WESTPAC ECONOMIC BULLETIN

GDP review, June quarter 2022.

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Haere mai.

- GDP rose by 1.7% in the June quarter, coming in very close to our forecast of 1.6%.
- The return of tourists as New Zealand reopened its border provided a hefty lift in services sector activity.
- Today's result confirmed that the 0.2% drop in GDP in the March quarter was due to temporary factors. It wasn't a case of avoiding recession so much as never really being in danger of one.
- That said, there are signs of a cooling in domestic demand. This is likely to continue as interest rates rise and as spending returns towards pre-Covid patterns.
- The GDP result was right in line with the Reserve Bank's view. We continue to expect the OCR to peak at the end of this year.

Key results	Jun 22	Mar 22	Westpac f/c	Market f/c
GDP qtr %	**1.7**	-0.2	1.6	1.0
GDP ann %	**0.4**	1.0	0.5	0.0
GDP ann avg %	**1.0**	5.0	1.1	-

New Zealand recorded a strong 1.7% rise in GDP in the June quarter. That was very close to our forecast of 1.6%, and was substantially ahead of the median market forecast of a 1% rise. Today's result means that the economy has more than made up for the 0.2% drop in the previous quarter.

This wasn't a case of avoiding recession so much as not really being in danger of it in the first place. Our assessment at the time was that the March quarter drop was due to two temporary factors: disruptions to activity during the peak of the Omicron wave, and the absence of the uplift in tourist spending that we'd normally see at that time of year.

As we expected, both of those effects were reversed out in the June quarter. Covid cases eased off after peaking in March, with the country moving from the 'red' to the 'orange' traffic light setting, and worker absences becoming less of a constraint. We should note that we're not entirely free of Covid's influence as far as the near-term data goes – there was a sizeable second wave of Omicron through July.

More importantly, the phased reopening of the border since the end of February meant a strong lift in visitor numbers during what normally would have been the seasonal lull. The numbers themselves are still subdued – visitor numbers over the June quarter were around 20% of pre-Covid levels. But going from nothing to something can have a big impact on rates of growth.

That was evident in the spectacular quarterly gains recorded in some sectors. Accommodation and dining out was up by 30%, transport up 20%, and arts and recreational services up 20%. Administrative services, a group that includes travel agencies and tour operators, saw a 4.7% rise. The biggest uncertainty for our forecast was around the scale of the impact in these sectors, as they tend to be on the light side in terms of 'early indicator' data.

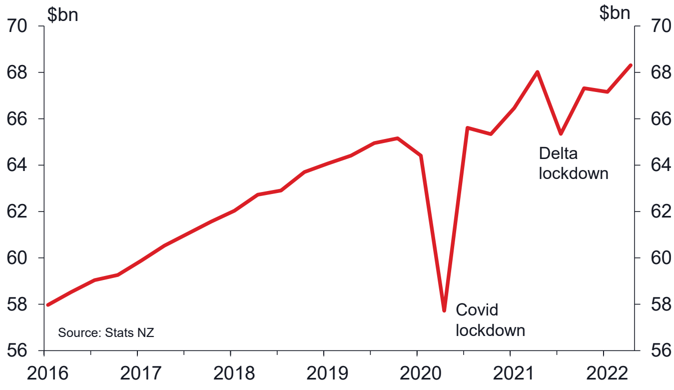
Even with the strong overall result, it's important to note that there are parts of the economy that were in decline. Retail sales were down 3.7%, mining shrank by another 8%, construction saw a surprising 2.4% fall, and non-food manufacturing (excluding petroleum) fell by 1.3%.

The reason we exclude petroleum manufacturing in the above figures is that the Marsden Point oil refinery was decommissioned in April and became an import-only facility. As a result, for GDP purposes its activities were reclassified from manufacturing to wholesaling. We don't have enough information to say whether there was a net impact on GDP, but it's likely that without the reclassification, the 1.7% rise in wholesale trade would have been a negative number instead. Given how many other sectors that the wholesale industry touches, it often serves as a bellwether for what's happening in the wider economy.

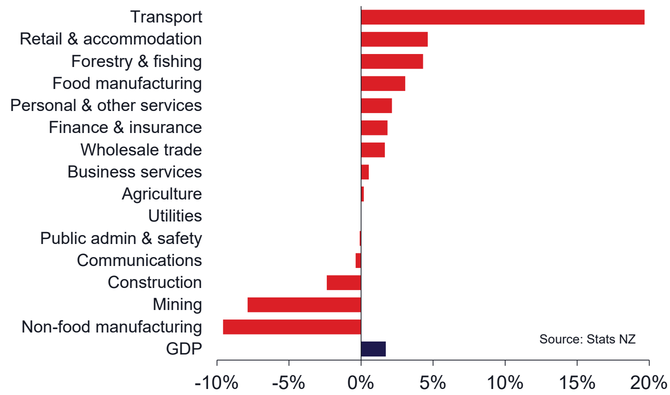
The overall picture is one of rebalancing, as both New Zealand and the world move beyond Covid restrictions. The parts of the economy that had been running the hottest in the last couple of years – as people switched their spending away from services and towards physical goods – now face a return to more sustainable levels of activity. At the same time, travel spending in particular, which was a sizeable net positive for New Zealand before the border closure, is just starting its recovery.

With today's result very much in line with the RBNZ's forecast of a 1.8% rise, there are no obvious implications for the interest rate outlook. The heart of the issue is that the economy is still running above its non-inflationary potential. Higher interest rates will work to close that gap over time, but the challenge is in managing that process. Doing too little means that inflation could become stubbornly persistent; too much could mean an unnecessary period of weak activity and high unemployment. We agree with the RBNZ that lifting the Official Cash Rate to 4% and holding it there would give the best chance of striking that balance.

Level of quarterly GDP



Q2 GDP growth by production



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