg %chg
Gross domestic product by industry – June 2023 quarter				
Agriculture, forestry, and fishing	-2.3	-0.1	-3.2	-5.3
Mining	2.7	0.0	0.1	14.7
Manufacturing	0.9	0.1	-5.5	-2.3
Electricity, gas, water, and waste services	3.1	0.1	3.4	5.4
Construction	-0.2	0.0	7.2	6.6
Wholesale trade	-0.5	0.0	2.5	-2.0
Retail trade and accommodation	-1.0	-0.1	0.2	-6.0
Transport, postal, and warehousing	1.5	0.1	13.4	3.2
Information media and telecommunications	0.4	0.0	4.0	4.6
Financial and insurance services	0.2	0.0	3.4	1.5
Rental, hiring, and real estate services	0.7	0.1	2.0	2.5
Prof, scientific, technical, admin, and support	2.1	0.2	6.1	4.4
Public administration and safety	2.8	0.1	2.7	4.1
Education and training	2.0	0.1	1.8	1.8
Health care and social assistance	0.9	0.1	8.0	6.0
Arts, recreation, and other services	2.3	0.1	8.7	3.1
Unallocated	-2.0	-0.2	4.6	1.4
Balancing item	..	0.3	..	..
Gross domestic product	**0.9**	**0.9**	**3.2**	**1.8**

Component	qtr % chg prev qtr	% pt cont to chg	ann % chg	ann avg %chg
Expenditure on gross domestic product – March 2023 quarter				
Final consumption expenditure				
Private	0.4	0.2	3.2	2.4
General government	2.0	0.4	0.1	-0.8
Gross fixed capital formation				
Residential buildings	-0.8	-0.1	3.5	-1.0
Other fixed assets	2.5	0.4	5.0	8.6
Exports of goods and services	5.0	1.2	12.1	13.1
Imports of goods and services	-2.0	0.5	3.3	1.4
Change in inventories and balancing item	..	-1.4	..	..
Expenditure on gross domestic product	**1.3**	**1.3**	**3.3**	**1.9**

But it's going to get a lot worse. We are forecasting zero change in activity for Q3. That will take annual growth to just 0.3%. We do not expect annual growth to exceed 1.0% again until Q4 2024. On a per capita basis this is simply awful given that population growth is now over 2.0% per annum.

It is, nonetheless, true that the surprise today's outturn delivers to the Reserve Bank increases the likelihood it will need to start raising interest rates again. But by how much is that likelihood genuinely increased and for how long? And is the market justified in its certainty that there will be another rate increase in New Zealand by April 2024?

In the August Monetary Policy Statement the RBNZ estimates that over the next three years New Zealand's potential growth rate is between 2.5% and 2.8%. Any number less than suggests the output gap will move into negative territory. It looks like that by 2024 we will be a long way from seeing an economy whose output gap is fundamentally inflationary.

This being the case, we will not be changing our view that the Reserve Bank keeps rates on hold on October 4 nor that the next move will be a cut.

In looking to next quarter's GDP outturn we note the following factors that may well have favourably distorted this quarter's outturn and/or which are not sustainable:

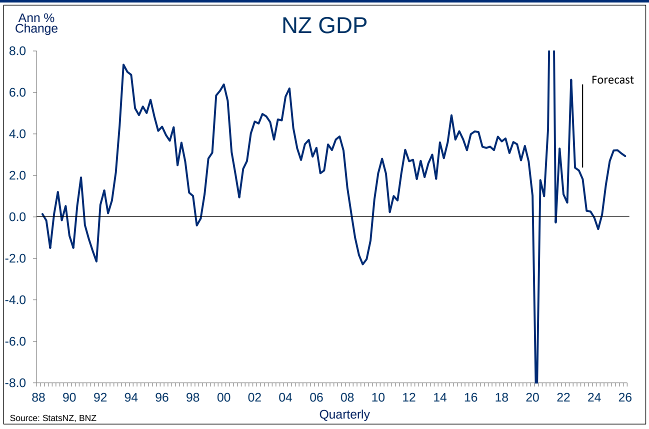
- Seasonal adjustment issues are elevated thanks to COVID. Symptomatic of this the balancing item in today's data added 0.3% to GDP. Had we incorporated a 0.3% balancing item we would have forecast a 0.9% outturn. We didn't. But, more importantly, what we can be reasonably sure of is that this balancing item support for GDP won't be repeated in Q3.
- Electricity, gas and water services output jumped 3.1% because of increased hydro usage. This won't be repeated. Moreover, a looming drought could see utilities' GDP slump.
- It is hard to imagine the jump reported for government services will be sustained.
- The 2.0% increase in education and training largely reflects the fact that the teacher's strike that occurred in Q1 was not repeated.
- Some of the bounce in Q2 activity is a response to the floods of Q1. New levels of activity may be sustained but not grown.

Looking further ahead we are expecting:

- A drop in investment activity due to a combination of falling business profitability and elevated interest rates.
- Constrained private consumption as effective real disposable incomes continue to be eroded.
- Weaker exports as global demand drops and agriculture sector production is pressured by the weather.

All that said, we stress that we continue to talk about a modest economic correction not a vicious recession.

In context



In summary, then, a definitively, surprisingly strong GDP outcome that rightly has folk questioning whether the RBNZ may be forced to give rates a nudge again. But, unfortunately, more likely an aberration, the optimism for which, will fade as the year progresses.

stephen_toplis@bnz.co.nz

Contact Details

BNZ Research

Stephen Toplis
Head of Research
+64 4 474 6905

Craig Ebert
Senior Economist
+64 4 474 6799

Doug Steel
Senior Economist
+64 4 474 6923

Jason Wong
Senior Markets Strategist
+64 4 924 7652

Stuart Ritson
Senior Interest Rate Strategist
+64 9 9248601

Mike Jones
BNZ Chief Economist
+64 9-956 0795

Main Offices

Wellington
Level 4, Spark Central
42-52 Willis Street
Private Bag 39806
Wellington Mail Centre
Lower Hutt 5045
New Zealand
Toll Free: 0800 283 269

Auckland
80 Queen Street
Private Bag 92208
Auckland 1142
New Zealand
Toll Free: 0800 283 269

Christchurch
111 Cashel Street
Christchurch 8011
New Zealand
Toll Free: 0800 854 854