WESTPAC ECONOMIC BULLETIN

GDP review, December quarter 2021.

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An uneven bounce.

- GDP rose by 3% in the December quarter, reversing most of the 3.6% decline in the September quarter. The result was slightly below market forecasts.
- Activity rebounded strongly in the goods-producing sectors, indicating that the Covid measures in place over the quarter were less restrictive than we initially expected.
- In contrast, many in-person services saw further declines. These sectors are likely to remain under pressure in the near term as Omicron makes its way through the country.
- Today's result was stronger than what the Reserve Bank forecast in its February policy review. However, the details suggest a faster recovery in potential output, rather than a greater degree of overheating in the economy.

Key results	Dec 21	Sep 21	Westpac f/c	Market f/c
GDP qtr %	**3.0%**	-3.6%	3.8%	3.3%
GDP ann %	**3.1%**	-0.2%	3.9%	3.3%
GDP ann avg %	**5.6%**	4.9%	5.8%	5.7%

The New Zealand economy expanded by 3% in the December quarter last year. That made back most of the 3.6% decline seen in the September quarter, which had seen activity running hot until the country was sent back into Covid lockdown in August.

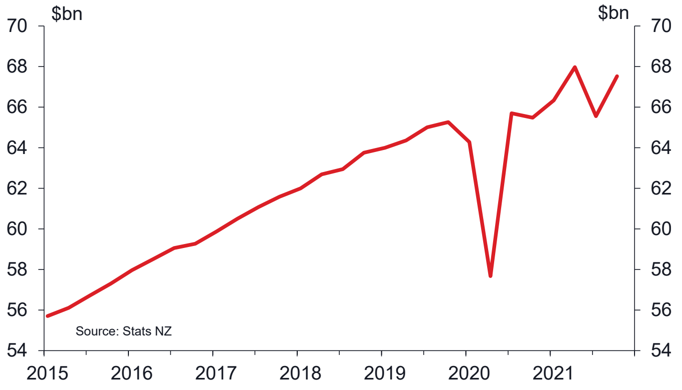
The result fell short of our 3.8% forecast on the day. However, we had initially expected a much more muted rebound, given that Covid restrictions were in place to varying degrees throughout the quarter. What today's results suggest is that those public health measures – indeed anything short of a Level 4 lockdown – are just not that limiting for many parts of the economy.

It might be tempting to dismiss this data as backward-looking, with the economy facing a new set of challenges already in 2022: the Omicron variant, the Russia-Ukraine conflict, growing inflation worries and falling house prices. But it's important to know where we're starting from to understand where we might be heading. In this case, the December quarter GDP data gives us a mixed picture of the economy's recovery. In some sectors, particularly those related to the production of physical goods, the post-lockdown rebound is already complete – limiting the scope for growth going forward. However, in service sectors like hospitality, the recovery still awaits on Covid developments.

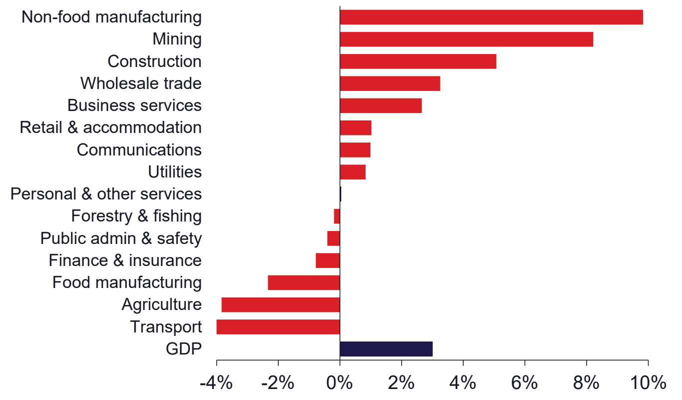
Today's result was above the 2.3% rise that the Reserve Bank forecast in its February Monetary Policy Statement (without the benefit of the more recent data releases that pointed to a stronger result). That doesn't make it another tick in the box for an even higher OCR track, however. The Reserve Bank's assumption was that both actual and potential output would be held back by Covid restrictions over the December quarter, with the economy still running 2% above its non-inflationary speed limit. What today's numbers suggest to us is that there was less restraint on the economy's potential than first thought.

We expect modest GDP growth over the course of 2022. The March quarter in particular isn't likely to be flash; indeed, the data flow over the next few months is going to be messy in a way that New Zealand hasn't seen so far in this pandemic – any weakness in activity will be due to behavioural changes in the face of Omicron rather than government-imposed restraints. However, the overseas experience also suggests that activity will pick up quickly again once people feel that the Omicron wave has passed its worst. And the gradual return of overseas tourists will provide an additional source of demand this year and beyond.

Level of quarterly GDP



Q4 GDP growth by sector



Details.

As we expected, the rebound in activity was strongest in the 'physical' world, where the Covid restrictions that were in place over the quarter were the least limiting on business activity. That included manufacturing, construction, wholesale trade and retailing (excluding hospitality).

In contrast, conditions in the services industries were more restrained. In particular, those focused on in-person activities such as education, hospitality and recreation went further backwards over the quarter. The notable exceptions were professional services (where a higher proportion of work can be done from home) and healthcare (an essential service during a Covid outbreak).

Agriculture was a notable point of weakness, down 3.8%. Milk collections were lower than usual for this time of the year due to poor weather, and there was a larger than expected drop in beef production. These also weighed on food manufacturing. Transport fell by 4% for the second straight quarter, most likely due to the restrictions on travel between regions.

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