WESTPAC ECONOMIC BULLETIN

Preview of June quarter GDP (15 September, 10:45am).

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Double, or nothing?

- We expect a 1.6% rise in GDP for the June quarter. This follows a 0.2% drop in the March quarter as Omicron swept through the country.
- The reopening of the border, and the resumption of overseas tourism, is expected to provide a significant boost to areas such as travel services, accommodation, and arts and recreation.
- A result in line with our view would emphasise that the New Zealand economy remains far from recession. Indeed, the challenge is one of an economy that is running too hot.

	Mar-22 actual	Jun-22 Westpac f/c	Jun-22 RBNZ f/c
GDP			
Quarterly % chg	-0.2	1.6	1.8
Annual % chg	1.2	0.5	0.6
Annual average % chg	5.1	1.1	1.2

New Zealand recorded a 0.2% drop in GDP in the March quarter as the Omicron wave swept through the country. That wasn't all that far from our forecast of a flat result. But with recession risks already on people's minds, that inevitably sparked an interest in what the June quarter figures would hold. Would we see a second quarter of decline, meeting the 'technical' criteria for a recession? Or would it turn out to be nothing, simply a product of noisy data in an unusual environment?

With all the available data now to hand, it looks more likely that the March drop was a big nothing – we estimate that GDP bounced by 1.6% in the June quarter. That's an upgrade from our initial forecast of a 1% rise, and is closer to the 1.8% increase that the Reserve Bank forecast in its recent *Monetary Policy Statement*.

That said, the margin of uncertainty around our forecast – already quite wide throughout the pandemic – is particularly large this time. There were some big forces operating on the economy through the June quarter – not just the easing of the Omicron wave, but also the scaling back of the Covid response. And most importantly, the reopening of the border has seen the return of overseas tourists during what would normally have been the seasonal lull. We're expecting to see some big sectoral shifts in both directions, and it's not at all clear where the balance will lie.

Transport and accommodation were the obvious beneficiaries from the return of overseas tourists. The challenge has been in identifying what they did once they got here. They clearly weren't hitting the shops – retail spending was down more than 2% for the quarter. Instead, the gains will come through in sectors such as administrative services (which includes tour operators) and arts and recreation.

A number of sectors appear to have benefited from the easing of the Omicron wave over the June quarter, in particular the reduced degree of worker absences. We expect around a 4% lift in food manufacturing, helped by meatworks operating closer to full capacity, as well as improved growing conditions relative to previous quarters. Construction, non-food manufacturing and professional services are also expected to see an uptick to varying degrees.

Some of the sectoral details of GDP will need to be read with caution. The Marsden Point oil refinery was decommissioned in April and became an import-only facility. That means for GDP purposes its activities have been reclassified from manufacturing to wholesale and distribution. Without that effect, we'd be expecting to see a solid lift in non-food manufacturing, but a drop in wholesale trade, for the June quarter.

There are two areas where we expect to see a meaningful drag on GDP. The first is mining, with substantially lower oil and gas extraction during the quarter. That said, mining is a small sector (the decline knocks maybe 0.1% off total GDP growth for the quarter) and it doesn't tell us much about the health of the wider economy.

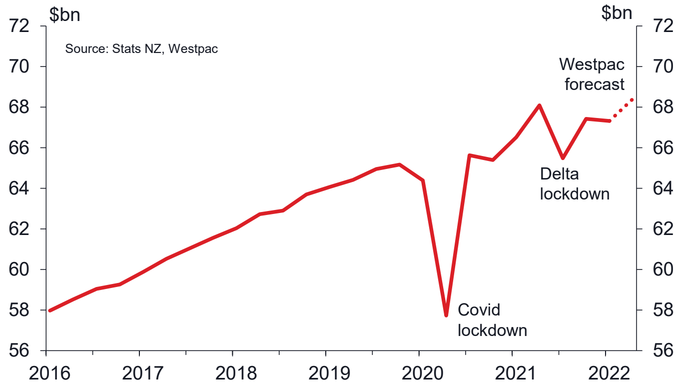
The second is healthcare. That, however, is more about returning to normal levels of activity. The Covid vaccination programme has largely wound down, as has PCR testing, with home tests taking over.

In New Zealand the production measure of GDP is generally considered more reliable, compared to the expenditure approach that's often favoured overseas. That's going to be particularly true for the June quarter figures. For one, the absence of overseas tourists until now has completely thrown off the usual seasonal patterns in services exports. Stats NZ also notes that there are issues with identifying how consumer spending is apportioned between tourists and New Zealand households, so that increased volatility has affected the household consumption figures as well. The production measure of GDP is much less affected by these issues.

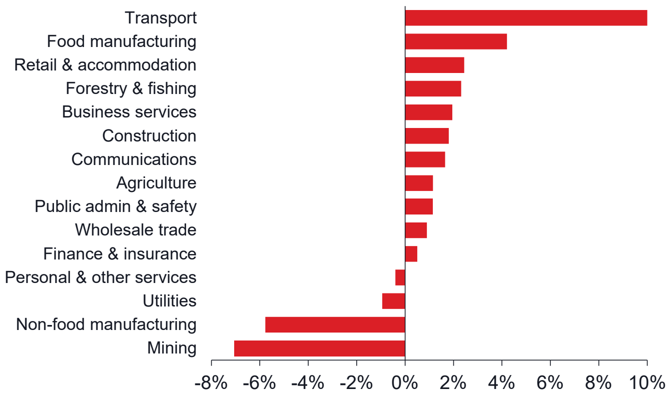
A bounce in GDP in line with our forecasts would leave us with a picture of an economy that's still operating well above its sustainable potential. The Reserve Bank's task will be to close that gap in a timely manner in order to bring inflation pressures to heel, while also avoiding unnecessary volatility in the economy. We're already well down the path of higher interest rates, and we expect to see those have an increasing impact on activity in the months ahead.

But this process could take quite some time to play out, before we see the benefits of a return to low and stable inflation. So it's likely that some parts of the economy (such as the household sector) will have some pain to wear in the years ahead, even as other sectors such as tourism begin their recovery.

Level of quarterly GDP



Q2 GDP forecast by production



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