WESTPAC ECONOMIC BULLETIN

GDP review, March quarter 2022.

16 June 2022

Michael Gordon, Acting Chief Economist
+64 9 336 5670
michael.gordon@westpac.co.nz

Paths of glory.

- GDP dipped by 0.2% in the March quarter, close to our forecast of a flat result.
- Covid continued to disrupt activity, with the Omicron wave keeping many people at home.
- Notwithstanding the modest fall in GDP, the economy is still running above its non-inflationary potential.
- For the Reserve Bank, the task that lies ahead is to realign demand and supply in a way that avoids unnecessary volatility.
- In that light, the RBNZ won't be too concerned if it finds itself on a quicker adjustment path than it expected.
- Though that would imply that interest rates won't need to go as high as the RBNZ's projections.
- Our forecast remains for the OCR to peak at 3.5% at the end of this year.

Key results	Mar 22	Dec 21	Westpac f/c	Market f/c
GDP qtr %	-0.2%	3.0%	0.0%	0.6%
GDP ann %	1.2%	3.1%	1.8%	2.4%
GDP ann avg %	5.1%	5.7%	5.2%	5.3%

The 0.2% drop in GDP for the March quarter was close to our expectation of a flat result. As we highlighted in our preview, Covid has continued to disrupt the economy in varying ways. While the previous two quarters were affected by Government-imposed restrictions as a result of the Delta outbreak, in the March quarter the restrictions were largely self-determined ones. People stayed away from retail spaces out of caution, and the surge in infections meant that worker absenteeism proved to be a major headache for many businesses.

We also noted in our preview that: "A flat forecast does mean there's a good chance that GDP could go backwards for the quarter. But that wouldn't tell us anything about the prospects of a recession this year." So while we can't quite claim credit for predicting this result, the second point still stands. Even with a slight pullback in the last quarter, there is every indication that the level of economic activity is running too hot, not too cold.

The disruptive effects of Covid also mean that the GDP figures are more volatile than normal, with a higher chance of a one-quarter drop at any point in time. Indeed, this isn't the first one that we've seen in recent times. After the initial Covid lockdown ended in 2020, GDP surged by 13.7% in the September quarter, followed by a 0.4% drop in the December quarter. That fall was a combination of catch-up activity petering out, and a disruption in the usual patterns of spending during what would have been the peak of the international tourist season. Both of

those factors appear to have played a role in the latest quarter as well.

The result was softer than the 0.7% rise that the Reserve Bank forecast in its May *Monetary Policy Statement*, although that was prepared without the benefit of recent data that shed more light on the extent of the Covid impact. Still, a surprise is a surprise. So where does that leave the outlook for monetary policy after today's figures – especially in light of the market's enthusiasm for pricing in ever-larger OCR increases, egged on by overseas developments?

Paths of adjustment.

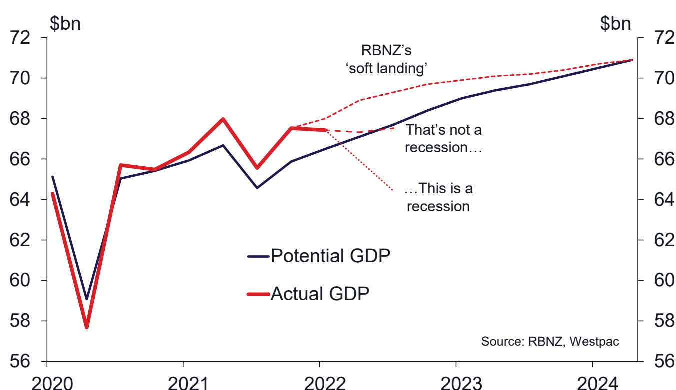
We suspect that the Reserve Bank will actually be quite comfortable with a slightly softer GDP result. Its task has been to realign demand and supply in the economy in order to bring inflation pressures to heel. If that realignment happens sooner – as long as it happens in a controlled way – then so much the better.

It would mean that the RBNZ wouldn't have to raise the Official Cash Rate as high as the 4% peak that it was projecting in May, but that's fine too. The RBNZ wants to be vindicated on its inflation forecasts, not its interest rate forecasts. And market forecasters should be fine with that too, since none of them were predicting the OCR to go that high anyway. Our forecast remains for a peak of 3.5% by the end of this year.

The RBNZ had previously estimated that the economy was running about 2% above its non-inflationary potential – that is, demand exceeded our ability to meet it, at least without leading to rising prices. That left the RBNZ with the challenge of realigning demand and supply in a way that would bring inflation under control without imposing unnecessary pain on businesses and consumers.

The RBNZ's expected path of adjustment – the 'soft landing' shown in the chart below – assumed very low but still positive growth in activity over the next few years, while the economy's capacity caught up. That certainly ticks the box of avoiding unnecessary pain, but it comes with the risk that it might not be enough to anchor inflation at the 2% target midpoint. After all, this path would see the economy running above its non-inflationary potential for almost four years before closing the gap.

Potential paths of adjustment



Another – hypothetical – path of adjustment would be a swifter closing of the gap, over a few quarters rather than a few years. That might involve two consecutive quarters of falling GDP, but that wouldn't really be in the spirit of what we call a 'recession'. A true recession would see a sharper drop in activity to below its potential, with a meaningful rise in unemployment and a rapid drop-off in domestic wage and price pressures.

Today's GDP result puts us a bit closer to that 'quick adjustment' middle path. We should be careful of reading this too literally – the details of the GDP figures suggest that the economy's potential may have also been more restrained over the quarter than the RBNZ assumed. Nevertheless, the RBNZ wouldn't be displeased to find that it's closer to achieving its goal than it expected.

We don't expect a second drop in GDP in the June quarter – in fact we've pencilled in a 1% rise. Fewer Omicron disruptions, and the gradual reopening of the border, will provide a more supportive environment for growth. More broadly, we're expecting modest growth in the economy over the rest of this year, though with a fairly subdued outlook for consumer spending as it bears the brunt of rising interest rates and falling house prices.

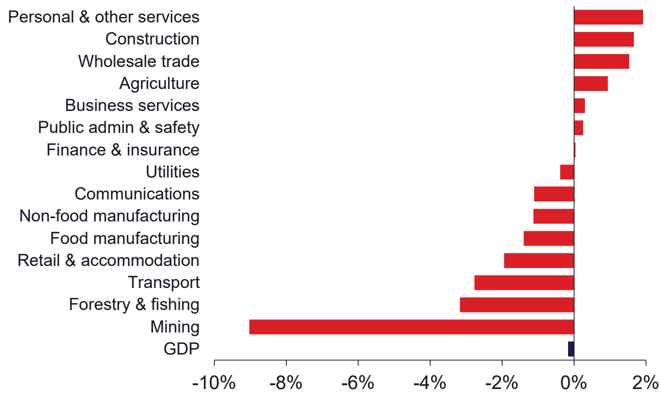
Details.

The Omicron wave kept a lot of people at home at times during the March quarter, either out of caution or because they were self-isolating. Accordingly, some of the weakest contributors to GDP were retail trade (-2.4%) and transport (-2.8%). Hospitality saw a more modest 0.6% decline, but that was relative to an already very weak December quarter. The biggest percentage falls were in fishing and mining, but these are two small and volatile sectors that tell us little about the overall state of the economy.

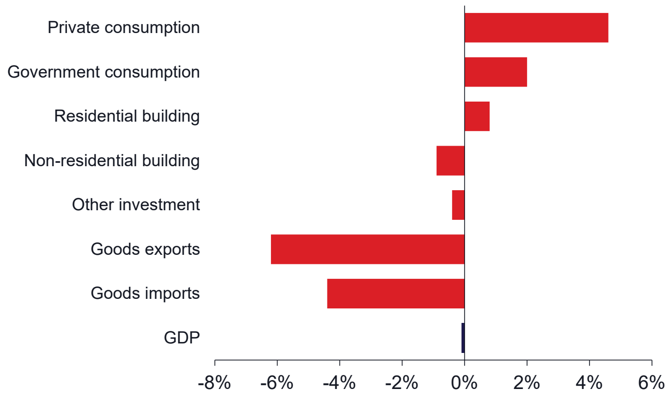
One aspect of GDP that we haven't remarked on much before is that the agricultural sector has been doing it tough on volumes lately (though prices have been strong). On-farm production was actually a little higher this quarter – the big drop happened in the previous two quarters – but the downstream effects were apparent. Food manufacturing was down 1.4% for the quarter, with particular weakness in fruit processing and beverages. And on the expenditure measure of GDP, goods exports were down a whopping 6%. That also weighed on output for the transport sector, due to lower port volumes.

On the more positive side, consumer spending was still perky over the quarter – not so much on the retail side, but with a surge in spending on services. Residential and non-residential construction continued to lift, although infrastructure dropped back after a surge of catch-up work in the December quarter.

Q1 GDP growth by production



Q1 GDP growth by expenditure



Contact the Westpac economics team

Michael Gordon, Acting Chief Economist
+64 9 336 5670

Satish Ranchhod, Senior Economist
+64 9 336 5668

Nathan Penny, Senior Agri Economist
+64 9 348 9114

Paul Clark, Industry Economist
+64 9 336 5656

Any questions email:
economics@westpac.co.nz

Disclaimer

Things you should know

Westpac Institutional Bank is a division of Westpac Banking Corporation ABN 33 007 457 141 ('Westpac').

Disclaimer

This material contains general commentary, and market colour. The material does not constitute investment advice. Certain types of transactions, including those involving futures, options and high yield securities give rise to substantial risk and are not suitable for all investors. We recommend that you seek your own independent legal or financial advice before proceeding with any investment decision. This information has been prepared without taking account of your objectives, financial situation or needs. This material may contain material provided by third parties. While such material is published with the necessary permission none of Westpac or its related entities accepts any responsibility for the accuracy or completeness of any such material. Although we have made every effort to ensure the information is free from error, none of Westpac or its related entities warrants the accuracy, adequacy or completeness of the information, or otherwise endorses it in any way. Except where contrary to law, Westpac and its related entities intend by this notice to exclude liability for the information. The information is subject to change without notice and none of Westpac or its related entities is under any obligation to update the information or correct any inaccuracy which may become apparent at a later date. The information contained in this material does not constitute an offer, a solicitation of an offer, or an inducement to subscribe for, purchase or sell any financial instrument or to enter a legally binding contract. Past performance is not a reliable indicator of future performance. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The ultimate outcomes may differ substantially from these forecasts.

Country disclosures

Australia: Westpac holds an Australian Financial Services Licence (No. 233714). This material is provided to you solely for your own use and in your capacity as a wholesale client of Westpac.

New Zealand: In New Zealand, Westpac Institutional Bank refers to the brand under which products and services are provided by either Westpac or Westpac New Zealand Limited ("WNZL"). Any product or service made available by WNZL does not represent an offer from Westpac or any of its subsidiaries (other than WNZL). Neither Westpac nor its other subsidiaries guarantee or otherwise support the performance of WNZL in respect of any such product. The current disclosure statements for the New Zealand branch of Westpac and WNZL can be obtained at the internet address www.westpac.co.nz. For further information please refer to the Product Disclosure Statement (available from your Relationship Manager) for any product for which a Product Disclosure Statement is required, or applicable customer agreement.

China, Hong Kong, Singapore and India: This material has been prepared and issued for distribution in Singapore to institutional investors, accredited investors and expert investors (as defined in the applicable Singapore laws and regulations) only. Recipients in Singapore of this material should contact Westpac Singapore Branch in respect of any matters arising from, or in connection with, this material. Westpac Singapore Branch holds a wholesale banking licence and is subject to supervision by the Monetary Authority of Singapore. Westpac Hong Kong Branch holds a banking license and is subject to supervision by the Hong Kong Monetary Authority. Westpac Hong Kong branch also holds a license issued by the Hong Kong Securities and Futures Commission (SFC) for Type 1 and Type 4 regulated activities. This material is intended only to "professional investors" as defined in the Securities and Futures Ordinance and any rules made under that Ordinance. Westpac Shanghai and Beijing Branches hold banking licenses and are subject to supervision by the China Banking and Insurance Regulatory Commission (CBIRC). Westpac Mumbai Branch holds a banking license from Reserve Bank of India (RBI) and subject to regulation and supervision by the RBI.

UK: The contents of this communication, which have been prepared by and are the sole responsibility of Westpac Banking Corporation London and Westpac Europe Limited. Westpac (a) has its principal place of business in the United Kingdom at Camomile Court, 23 Camomile Street, London EC3A 7LL, and is registered at Cardiff in the UK (as Branch No. BR00106), and (b) authorised and regulated by the Australian Prudential Regulation Authority in Australia. Westpac is authorised in the United Kingdom by the Prudential Regulation Authority. Westpac is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request. Westpac Europe Limited is a company registered in England (number 05660023) and is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.

This communication is being made only to and is directed at (a) persons who have professional experience in matters relating to investments who fall within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "Order") or (b) high net worth entities, and other persons to whom it may otherwise lawfully be communicated, falling within Article 49(2)(a) to (d) of the Order (all such persons together being referred to as "relevant persons"). Any person who is not a relevant person should not act or rely on this communication or any of its contents. The investments to which this communication relates are only available to and any invitation, offer or agreement to subscribe, purchase or otherwise acquire such investments will be engaged in only with, relevant persons. Any person who is not a relevant person should not act or rely upon this communication or any of its contents. In the same way, the information contained in this communication is intended for "eligible counterparties" and "professional clients" as defined by the rules of the Financial Conduct Authority and is not intended for "retail clients". With this in mind, Westpac expressly prohibits you from passing on the information in this communication to any third party. In particular this communication and, in each case, any copies thereof may not be taken, transmitted or distributed, directly or indirectly into any restricted jurisdiction. This communication is made in compliance with the Market Abuse Regulation (Regulation(EU) 596/2014).

Investment recommendations disclosure

The material may contain investment recommendations, including information recommending an investment strategy. Reasonable steps have been taken to ensure that the material is presented in a clear, accurate and objective manner. Investment Recommendations for Financial Instruments covered by MAR are made in compliance with Article 20 MAR. Westpac does not apply MAR Investment Recommendation requirements to Spot Foreign Exchange which is out of scope for MAR.

Unless otherwise indicated, there are no planned updates to this Investment Recommendation at the time of publication. Westpac has no obligation to update, modify or amend this Investment Recommendation or to notify the recipients of this Investment Recommendation should any information, including opinion, forecast or estimate set out in this Investment Recommendation change or subsequently become inaccurate.

Westpac will from time to time dispose of and acquire financial instruments of companies covered in this Investment Recommendation as principal and act as a market maker or liquidity provider in such financial instruments.

Westpac does not have any proprietary positions in equity shares of issuers that are the subject of an investment recommendation.

Westpac may have provided investment banking services to the issuer in the course of the past 12 months.

Westpac does not permit any issuer to see or comment on any investment recommendation prior to its completion and distribution.

Individuals who produce investment recommendations are not permitted to undertake any transactions in any financial instruments or derivatives in relation to the issuers covered by the investment recommendations they produce.

Westpac has implemented policies and procedures, which are designed to ensure conflicts of interests are managed consistently and appropriately, and to treat clients fairly.

The following arrangements have been adopted for the avoidance and prevention of conflicts in interests associated with the provision of investment recommendations.

(i) Chinese Wall/Cell arrangements;
(ii) physical separation of various Business/Support Units;
(iii) and well defined wall/cell crossing procedures;
(iv) a "need to know" policy;
(v) documented and well defined procedures for dealing with conflicts of interest;
(vi) steps by Compliance to ensure that the Chinese Wall/Cell arrangements remain effective and that such arrangements are adequately monitored.

U.S: Westpac operates in the United States of America as a federally licensed branch, regulated by the Office of the Comptroller of the Currency. Westpac is also registered with the US Commodity Futures Trading Commission ("CFTC") as a Swap Dealer, but is neither registered as, or affiliated with, a Futures Commission Merchant registered with the US CFTC. Westpac Capital Markets, LLC ('WCM'), a wholly-owned subsidiary of Westpac, is a broker-dealer registered under the U.S. Securities Exchange Act of 1934 ('the Exchange Act') and member of the Financial Industry Regulatory Authority ('FINRA'). This communication is provided for distribution to U.S. institutional investors in reliance on the exemption from registration provided by Rule 15a-6 under the Exchange Act and is not subject to all of the independence and disclosure standards applicable to debt research reports prepared for retail investors in the United States. WCM is the U.S. distributor of this communication and accepts responsibility for the contents of this communication. All disclaimers set out with respect to Westpac apply equally to WCM. If you would like to speak to someone regarding any security mentioned herein, please contact WCM on +1 212 389 1269. All disclaimers set out with respect to Westpac apply equally to WCM.

Investing in any non-U.S. securities or related financial instruments mentioned in this communication may present certain risks. The securities of non-U.S. issuers may not be registered with, or be subject to the regulations of, the SEC in the United States. Information on such non-U.S. securities or related financial instruments may be limited. Non-U.S. companies may not subject to audit and reporting standards and regulatory requirements comparable to those in effect in the United States. The value of any investment or income from any securities or related derivative instruments denominated in a currency other than U.S. dollars is subject to exchange rate fluctuations that may have a positive or adverse effect on the value of or income from such securities or related derivative instruments.

The author of this communication is employed by Westpac and is not registered or qualified as a research analyst, representative, or associated person under the rules of FINRA, any other U.S. self-regulatory organisation, or the laws, rules or regulations of any State. Unless otherwise specifically stated, the views expressed herein are solely those of the author and may differ from the information, views or analysis expressed by Westpac and/or its affiliates.