Research

Economy Watch

19 December 2024

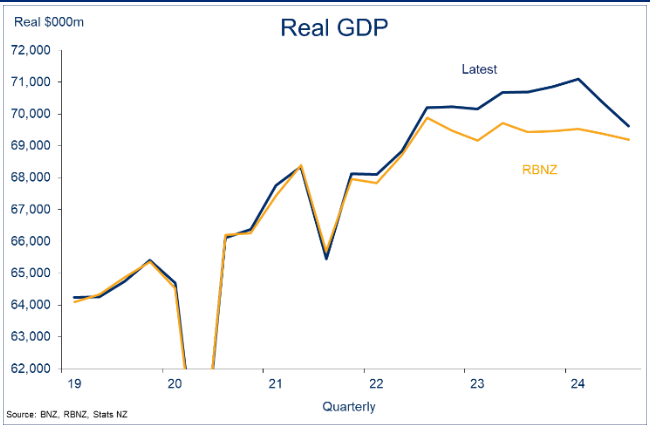
Strong GDP Demands Rate Cuts

- **GDP level stronger than expected**
- **GDP trajectory weaker than expected**
- **We lower our projected rate track**
- **50-point OCR cut now expected in February**
- **We reaffirm expectation of a 2.75% low**

We knew today's GDP data would be nigh on impossible to interpret because of revisions to historical data. And that is, indeed, the case.

While it is right for headline writers to focus on just how much the economy has collapsed over the last six months, we note that very few are acknowledging that economic activity, as at the end of the September quarter, was 0.6% higher than the Reserve Bank had estimated when it put together its November Monetary Policy Statement.

Stronger than expected?



So how does one interpret a third quarter decline of 1.0% (accompanied by a downwardly revised Q2 of -1.1 from -0.2%), when the level of activity is stronger than anticipated and when the published numbers drive the currency lower suggesting higher inflation ahead?

The answer, very carefully.

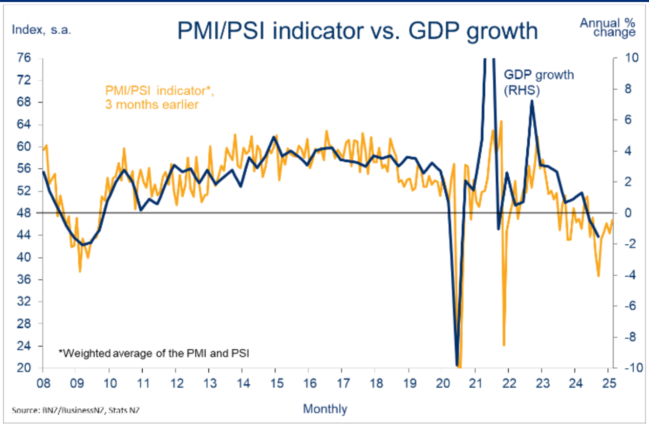
Interestingly, the data as they are now published fit much better with how we are all feeling and are more consistent with our PMI and PSI surveys, which have been suggesting an economy much weaker than the previously published data did.

Industry	qtr % chg prev qtr	% pt cont to chg	ann avg %chg	ann % chg
Gross domestic product by industry – September 2024 quarter				
Agriculture, forestry, and fishing	1.4	0.1	5.4	4.4
Mining	-2.2	0.0	-7.8	-12.6
Manufacturing	-2.6	-0.2	-1.4	-3.0
Electricity, gas, water, and waste services	-3.7	-0.1	-0.4	-3.6
Construction	-2.8	-0.2	-4.5	-7.9
Wholesale trade	-0.2	0.0	-5.1	-4.0
Retail trade and accommodation	-1.1	-0.1	-2.9	-3.4
Transport, postal, and warehousing	-1.2	0.0	-2.2	-1.3
Information media and telecommunication	0.7	0.0	0.3	0.3
Financial and insurance services	0.2	0.0	1.9	1.1
Rental, hiring, and real estate services	1.0	0.2	4.1	3.6
Prof, scientific, technical, admin, and suppo	-1.5	-0.2	-1.7	-3.5
Public administration and safety	-1.8	-0.1	3.2	-1.4
Education and training	0.1	0.0	2.3	0.7
Health care and social assistance	-0.9	-0.1	4.2	1.1
Arts, recreation, and other services	-2.9	-0.1	1.2	-7.1
Unallocated(2)	-1.4	-0.1	-1.2	-2.9
Balancing item(3)	..	-0.1	..	..
Gross domestic product	**-1.0**	**-1.0**	**0.1**	**-1.5**

Component	qtr % chg prev qtr	% pt cont to chg	ann avg %chg	ann % chg
Expenditure on gross domestic product - September 2024 quarter				
Final consumption expenditure				
Private	-0.3	-0.2	0.2	0.5
General government	-1.9	-0.4	0.7	-2.2
Gross fixed capital formation				
Residential buildings	-2.0	-0.1	-7.9	-11.2
Other fixed assets	-2.5	-0.4	-2.2	-1.9
Exports of goods and services	-2.1	-0.5	5.3	2.5
Imports of goods and services	-0.4	0.1	-0.8	0.3
Change in inventories and balancing ite	..	0.7	..	..
Expenditure on gross domestic product	**-0.8**	**-0.8**	**0.1**	**-1.0**

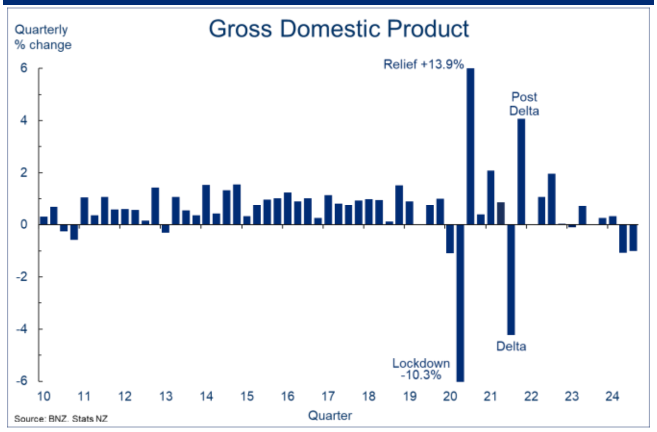
Of course, the data throw the cat amongst the pigeons for those in the central bank and Treasury who have been focused on the demise of productivity. Historical data now show that productivity is much higher than assumed albeit now correcting lower. We continue to stress that we do not believe decision making should be based on short term productivity measures given that they are prone to substantial revision and are highly cyclical.

Making more sense



And then there are those who couldn't resist the "Economy back in recession line". We don't place much weight on the concept that you need two consecutive negative quarters to delineate a recession. The world is far more complex than that. But those who do should note that we can't be back in a recession because the earlier two quarters of recession have been revised away.

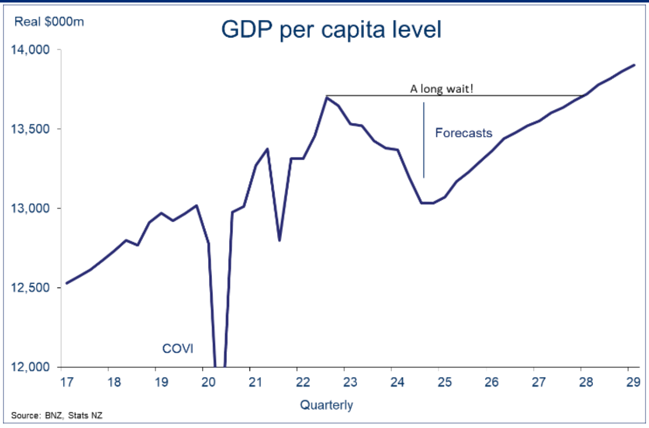
Back in recession?



While the detail of the data is substantially different to what we had been led to believe, the bigger picture hasn't changed. In short, we think the June and September quarters 2024 were the worst that we will see this cycle. There is a chance Q4 will also be negative but, if it is, it will be a small negative. We continue to believe the economy will be recovering relatively strongly in the second half of next year but that it will take a very long time before activity on a per capita basis gets back to its previous highs.

Importantly, we believe today's data offer support to our view that the cash rate will need to fall to well below neutral to create activity sufficient to close the ever-widening output gap. On that basis we will stick with our call for the cash rate to ultimately fall to 2.75%, a view we have held for a very long time now.

A long way back

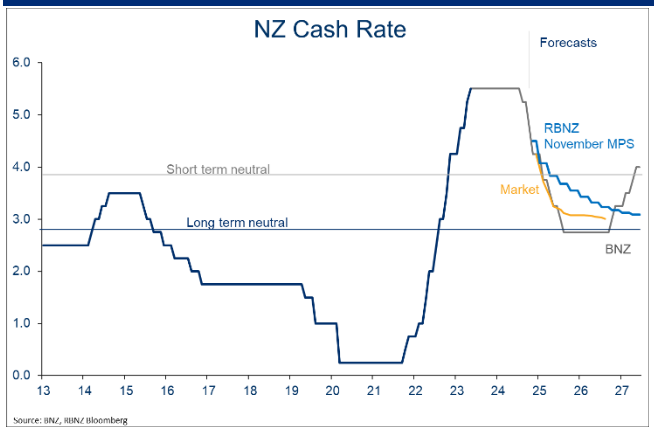


But, despite the revisions to the back-data, we believe the RBNZ will be spooked by the momentum in the latest figures which show the economy to have been declining at an annualised rate of over 4.0% per annum for the past six months. This surprising result has encouraged us to change our February 2025 rate cut call to 50 basis points (to 3.75%) from 25.

From there on in we maintain our view of 25 point cuts at each meeting, so the low of 2.75% is simply reached in August 2025 compared to our previous pick of October.

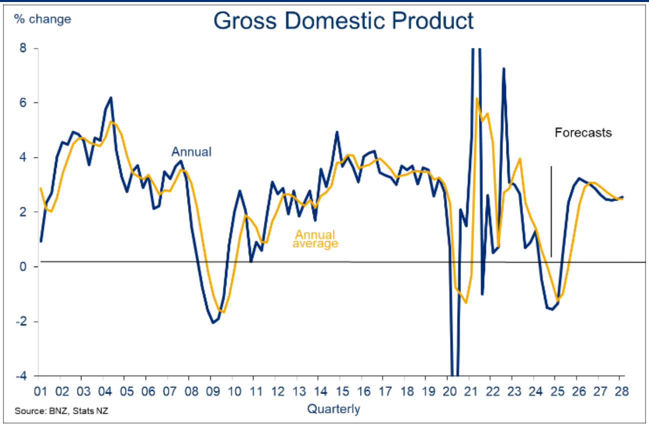
We do not believe there is any need for the RBNZ to go 75 basis points in February. This would reek of panic. Anyway, with the cash rate at 3.75% in February, and further rate cuts projected, the Bank should feel it can comfortably allow a slower adjustment as it feels out where the neutral rate is.

Cash rate headed much lower



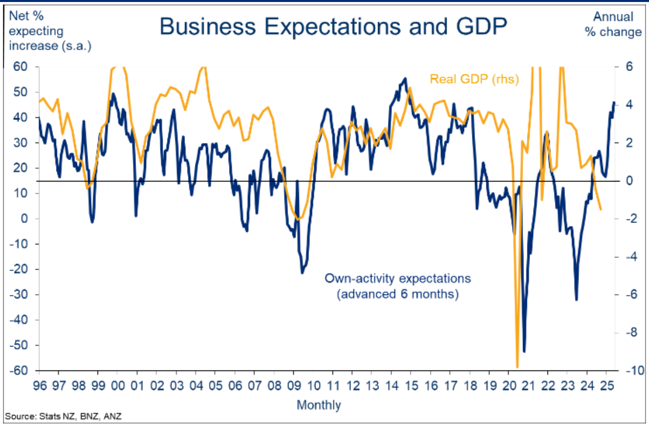
The good news is that we still think we are through the worst. We estimate that the economy contracted 0.6% in calendar 2024. We think it will expand around 1.5% in calendar 2025 before climbing to the heady heights of 3.1% in 2026.

A long way back



There is little in the real data to support this but leading indicators continue to provide a lot of hope. Today's ANZ survey was no different, in this regard, with business expectations for their own activity remaining at very elevated levels.

There is hope!



Most ANZ Survey indicators displayed a relatively high degree of optimism. If there was a point of concern it's that pricing intentions remain much higher than the RBNZ would like with a net 42.7% of businesses still intending to raise prices. This is inconsistent with the RBNZ achieving its inflation target. On the other hand, inflation expectations at 2.63% are entirely consistent with the objective being met.

We continue to believe the Reserve Bank has inflation broadly under control but we caution that price pressures are not dead and complacency would be unwise as would an overly aggressive approach to cutting rates.

So, New Zealand ends 2024 very much in a state of distress. But there is good reason to believe that for many 2025 will be a Happy New Year and 2026 will be a happier year again.

Hang in there!

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