Modest rebound

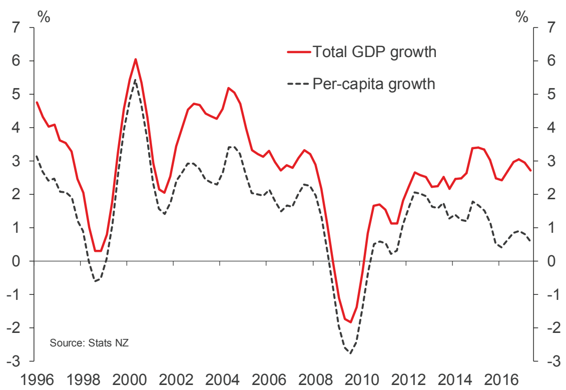
NZ Q2 GDP rose 0.8%

21 September 2017

- GDP rose by 0.8% in the June quarter, in line with market forecasts.
- Growth in the quarter benefited from a one- off boost to tourist spending and a recovery from earlier disruptions in dairying and transport.
- The underlying pace of growth remains very subdued outside of population growth.

Key Results	Mar 2016	Jun 2017	Westpac f/c	Market f/c
GDP Q/Q %	0.6	**0.8**	0.8	0.8
GDP Ann %	2.5	**2.5**	2.5	2.5
GDP Ann Avg %	2.9	**2.7**	2.8	-

Annual Average GDP growth



New Zealand's GDP growth rebounded modestly in the June quarter, after two quarters of relatively subdued growth. The 0.8% rise for the quarter was in line with our forecast and the median market pick, but slightly below the 0.9% rise that the Treasury and the Reserve Bank forecast.

We think that the June quarter will prove to be the high point for growth during this year, as it benefited from both a one-off boost from tourist spending and a rebound from temporary disruptions in some sectors. In that light, a 0.8% quarterly increase is not that impressive. And growth remains very subdued once we take out population growth: per-capita GDP was up 0.3% for the quarter, and just 0.6% over the last year.

In some respects, the slowdown in growth reflects the fact that the economy's upturn is now well advanced – into its seventh straight year. Still, there are some signs that the economy is underperforming its potential – the ultimate measure being the lack of any meaningful pickup in underlying inflation or wage growth.

We recently revised our GDP growth forecasts for the rest of this year, partly due to signs that the construction sector is struggling to make further progress. More importantly, we think that growth over the next couple of years will fall significantly short of the Reserve Bank's forecasts. That supports our view that interest rates will need to remain low for a long time.

Details

The production measure of GDP rose 0.8% in the June quarter, as expected. There was a slight upward revision to March quarter growth from 0.5% to 0.6%, but an offsetting downward revision to growth in 2016.

The June quarter saw the expected surge in tourist spending, supported by two major sporting events during the quarter: the World Masters Games and the Lions rugby tour. Retail spending was up 1.7%, and accommodation rose by 5.4%.

There was also an expected rebound in transport activity, up 3.5% in June after a 1.6% fall in March. The wildfires around Christchurch in February had disrupted rail activity in particular, but this impact has now unwound. Transport is likely to see a further rebound over coming quarters, as the rail line that was damaged by last year's Kaikoura earthquake is reopened to freight.

Manufacturing activity rose by 1.8%, largely driven by a 5.7% jump in food manufacturing. Milk collections were stronger over the quarter, and there were strong gains in fruit and beverages. There was also a surprisingly large 4.1% rise in petroleum and chemical manufacturing, but other aspects of manufacturing were generally softer.

Construction activity fell by 1.1%, on top of a 2.1% fall last quarter. In recent weeks we've detailed the slowdown in residential and non-residential building work, and the GDP figures revealed that infrastructure and civil work also slowed over the quarter. We expect further growth in construction over the next couple of years, given the pipeline of work required. But with the industry's capacity constraints becoming more evident, we think that the pickup will be gradual.

The housing market slowdown has had some direct impact on the recent GDP figures, with slowing growth in both finance and real estate services. In contrast, it doesn't appear to have dampened households' willingness to spend over the June quarter (although the more recent card spending data has been weak).

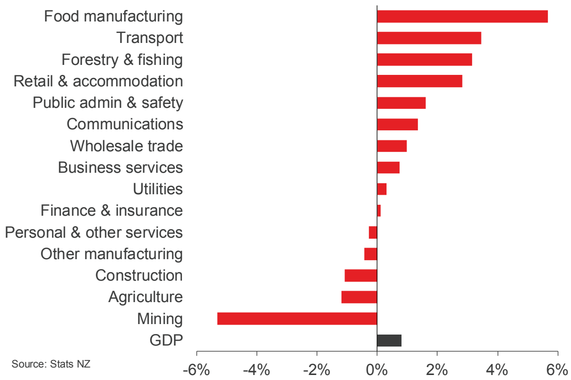
Implications

In its August *Monetary Policy Statement*, the Reserve Bank forecast annual GDP growth to accelerate to 3.8% over the next year, from its current pace of 2.5%. That kind of acceleration is looking increasingly out of reach, particularly given that it relies partly on a strong pickup in construction, a sector that has been going backwards recently. Moreover, faster headline growth will be even harder to achieve if population growth slows as we expect – today's migration figures reinforced that the balance has started to shift, with departures of non-New Zealand citizens trending higher.

We remain of the view that interest rates will need to remain low for a long time, in order to get inflation back up to 2% on a sustained basis. We expect OCR hikes to be delayed until late 2019. In contrast, market pricing continues to suggest a hike by September next year.

Michael Gordon
Senior Economist

Q2 GDP changes by sector



Source: Stats NZ

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