Economic Bulletin.

11 September 2020

Preview of Q2 GDP (17 Sep, 10:45am) and current account (16 Sep, 10:45am)

- We expect an 11.5% drop in GDP for the June quarter.
- The Alert Level 4 lockdown effectively put about a third of the economy out of action during April.
- However, activity appears to have bounced back readily as the alert level was lowered.
- GDP will rise again sharply in Q3 and Q4, but the ongoing closure of the international borders will cap the extent of the rebound beyond this.
- We expect the current account deficit to narrow to 2.6% of GDP, due to a sharp drop in imports while domestic demand was suppressed.

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	Mar-20 actual	Jun-20 Westpac f/c	Jun-20 RBNZ f/c
GDP			
Quarterly % chg	-1.6	-11.5	-14.2
Annual % chg	-0.2	-11.8	-14.5
Annual average % chg	1.5	-1.9	-2.7
Balance of Payments			
Current account balance $m	-1,557	690	-
Annual balance $m	-8,506	-7,880	-7,550
Annual balance % of GDP	-2.7	-2.6	-2.5

The Covid-19 lockdown was one of the most extraordinary events in New Zealand's economic history, and next Thursday we finally get the full tally of its impact. We estimate that GDP was 11.5% lower in the June quarter, following a 1.6% drop in the March quarter that included the first week of the lockdown.

Such a massive change inevitably comes with a wide margin of uncertainty. And it won't be the final word on the matter, as GDP figures can be subject to revisions for years afterward as more data becomes available. But market forecasts have clearly been trending towards a smaller negative number in recent weeks, as the data showed that the economy bounced back readily from the lockdown.

While the depth of the Q2 hit to the economy is of interest, what's more crucial is how far the rebound extends. Assuming no new Level 4 lockdown, we're forecasting GDP to jump by around 8% in the September quarter and almost 4% in the December quarter. That would bring GDP to around 5% below its pre-Covid trend by the end of the year. However, that gap represents the loss of international travel and tourism due to border closures, so is likely to persist for some time.

The impact of Covid-19 will also be felt in next Wednesday's balance of payments release for the June quarter. Reduced demand during the lockdown meant a drop in imports, in turn improving the trade balance. We expect the current account deficit to narrow to 2.6% of GDP, compared to what we expect to be a revised 3.2% of GDP in March.

Q2 GDP, 17 September.

Pinning down a June quarter GDP estimate is extremely difficult, in terms of both what actually happened and in how well the GDP methodology will capture this. Stats NZ has had to go beyond its usual data sources to try to capture the extraordinary changes with the quarter, and some of the data they have used isn't available to us. With that in mind, we're not going to dwell too much on the specifics of our forecast, particularly around how the hit is allocated across sectors.

That said, there is a clear hierarchy. Those sectors directly affected by the border closures will be hit hardest. That includes transport, which we estimate could be down by as much as a half (led by air travel, which was down by around 95%), and accommodation and hospitality.

Next will be those sectors that were deemed 'non-essential services' during the level 4 lockdown, which includes non-food manufacturing, construction, and some retailing and personal services. These sectors were effectively out of action for one-third of the quarter, although in most cases the indicators suggest that the hit to activity was less than this, reflecting the economy's quick rebound and the extent of pent-up demand as the alert level was lowered.

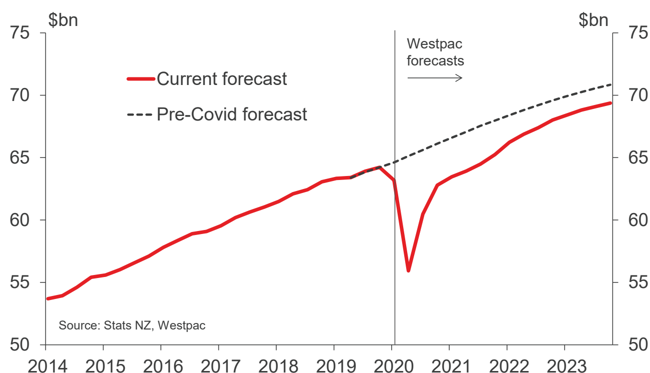
Those sectors that fared best will be those that were most able to operate under level 4, either due to being deemed 'essential' or being able to continue working from home. That includes agriculture, food manufacturing, finance, some professional services, and government. That said, some of them will still have taken a sizeable hit from the drop in domestic demand during the lockdown.

The expenditure measure of GDP usually gets less attention than the production measure, as it's considered less reliable on a quarter-to-quarter basis. However, this time it may do a better job of elucidating the impact of Covid-19. We estimate a 14% drop in household spending, and an even larger decline in construction (deemed non-essential under level 4) and business investment. However, this was accompanied by a sharp drop in goods imports, dampening the impact on New Zealand's GDP.

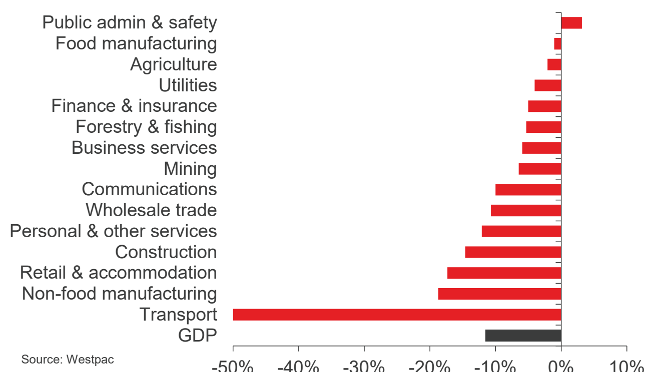
Goods exports fell by about 7%. The biggest declines were in wood products and manufactured goods – again, non-essential sectors – which suggests that the drop was due to the lockdown more so than a drop in domestic demand. Subsequent trade data has shown a strong rebound. Trade in services was down sharply, due to the loss of international travel in both directions.

We expect a positive contribution from government spending, though this is highly uncertain. Bear in mind that this component only captures final demand from government – services such as education, health and law and order. Most of the Government support provided during the lockdown was in the form of transfers to households and businesses, the largest of which was the wage subsidy scheme. Consequently, the main impact on GDP was probably in the form of preventing an even bigger drop in consumer spending.

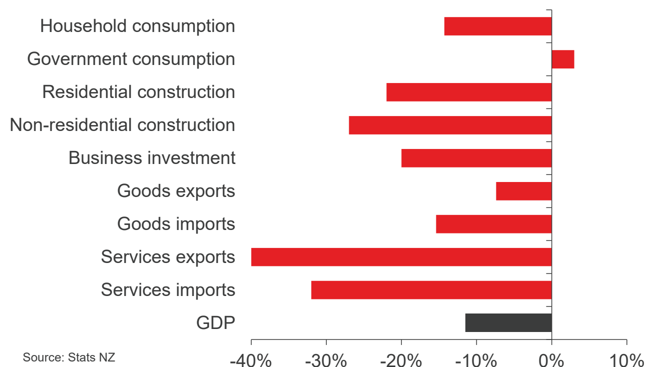
Level of quarterly GDP



Q2 GDP forecasts by production



Q2 GDP forecasts by expenditure

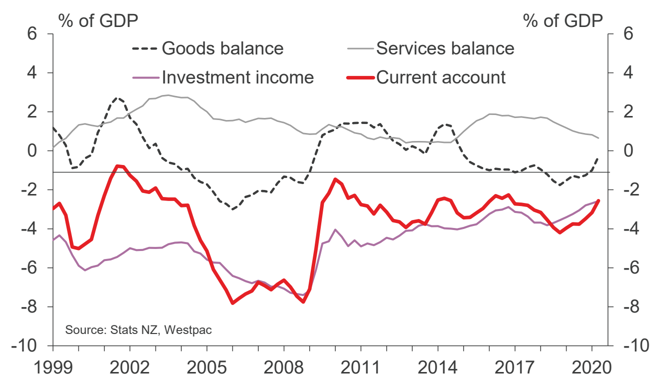


Q2 current account, 16 September.

We expect the current account deficit to narrow to 2.6% of GDP in the June quarter. The main driver, as detailed above, was a sharp drop in imports of goods, which led to an improvement in the trade balance. This outweighed the fall in the services balance, due to the (net) drop in tourism spending. We also expect a fall in investment income outflows, due to lower interest rates on overseas debt and lower profits for overseas-owned firms in New Zealand.

Our expected published result of -2.6% understates the extent of the narrowing in the deficit. Stats NZ will be revising the figures over the last few years to incorporate new data sources. In particular, digital imports have been revised sharply higher – Kiwis have spent much more on binge-watching than was previously recorded. This new data will increase the current account deficit over the last few years by as much as 0.5% of GDP – that is, we expect the March quarter deficit to be revised from 2.7% to 3.2%.

Annual current account balance



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