Neither good nor bad

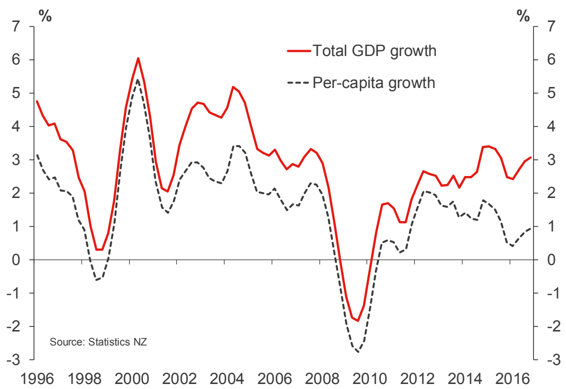
GDP rose by 0.4% in the December quarter

16 March 2017

- GDP rose by 0.4% in the December quarter, a touch below our forecasts, with a downward revision to September quarter growth adding to the soft tone of the release.
- Growth was driven by services sectors, which are benefitting from a rapidly rising population, while declines in primary production and manufacturing weighed on growth.
- Although some of the weakness in primary production is temporary, headline growth remains moderate and is relatively subdued on a per-person basis.
- With strong population growth adding to the economy's supply base, the economy doesn't look at risk of over-heating. We expect the Reserve Bank to keep the OCR on hold for some time yet.

Key Results	2016 Q3	2016 Q4	Westpac f/c	Market f/c
GDP Q/Q %	0.8	**0.4**	0.5	0.7
GDP Ann %	3.3	**2.7**	3.0	3.2
GDP Ann Avg %	2.9	**3.1**		

Annual Average GDP growth



The December National Accounts suggest that the economy hit a bit of a soft patch through final quarter of 2016. GDP rose only 0.4% in the December quarter, a touch below our forecasts and below the market median of 0.7%, as well as the Reserve Bank's February MPS forecast of 1%. A downward revision to growth in the September quarter to 0.8% (from 1.1% previously) added to the soft tone of the report.

While declines in primary production and food manufacturing were significant drags on growth in the quarter and will likely bounce back strongly in the March quarter, more broadly, we're looking at an economy that continues to grow at a so-so pace. Growth in calendar 2016 was 3.1%, an improvement from 2015, but hardly a screaming result with population growth running in excess of 2%. As a result, annual growth in per-capita terms continued to linger below 1%.

Looking ahead, we expect a moderate pace of growth to continue. With migration inflows and tourist arrivals hitting new record highs in January, "people power" will remain an important part of the growth story this year. At the same time, prospects in regional New Zealand have improved, with better dairy incomes beginning to hit farmers' pockets (although recent declines in global dairy prices will keep farmers cautious about discretionary spending). On top of this, conditions for several other commodity producers, including beef and horticulture have remained positive. However, a soft run of building consent issuance suggests that the positive impulse from construction will flatten off in the first half of 2017, and slower growth in house prices might hold back household spending.

For the Reserve Bank, today's GDP result was a fair bit weaker than incorporated in the February MPS. All else equal, this means a softer starting point for activity and less pressure on capacity (and thereby domestic-led inflation pressure). Overall, with strong population growth adding to economy's supply capacity, it's not looking like an economy at risk of over-heating any time soon. As such, the Reserve Bank looks to have time on its side before thinking about raising the OCR. We continue to expect that the Reserve Bank will keep the OCR on hold for an extended period. Our preview for next week's OCR Review will be released tomorrow.

Details

The breakdown of activity by sector was similar to what we had expected. Population growth showed through as an important driver of growth in domestic-orientated services, while widespread declines in primary production and related falls in food manufacturing were the main drags on growth.

The services sectors that appeared to benefit the most from population growth were health care and arts and recreation (also benefitting from rising tourist numbers), which posted solid gains in the quarter. Business services also continued on its recent strong run. However, growth in retail spending has been surprisingly moderate given sheer growth in people numbers. The services sector as a whole grew by 0.7%, on the back of 0.6% population growth over the quarter.

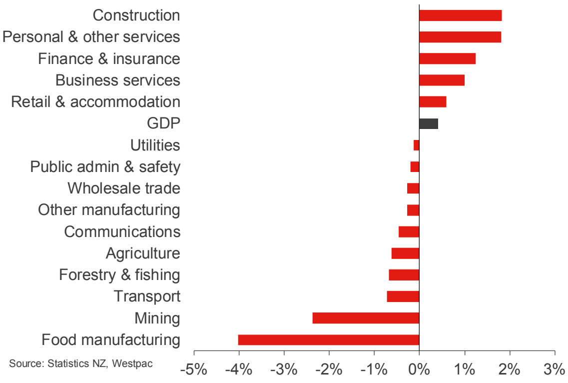
Construction remained an important contributor to growth, rising 1.8% in the quarter to be 10% higher than a year earlier. While residential construction levelled off in the quarter, this was more than offset by strong gains in non-residential construction and other construction (including infrastructure). Dwelling consents flattened off over the second half of last year (potentially relating to disruption around the Auckland Unitary Plan and Kaikoura earthquakes), suggesting that residential building might continue to track sideways in 2017H1. While this might hold back overall construction, there is still a solid pipeline of non-residential and infrastructure work across the country, especially in Auckland.

On the negative side of the ledger, it was all about primary sector weakness. Agriculture dragged on growth for the second consecutive quarter, as damp spring conditions continued to weigh on milk production. In turn, lower milk production, along with a slow start to the slaughter season, weighed on food manufacturing. But with milk production recovering well in early 2017 and slaughter improving, these sectors should return firmly to the positive side of the ledger in the March quarter. Meanwhile, forestry production declined 5%, with production and exports paring back most of September's strong gains. Mining activity also declined – partly due to a shutdown in the Maari oil platform in November, which came back online in early January.

Meanwhile, the expenditure measure of GDP, which is considered less reliable on a quarterly basis, rose 0.2% in the quarter. This soft result follows strong outturn in previous quarters, and in calendar 2016 expenditure GDP rose by a strong 3.9%. Underlying the quarterly movements were a modest 0.4% rise in consumption after strong gains in recent quarters, and an increase in investment. But the big drag in the quarter was from a record decline in goods exports, weighed down by declines in primary production discussed above and a fall in manufactured exports, which are expected to recover next quarter.

Sarah Drought
Economist

Q4 GDP changes by sector



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