Research
Economy Watch

21 March 2024

Recession Clocks Up Fifth Quarter

- **GDP weakness confirmed**
- **Per capita recession extends to five quarters**
- **Supports our view of OCR reduction later this year**
- **Economy tracking well below HYEFU projections**
- **A material headwind for government revenue**

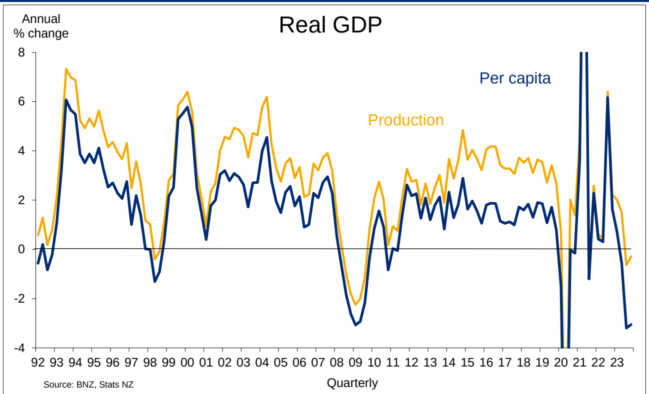
We were braced for weakness in today's Q4 GDP figures. In fact, we were braced for it as far back as May 2022 when we first said 'a recession seems difficult to avoid' and 'growth stalls completely in 2023'. That's essentially what happened last year.

GDP fell 0.1% in Q4, to be down 0.3% on a year earlier. Cue more talk about NZ re-entering technical recession. Technical recession or not (who knows, it could get revised away), to us the bigger picture remains the same. The economy continues to bump along the bottom. It has struggled to grow for more than a year now, real per capita incomes have dropped sharply, and the unemployment rate is rising.

Real GDP per capita fell 0.7% in the quarter. That is the fifth consecutive quarterly decline in this measure, which sits 3.1% lower than a year ago. The per capita recession rolls on and remains clear for all to see.

The Q4 GDP outcome was a couple of ticks lower than the +0.1% expected by the market (and us on the day, albeit with downside risk). The outcome was also a tick below the RBNZ's flat estimate for the quarter. With no material historical revisions at the headline level, this puts the level of GDP a tick under the Bank's projections.

Retreat



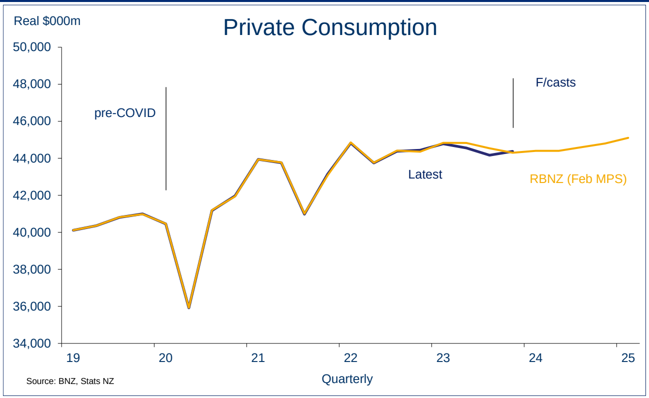
Industry	qtr % chg prev qtr	% pt cont to chg	ann % chg	ann avg %chg
Gross domestic product by industry – December 2023 quarter				
Agriculture, forestry, and fishing	0.7	..	1.5	-0.2
Mining	-3.4	..	2.7	0.8
Manufacturing	-0.4	..	-5.2	-3.7
Electricity, gas, water, and waste services	0.3	..	1.9	0.5
Construction	0.1	..	-0.1	-0.4
Wholesale trade	-1.8	-0.1	-2.0	-5.3
Retail trade and accommodation	-0.9	-0.1	-3.5	-3.5
Transport, postal, and warehousing	-0.7	..	0.3	-5.1
Information media and telecommunications	..	..	3.7	3.2
Financial and insurance services	0.7	..	3.7	4.4
Rental, hiring, and real estate services	1.0	0.2	2.4	3.7
Prof, scientific, technical, admin, and support	0.6	0.1	1.3	-1.8
Public administration and safety	2.8	0.1	4.7	7.4
Education and training	..	..	..	1.6
Health care and social assistance	0.4	..	2.5	1.2
Arts, recreation, and other services	-0.8	..	4.6	2.6
Unallocated(2)	-0.1	..	-0.9	-3.5
Balancing item(3)	..	-0.3	..	..
Gross domestic product	**-0.1**	**-0.1**	**0.6**	**-0.3**

Component	qtr % chg prev qtr	% pt cont to chg	ann % chg	ann avg %chg
Expenditure on gross domestic product – December 2023 quarter				
Final consumption expenditure				
Private	0.5	0.3	0.3	-0.1
General government	0.2	..	-1.1	0.7
Gross fixed capital formation				
Residential buildings	-1.6	-0.1	-4.3	-3.7
Other fixed assets	0.6	0.1	0.5	-1.9
Exports of goods and services	3.2	0.8	10.0	6.0
Imports of goods and services	-2.9	0.8	-0.3	-5.6
Change in inventories and balancing item(2)	..	-1.9	..	..
Expenditure on gross domestic product	**..**	**..**	**0.6**	**-0.5**

An undershoot relative to RBNZ expectations can only encourage the market to bring forward the timing of expected OCR reductions. At the margin, this is fair enough. At face value, today's GDP figures increase the chance that the RBNZ brings forward the timing of its projected first reduction in the OCR from H1 2025 into this year. But we wouldn't overstate the case. After all, it is only a 0.1% miss relative to RBNZ priors.

At first glance, the demand picture looked significantly stronger than either we or the RBNZ expected. Private consumption rose 0.5% in Q4, against expectations of a similarly-sized decline. But there were significant downward historical revisions to Q2 and Q3 private consumption such that we estimate that the level of private consumption in Q4 is around 0.2% higher than the Bank projected. So some offset to the marginal downside surprise to overall GDP, but nothing like the headline 1.0% upside surprise that it looks like from Q4 growth outcome alone.

Not That Different, All Considered



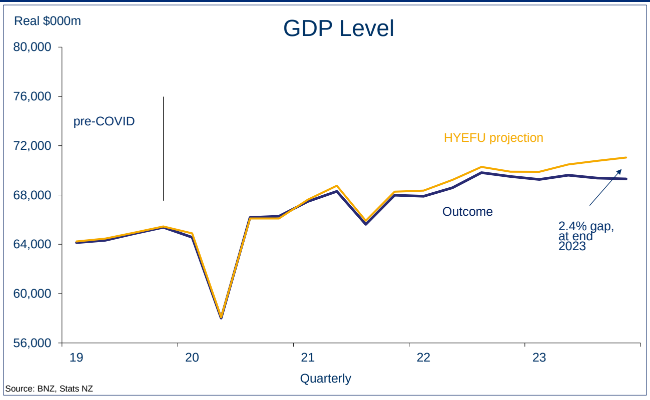
Standing back from the decimal points there is nothing in today's release that changes our broad economic view. We thought growth was tracking well below potential and that has been confirmed today. We think the output gap is already negative and it is becoming increasingly so. This is putting downward pressure on inflation and will eventually allow the RBNZ to start to relax monetary policy from its currently restrictive position. We remain firmly of the view that this process should start this year and continue to think that it will.

Interesting to see the GDP deflator fell 0.6% q/q, to take annual inflation in this broad gauge to 4.3% in Q4 from 7.0% in Q3. It is another indicator confirming the broad disinflationary process in play.

The economy's performance late last year also has implications for other policy makers. As we highlighted again in our weekly on Monday, GDP has materially undershot Treasury's HYEFU projections.

Recent Treasury commentary has noted a significant slowdown and expectations of a roughly flat result for today's Q4 GDP. But that is a downgrade from what was included in December's HYEFU projections. On our estimate, the level of GDP in Q4 is some 2.4% below the Treasury's HYEFU projections. The much lower starting point for the economy will have implications for Government revenue over coming years, compared to the HYEFU baselines.

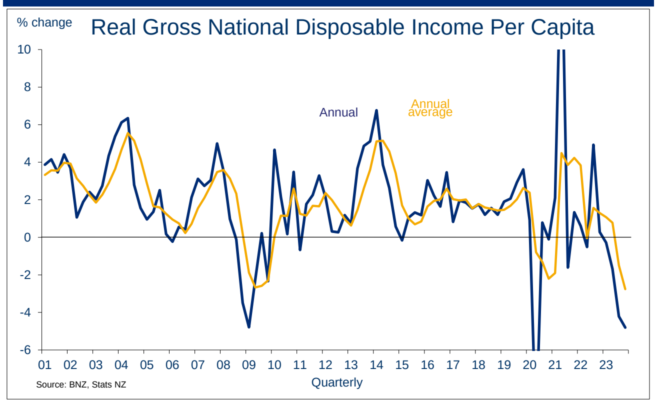
Economy Undershoots Treasury Projections



The squeeze on real incomes in today's release is clear. In fact, broader measures of income look even worse than GDP itself. We say this with reference to RGNDI, which accounts for the likes of purchasing power loss via lower terms of trade. RGNDI fell 2.0% in Q4 alone on a per capita basis, to be down a hefty 4.8% on a year ago. The peak-to-now decline in RGNDI has accumulated to 6.1%, which is now more than the peak to trough on this measure during the GFC.

With real incomes falling, it is no surprise domestic demand is under pressure albeit with lots of quarterly noise. On our estimates, domestic demand rose 0.8% in Q4 but that doesn't even recoup the 2.4% drop in Q3. Domestic demand is 0.8% lower than a year ago. Residential investment – think house building – fell 1.7% in the quarter and is down 3.7% on a year earlier. We think further declines are in train here, judging by the trend in building consents over the past year or so. Overall investment edged lower in the quarter, to be down 2.4% on a year ago.

Real Incomes Hit Harder Than During GFC



Net goods trade made a strong positive contribution to growth as export volumes rose and import volumes fell. The 4.2% slump in goods import volumes reflects the broad softening in domestic demand over the past year and also likely played a part in a chunky fall in inventories in the quarter.

All this was broadly in line with expectations, although the drop in inventories was larger than we had pencilled in and is where we saw the balance of risk. The expenditure measure of GDP was flat in the quarter.

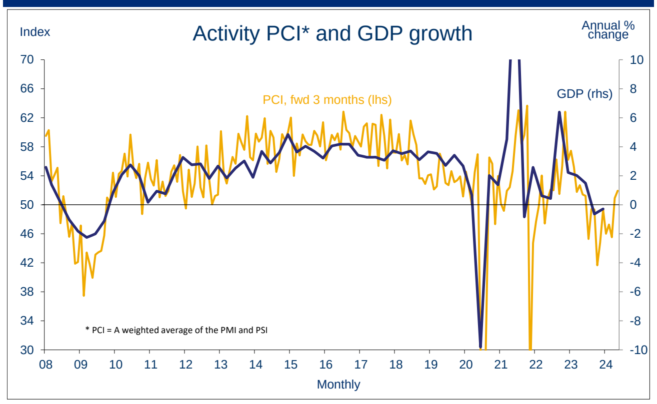
Looking across the industry detail, there were sharp moves every which way. We expected lots of noise and so there was. The expected weakness in the distribution sectors of retail and wholesale trade and transport and storage was visible, with quarterly GDP declines of 0.9%, 1.8%, and 0.7% respectively. Services also saw a range of ups and downs in the detail, but was subdued overall. Primary sectors saw some growth in the quarter, as we thought was the case. Utilities surprised a touch to the upside with some increase, against indicators like electricity generation. On the other side, manufacturing GDP saw a small decline against our priors of a small gain albeit admittedly we did see a wide scope for difference.

So a lot of noise, but nothing that immediately stands out as a reason to alter our broad view for what lies ahead. With Q4 GDP coming in marginally lower than we had, that might well reflect timing issues (and inventory adjustment) such that our estimate for Q1 adjusts as an offset. It is all marginal stuff. We will take a closer look at the details before settling on expectations for growth in subsequent quarters.

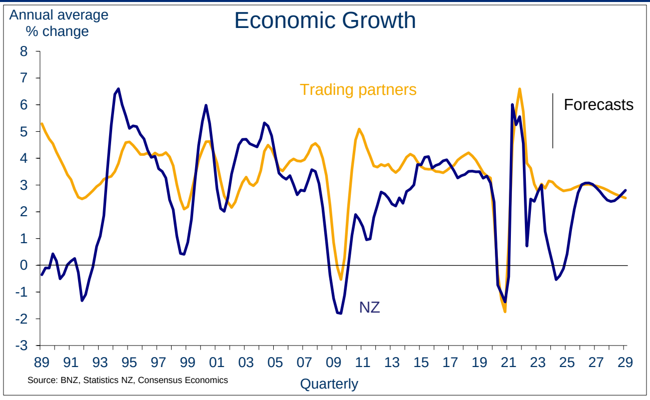
Our broad view for some return to growth later this year looks intact. That is certainly what we are sensing from the likes of somewhat better business and consumer confidence over recent months as well as firmer readings from the combined PMI and PSI activity indicator.

It all points to hope for a return to growth at some point this year – even if it still looks like being below potential. But, as today's Q4 figures confirm, any growth ahead follows a lengthy period of bumping along the bottom. Only so much of that can be pinned on below average global economic growth, with NZ's average annual growth through calendar 2023 well below the equivalent for our major trading partner economies.

Hope For A Return To Growth This Year



Underperforming



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