Soft spot

Preview of Q3 GDP (21 Dec, 10.45am) and current account (20 Dec, 10.45am)

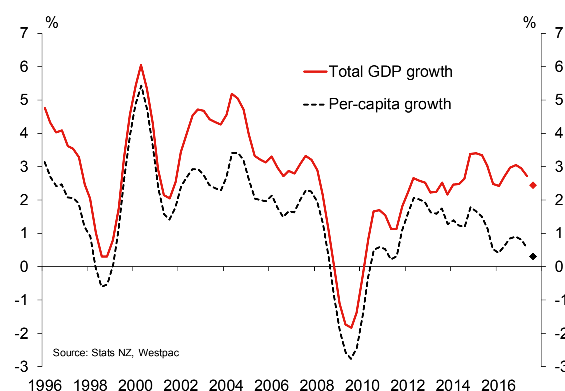
14 December 2017

- The September quarter is likely to mark the weak point for economic growth this year. We expect a 0.4% rise in GDP.
- Much of the slowdown in growth is due to temporary factors, such as lower milk production and a pullback in tourist spending after an earlier spike.
- The annual current account deficit is expected to narrow to 2.5% of GDP, due to lower imports.
- Annual revisions to the national accounts are likely to show higher GDP growth over the last few years than previously thought.

	Jun-17 actual	Sep-17 Westpac f/c
GDP		
Quarterly % chg	0.8	0.4
Annual % chg	2.5	2.2
Annual average % chg	2.7	2.4

Balance of Payments		
Current account balance $m, s.a.	-1,598	-980
Annual balance $m	-7,491	-6,810
Annual balance % of GDP	-2.8	-2.5

Annual average GDP growth



The September quarter national accounts will be released next week. We expect a fairly soft result for GDP (Thursday), with a rise of just 0.4%. Much of the expected weakness is isolated to the primary sectors, some of which are on track to return to growth in the December quarter. Nevertheless, it does seem that the economy has been on a slower growth trend this year. Meanwhile, we expect the annual current account deficit (Wednesday) to narrow, reflecting the lift in dairy export prices and volumes over the last year.

Our forecast implies that GDP growth will be towards the lower end of the range of expectations. The Reserve Bank forecast a 0.7% rise in its November Monetary Policy Statement, the Treasury recently revised down its forecast to 0.6%, and we've seen market forecasts ranging from 0.3% to 0.7%. A soft GDP result could knock interest rates and the New Zealand dollar lower on the day, although there's already evidence emerging that the September quarter weakness was temporary. The current account generally doesn't elicit much market reaction; a narrowing of the deficit could be at best a small positive for the NZD.

The September quarter releases will also include the annual revisions to the national accounts, as new data and benchmarks are incorporated into the historic figures. Figures already released by Stats NZ point to substantial upward revisions to nominal GDP for the past few years: the level of nominal GDP for the year to March 2017 is now 1.8% higher than previously reported. We won't see until next week how much of the revision is due to higher prices or higher real activity, but we suspect that it will largely be the latter.

The annual revisions play an important part in understanding the economy's recent performance. Notably, the revisions cover a period when GDP growth was reported to have slowed in per-capita terms, as shown in the chart to the left. The revised figures may show a steadier path for per-capita growth, at least up to 2016.

The GDP revisions have minor implications for monetary policy. Higher measured GDP growth also suggests, to some degree, a higher rate of non-inflationary potential growth than previously thought. The revisions are perhaps more significant for the fiscal accounts; at the least, they shed some light on why the Treasury has underestimated

the tax take in recent years. The higher level of nominal GDP also gives the Government room to borrow an extra $1bn while still meeting its target of a 20% net-debt-to-GDP ratio after five years.

Q3 GDP, 21 December

We expect a 0.4% rise in the production measure of GDP, following a 0.8% rise in the June quarter. Just as the June quarter result was boosted by temporary factors, we expect the September quarter to be weighed down by temporary declines in a handful of sectors.

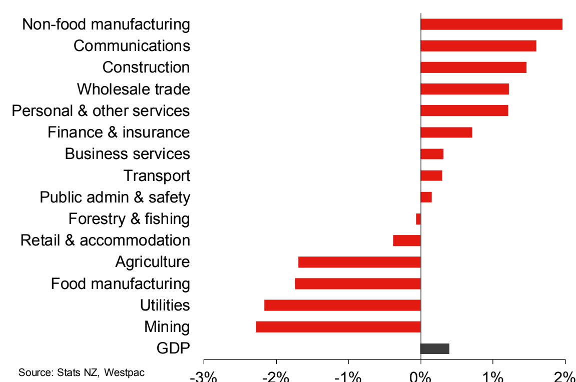
Dairying had a poor start to the new season, after a strong finish to the end of last season. We estimate that milk collections were down 10% seasonally adjusted in the September quarter, the biggest one-quarter drop in over four years. Consequently, both agriculture and food processing were a significant drag on GDP for the quarter. Milk production is on track for a modest rise in the December quarter, notwithstanding the emerging risks of drought.

Another notable temporary influence on GDP was a decline in accommodation and hospitality, which had been boosted by the Lions rugby tour in the June quarter. The underlying upward trend in tourist arrivals looks to have continued into the December quarter. Electricity generation was down for the quarter, but this is a volatile component and has a low correlation with economic activity.

We expect significant positive contributions from the non-food manufacturing sectors, particularly in machinery and equipment. Construction saw a solid gain in the September quarter, following small declines in the first half of the year when poor weather may have delayed some activity.

The services sectors appear to have had a mixed performance over the quarter. We expect to see strong gains in telecommunications, wholesale trade, retailing, healthcare and recreation. However, we expect business services and central government administration to show softer growth compared to what we've seen in recent quarters. Transport was held back by a surprising decline in rail, despite the South Island trunk line being partially reopened for the first time since the Kaikoura earthquake.

Q3 GDP changes by sector



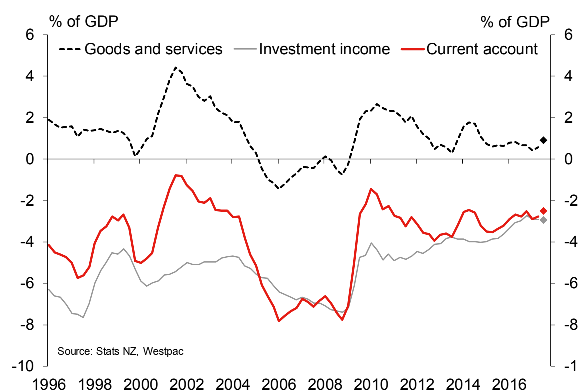
Q3 current account, 20 December

We expect the annual current account deficit to narrow to 2.5% of GDP, from 2.8% in the June quarter. Note that these figures don't account for the revisions to nominal GDP, which could narrow the deficit further (depending on rounding).

In seasonally adjusted terms, the goods trade balance moved strongly into surplus in the September quarter. The value of exports was steady, with lower prices but higher volumes. Import prices and volumes were both down for the quarter. Services exports were down in the September quarter as the boost from the Lions tour dropped out. The investment income deficit widened due to higher profits for overseas-owned firms.

The improvement in the annual deficit is partly due to base effects. The earlier weakness in dairy export prices and volumes is now dropping out of the calculation, and this effect will play out for a few more quarters. We expect the deficit to narrow to 1.9% of GDP by early next year, which would be the smallest deficit since 2010 – in the wake of the Global Financial Crisis, when import demand had collapsed and interest rates on overseas borrowing had plunged.

Annual current account balance



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