

Economic Note

Q2 2024 GDP Review

19 September 2024

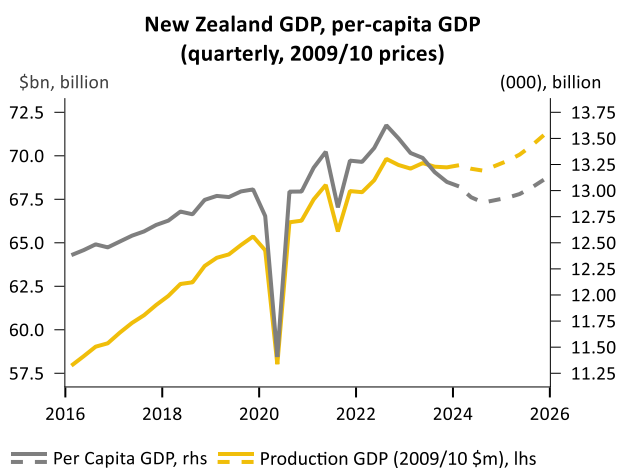
Economy stumbles in Q2

- NZ economic activity fell 0.2% qoq in Q2 2024, roughly in line with our expectations.
- The key driver of this quarter’s outturn was a fall in the primary sector, but there were signs of weakness throughout the data.
- We don’t expect the data to change the outlook for the RBNZ, and we expect another 50bp of OCR cuts before the year is out.

| GDP | Actual | ASB | Market | RBNZ |
|------------------------|--------|------|--------|------|
| Production GDP (% QoQ) | -0.2 | -0.3 | -0.4 | -0.5 |
| Production GDP (% YoY) | -0.5 | -0.5 | -0.6 | -0.7 |

Real production-based GDP fell 0.2 qoq in the June quarter (-0.5% yoy). The print was largely in line with what we were expecting but slightly stronger than RBNZ forecasts in the August MPS. There were some minor revisions to previous quarters – for example, Q1 2024 GDP was revised lower from 0.2% qoq, to 0.1% qoq, and the H2 2023 technical recession has been revised away. Overall, the revisions don’t change the wider picture being one of a weak economic backdrop.

Revised data show that this was the fourth quarterly contraction in GDP in the last seven quarters. Moreover, the data show that the NZ economy has shrunk to levels not seen since Q1 2023. As expected, there remains pronounced weakness in the per-capita measures. GDP per capita fell 0.5% qoq, to be 2.7% lower than a year ago and has shrunk 4.6% since the peak in Q3 2022. This highlights the underlying weakness in the economy at a time when population growth has been robust. While population growth is now slowing as net migration eases, it will remove what has been one of the key tailwinds for the NZ economy over the past two or so years.



Source: Macrobond, ASB

The primary sector was the predominant driver of the fall in GDP in Q2. Agriculture, forestry and fishing production fell 1.4% qoq. As expected, there was a sharp 10.4% qoq fall in forestry and logging, with agricultural production also down -0.4%. We have noted lately that there has been a lift in commodity prices, but the volume story for some of our key commodity exports remains more muted. We do expect a recovery in demand in some of our export markets as other central banks also ease interest rates. However, the outlook for a lift in Chinese demand remains subdued.

The goods-producing sector was slightly stronger than we had anticipated in Q2, lifting 0.7% qoq. The strength was predominantly driven by the non-food manufacturing sector, which we had expected. Food manufacturing production fell 1.2% qoq in the quarter. Within the non-food manufacturing segments, transport equipment, machinery & equipment manufacturing led the rise, up 8.1% qoq. Volatility remained a key theme in the petrochemical sub-sector, rising 7.9% qoq, following a 18.2% fall in Q1. However, we don't expect the strength in the manufacturing sector to continue into Q3, with numerous disruptions to production (as well as a handful of manufacturing businesses closing) amid the sharp rise in electricity prices in the quarter. Construction activity fell 0.4% qoq, as expected, and aligns with building work put in place data that were released ahead of GDP. The weak housing market, still reasonably high construction costs and heightened economic uncertainty have had a material impact on the residential construction sector.

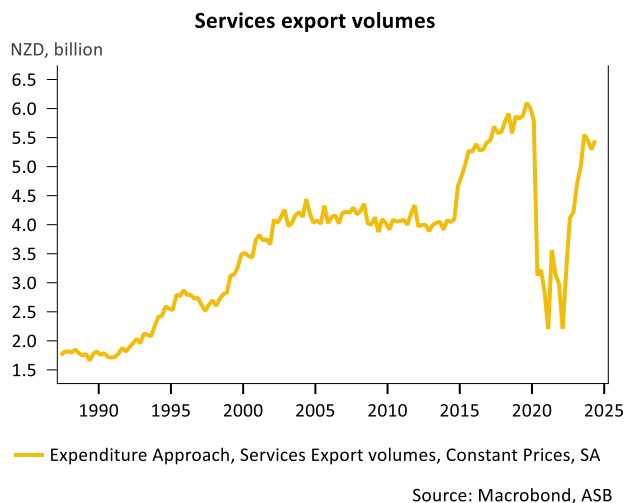
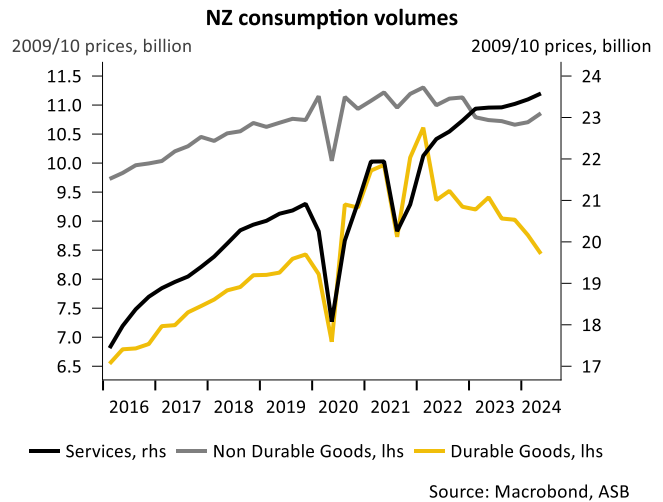
Services activity was mixed, but on balance was flat over the quarter. The largest falls were in wholesale trade and retail trade & accommodation services, in line with our expectations. Both sectors declined 1.3% qoq. Within retail trade & accommodation, accommodation led the decline (down 1.9% yoy) highlighting the combination of weak domestic demand and plateauing overseas tourism arrivals.

The unallocated component fell, following Q1's 6.5% qoq lift. The 2.7% fall detracted 0.2ppts from headline GDP. The unallocated component includes taxes on production and imports not included elsewhere, as well as the seasonal adjustment balancing item.

On a real expenditure basis, GDP was flat in Q2 2024, slightly stronger than we had expected. Private consumption rose 0.4% qoq, while Q1's 1.6% qoq lift was revised lower to 0.5%. Much of this revision was due to Stats NZ reallocating retail spending to tourists (and revising up services exports). Government expenditure rose 0.8% qoq, but we continue to expect the outlook for government expenditure is muted while the Government remains focussed on rebalancing the books.

The details highlighted that weakness in household demand remains, as durable spending fell 3.7% qoq (the seventh fall in the last 9 quarters) to be 2.8% lower on an annual basis. The substitution effect was also still evident in elevated growth in imports of low-value goods (+3.3% qoq). We expect to see households continuing to purchase from cheaper offshore platforms while cost of living pressures (and employment concerns) remain front of mind.

Gross capital formation rose 0.2% in Q2, following a 0.5% decline in Q1. Transport equipment (+3.1% qoq) and plant, machinery & equipment (+1.9% qoq) led the rise. Non-residential and residential buildings both declined (-0.8% qoq and -1.0% qoq, respectively). Goods exports fell by 4.4% qoq, offsetting a 3% qoq rise in services exports. As expected, last quarter's -13.2% qoq



fall in services exports was revised to a smaller -2.8% qoq fall. On balance, exports of goods and services fell 0.8% qoq. Meanwhile, goods and services imports fell 2.0% qoq, once again highlighting the weak demand backdrop in NZ. Net exports positively contributed to expenditure GDP in Q2 2024.

Where to from here

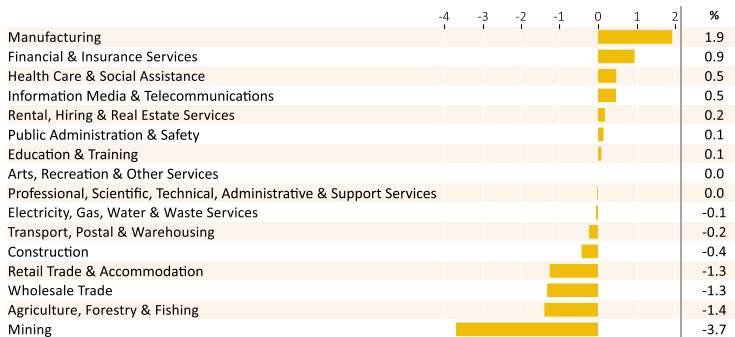
GDP data are rather volatile, with revisions to historical data slightly altering the historic trend, but not, in our opinion, changing the story. We expect even more revisions in Q3, when Stats NZ does its annual benchmark revisions.

Nevertheless, the data today highlight that the economy was indeed in a weak patch in Q2, with widespread evidence that private demand is soft and that this is flowing through to multiple sectors of the economy. Q3 data to date have been ‘better’ than the corresponding Q2 data, but these point to a stabilisation in activity, rather than a turnaround.

For the RBNZ, we don’t expect today’s GDP print will significantly alter the picture at present. The economy is weak, as to be expected after a prolonged period of restrictive monetary policy. Further OCR cuts should help to spur some economic growth (especially the interest rate sensitive sectors). However, ongoing headwinds, including our expectation for further weakening in the labour market, suggests we are unlikely to see a rapid turnaround in the economy. We expect a more pronounced recovery will become evident as we progress through 2025.

We continue to expect the RBNZ to cut the OCR by another 50bp in 2024 (25bp in October and November) with steady declines over 2025, taking the OCR to 3.25%. Overall, weak demand and a cooling labour market will help to reinforce that inflation is on track to fall back within target and, importantly, stay there. The possibility of a 50bp cut remains, especially if the RBNZ becomes more concerned about the labour market outlook and if the risks grow that inflation falls more rapidly than the RBNZ is factoring in – the pace is still very data dependent. Even with steady 25bp cuts, the OCR would remain in restrictive territory for some time.

NZ GDP by sector - quarterly %



Source: Macrobond, ASB

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