20 March 2025

Recovery begins

- **GDP stronger than expected in Q4**
- **Noisy data likely overstates underlying progress**
- **Economic activity down 1.1% y/y**
- **Recovery underway; won't stop further OCR cuts**
- **More recovery expected in 2025**

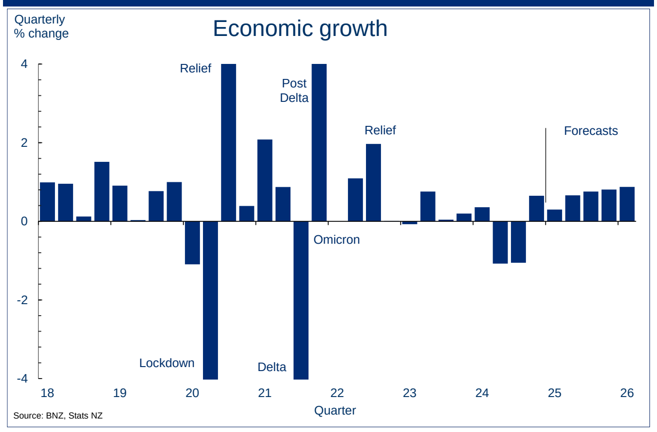
The NZ economy finished an abysmal 2024 with a lift in the final quarter. That was the main message from today's Q4 GDP figures.

GDP grew 0.7% in the final quarter of last year. That was much stronger than expected. The market consensus was looking for 0.4%, we had 0.2%, and the RBNZ had 0.3%.

We should say that the 0.7% figure wasn't completely out of the blue – that is what our GDE calculations pointed to. As it turned out, GDE rose 0.8% q/q in today's data.

Cue talk of NZ coming out of recession. Technically true, and it is a decent bounce in the quarterly numbers, but there remains a long recovery road ahead. On a per capita basis our forecasts suggest the previous peak in activity will not be achieved until early 2028.

Quarterly pop



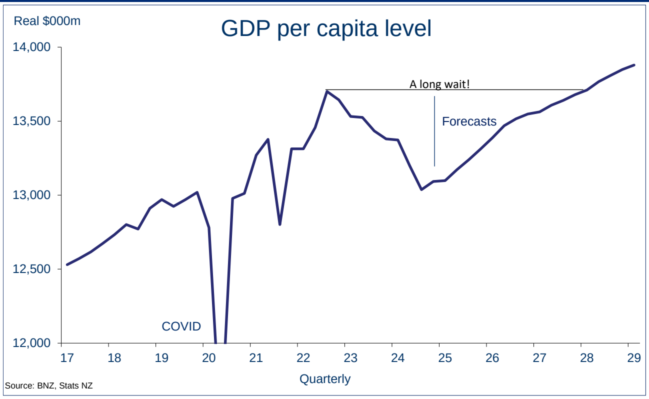
It is good to see the recovery we have long forecast has started. However, we are not convinced the underlying performance is as strong as the quarterly result suggests.

Ordinarily, such a quarterly surprise would have us wondering about the pace of underlying economic expansion we expect. But, frankly, quarter to quarter movements are currently very difficult to fully trust. The large upside quarterly surprise follows a big downside surprise in the previous quarter.

Component	qtr % chg prev qtr	% pt cont to chg	ann avg %chg	ann % chg
Expenditure on gross domestic product - December 2024 quarter				
Final consumption expenditure				
Private	0.1	0.0	0.2	0.1
General government	1.9	0.4	0.0	-0.1
Gross fixed capital formation				
Residential buildings	-3.9	-0.3	-10.2	-13.0
Other fixed assets	1.5	0.3	-2.2	-1.2
Exports of goods and services	3.5	0.8	4.2	3.5
Imports of goods and services	1.1	-0.3	2.4	6.0
Change in inventories and balancing ite	..	-0.1	..	..
Expenditure on gross domestic product	**0.8**	**0.8**	**-0.1**	**-0.4**

Industry	qtr % chg prev qtr	% pt cont to chg	ann avg %chg	ann % chg
Gross domestic product by industry - December 2024 quarter				
Agriculture, forestry, and fishing	1.4	0.1	4.4	3.3
Mining	-1.1	0.0	-10.3	-10.7
Manufacturing	0.3	0.0	-1.8	-2.2
Electricity, gas, water, and waste services	2.1	0.1	-0.9	-1.7
Construction	-3.1	-0.2	-7.3	-10.8
Wholesale trade	0.2	0.0	-4.1	-1.7
Retail trade and accommodation	1.9	0.1	-1.8	0.3
Transport, postal, and warehousing	2.4	0.1	-0.5	1.9
Information media and telecommunication	-3.0	-0.1	-1.3	-4.0
Financial and insurance services	0.5	0.0	1.2	1.1
Rental, hiring, and real estate services	1.1	0.2	3.8	3.4
Prof, scientific, technical, admin, and suppo	-0.2	0.0	-2.1	-2.9
Public administration and safety	-0.5	0.0	0.4	-3.6
Education and training	0.1	0.0	1.9	0.5
Health care and social assistance	1.9	0.1	3.1	1.4
Arts, recreation, and other services	1.9	0.1	-0.2	0.1
Unallocated(2)	-1.2	-0.1	-2.0	-4.1
Balancing item(3)	..	0.3	..	..
Gross domestic product	**0.7**	**0.7**	**-0.5**	**-1.1**

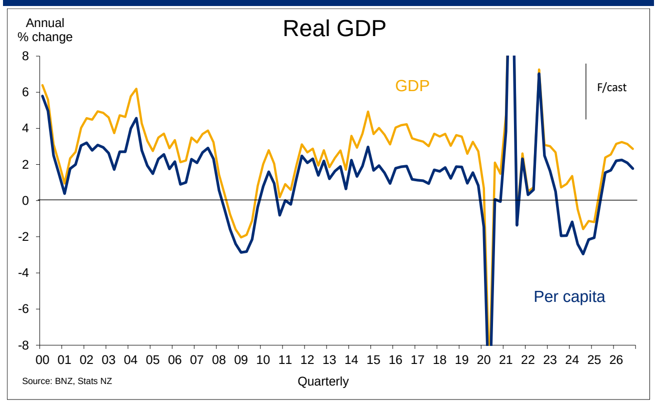
Long recovery road



There remains considerable noise in the detail, amid ongoing issues with seasonal adjustment following covid disruption. As an example of this, the ‘balancing item’ contributed nearly half (0.3 ppt) of the quarter’s growth and was most of the ‘surprise’ to us.

In the big picture, it is difficult to get too excited about a bounce in a quarter when even with that lift, economic activity is still 1.1% below year ago levels. And the 0.7% quarterly lift did not even recover the extent of the previous quarter’s fall.

Activity lower than a year ago



Quarterly growth was faster than the RBNZ’s estimate of potential, although annual growth remains well below. In any case, growth needs to be sustained to meaningfully close a wide output gap.

Some of today’s growth does not look sustainable. For example, the 2.1% q/q increase in utilities is a bounce from the weather and fuel driven Q3 energy crunch. The pace of growth here will not persist and indeed might reverse as dry conditions have hampered hydro lake levels again in Q1.

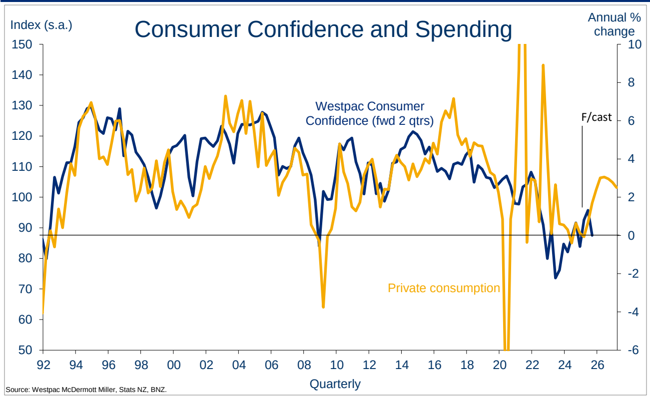
Likewise, drought conditions across significant parts of the country as Q1 has progressed will drag on parts of agriculture late in the growing season, although this often only shows up in the GDP figures with a lag.

On the expenditure side, government consumption grew 1.9% q/q. This was stronger than expected and is unlikely to maintain that pace judging by Treasury forecasts.

And retail trade and accommodation rose 1.9%, which was above what retail sales indicated either on a total or core basis – including a decent pick up in tourist spending. Even with further tourism growth, retail trade looks highly unlikely to sustain Q4’s growth pace.

This is reinforced by yesterday’s very sharp drop in consumer confidence. Confidence needs to increase a long way to be consistent with our forecasts of consumer spending ahead.

Confidence needs to lift



All this suggests some caution on putting too much weight on the latest GDP outcome, or any quarter, as an indicator of underlying progress or necessarily as a guide to what comes next.

The market seems to have come to a similar conclusion judging by a very muted reaction to the upside growth surprise for the quarter. Short end rates nudged a couple of points higher before fading with a similar dynamic in the NZD to both be broadly unchanged a few hours post data.

However, even with all the caveats above, it is true that GDP printed stronger than the RBNZ expected. The higher starting point will need to be factored into the Bank’s thinking. At face value that suggests the Bank may become more cautious on cutting rates, other things constant.

We do not think today’s outcome will stop further easing. The output gap remains materially negative and there remain important questions about the pace of recovery ahead while uncertainty remains rife on the outlook for global trade.

But the GDP outcome, wobbly or otherwise, is another outcome that, at the margin, has us wondering whether our own forecast 2.75% low in the cash rate is a touch too low. We leave our cash rate forecasts unchanged for now.

Of course, other things are not constant. As a rule of thumb, in the past the RBNZ has tended to see about half of an upside activity surprise as a lift in potential. We wonder if that may be a little more in the current circumstances – with the RBNZ’s estimate of potential growth recently becoming more responsive to changes in population. And working age population growth looks a little stronger than the RBNZ had factored in, courtesy of more signs that net migration is levelling off and at a higher level than the Bank anticipated.

And business investment rose in the quarter against a material contraction that the Bank had built in. While we hold reservations about the degree of business investment that may take place ahead, given widespread uncertainty, today's outcome suggests additional capacity expansion at the end of last year.

It's important that private consumption, which barely grew at all in Q4 (+0.1% q/q), undershot the RBNZ's expectations (+0.4%) in contrast to the stronger business investment relative to the Bank's expectations. That gives a different feel to the balance of important components of supply and demand relative to the Bank's expectations, compared to a casual observation of stronger growth.

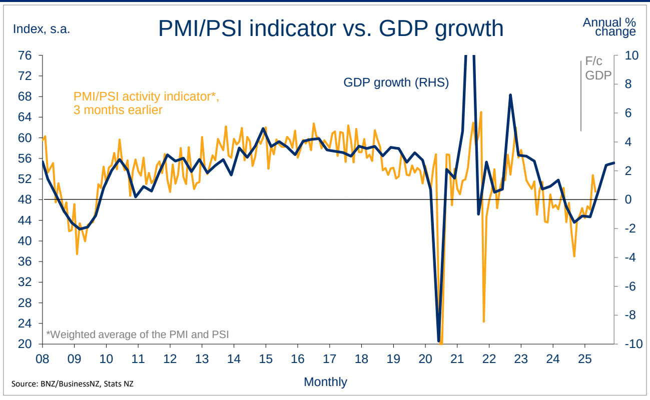
It is interesting to observe that today's quarterly growth figure is much stronger compared to, say, falling employment, hours worked, or paid hours, that was recorded in the quarter. It is not immediately clear what this means for inflationary pressure.

It may mean upside as some previous slack in resource use is used up or it may mean more benign inflationary pressures as the difference represents a pickup in underlying productivity. We would caution strongly against trying to understand productivity trends from one quarter's data. Only time will tell, although it is worth noting that when population growth was slowing, and GDP was previously undershooting expectations, it coincided with the Bank adjusting its potential growth estimates downward.

Focus now turns back to the high frequency data to get a feel for activity in 2025. We expect economic recovery to continue, supported by lower interest rates and very strong export revenue.

The balance of the latest PMI and PSI are encouraging, but they need to lift further to be consistent with the pickup in growth we forecast. Lagging new orders remain an area of concern – and perhaps more so now given the latest drop in consumer confidence. High frequency data generally suggests growth into 2025, but it is hardly uniform, and uncertainty remains rife on the outlook for global trade.

Positive signs, more required



The next Quarterly Survey of Business Opinion (QSBO) will be important for gaining businesses views on the likes of activity in Q1, the near term outlook, and the relative pressures on resource use as another guide to medium term inflationary pressures. Pricing indicators and employment and investment intentions will also be important to monitor. The QSBO is due on 8 April, the day before the RBNZ's April OCR review.

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