Coming up short again

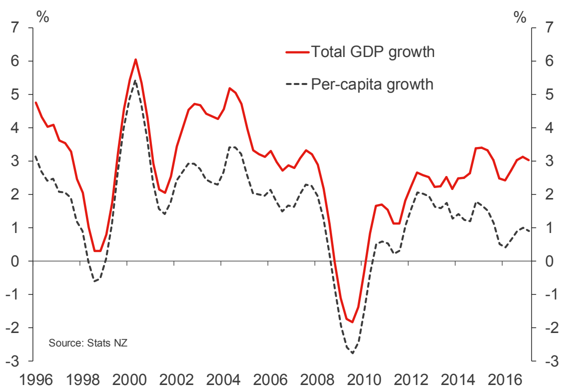
GDP rose by 0.5% in the March quarter

15 June 2017

- GDP rose by 0.5% in the March quarter, the second quarter in a row of subdued growth.
- The main contributors were a rebound in dairy production and strong gains in consumer spending and business investment.
- Construction and transport services declined over the quarter, though we don't think that these falls will be sustained.
- GDP growth remains quite modest on a per-person basis, with little to suggest that the economy is at risk of overheating. We expect the Reserve Bank to keep the OCR on hold for some time yet.

Key Results	Dec 2016	Mar 2017	Westpac f/c	Market f/c
GDP Q/Q %	0.4	**0.5**	0.8	0.7
GDP Ann %	2.7	**2.5**	2.8	2.7
GDP Ann Avg %	3.1	**3.0**	3.0	3.0

Annual Average GDP growth



For the second time in a row, quarterly GDP growth came in substantially lower than expected. The production measure of GDP rose by 0.5% in the March quarter, compared to a median forecast of 0.7%, the Reserve Bank's forecast of 0.9%, and the Treasury's forecast of 1.1%. We expected a 0.8% increase.

Quarterly GDP is inherently volatile, and can be strongly influenced by short-term movements in particular sectors. In the December quarter it was a downturn in milk production that weighed on total output; this time around we saw an expected rebound in dairying, but this was outweighed by a sharp drop in transport and construction. We think these movements will also be temporary, so we're inclined to bump up our forecast of June quarter growth.

But even if we smooth through the quarterly surprises, the broader picture remains that, outside of population growth, the economy is growing a very muted pace. That doesn't suggest that the economy is at risk of overheating, or that action to contain inflation is needed any time soon. Our view remains that the OCR will be left unchanged through this year and next year, in contrast to market pricing which continues to linger around a mid-2018 rate hike.

Details

The main contributors to growth in the March quarter were largely as anticipated. Agriculture rose by 4.3%, spearheaded by a 7.5% rise in dairy production. Milk production was weak over the second half of last year due to poor weather and low milk prices, both of which had turned the corner by early this year. The rebound in milk volumes also provided a lift to food manufacturing (and is ready to boost the export figures next quarter).

We also saw solid growth in domestic spending, by both households and businesses. Retail and accommodation rose by 1.8%, wholesale trade was up 1.4%, and investment in capital equipment rose sharply, from both imported and locally produced sources.

There were two particular areas of weakness in the March quarter. Construction activity fell by 2%, largely due to a sharp fall in non-residential investment but with declines in housing and infrastructure as well. And transport services also fell by 2% for the quarter, accounting for most of the shortfall in GDP compared to our forecast.

We're sceptical that the drop in construction work will be sustained. The pipeline of work that's required will sustain the industry for years, and the fact that employment in the sector rose strongly over the last two quarters doesn't suggest that there is really less work on. Wet weather and the lumpy timing of large projects probably has more to do with it.

Similarly, we don't think the decline in transportation will be sustained, though we're less confident about when it will rebound – for instance, restoring the main trunk line in the South Island after the Kaikoura earthquake will take some time. But that simply points to the need to use alternative routes. We wouldn't expect to see a sustained leg down in transport services while the number of goods and people to be moved around the country continues to grow.

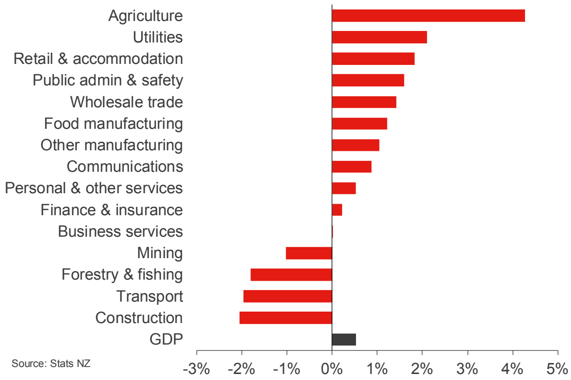
On an annual basis, GDP has continued to grow at around a 3% pace, of which a little more than 2% can be attributed to population growth. Per-capita growth has slowed as the economic upturn has moved into a more mature phase, and is markedly slower than what we saw in the mid-2000s boom. We expect this pace of growth to be broadly maintained over the next couple of years, which would be consistent with only a gradual decline in unemployment and modest upward pressure on wages and prices.

Implications

In its May *Monetary Policy Statement*, the Reserve Bank put a lot of emphasis on the softer than expected GDP growth over the second half of 2016. In its view, the softer than expected starting point meant a slower return to full capacity and a more delayed pick-up in inflation pressures. Today's GDP result, which once again fell significantly short of the RBNZ's forecast, will only reinforce the RBNZ's view that the need for interest rate hikes is a long way off.

Michael Gordon
Acting Chief Economist

Q1 GDP changes by sector



Source: Stats NZ

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