

Subdued growth persists

NZ Q4 GDP review

15 March 2018

- GDP rose by 0.6% in the December quarter, in line with our forecast.
- The details were a mixed bag, with declines in agriculture and manufacturing, against solid growth in domestically-focused services.
- The pace of economic growth has slowed over the last year. We expect it to remain subdued in the near term, with poor dairying conditions, growth constraints in the building industry, and the uncertain impact of the new Government's policies.
- Slowing GDP growth reinforces our view that OCR hikes are further away than the market is anticipating.

Key Results	Sep 2017	Dec 2017	Westpac f/c	Market f/c
GDP Q/Q %	0.6	0.6	0.6	0.8
GDP Ann %	2.7	2.9	3.0	3.1
GDP Ann Avg %	3.0	2.9	2.9	2.9

GDP rose by 0.6% in the December quarter, matching the pace seen in the September quarter. The result was right in line with our forecast, which was at the lower end of the range of market forecasts (the median was 0.8%). It was also slightly below the Reserve Bank's forecast of a 0.7% increase.

Incidentally, we were labelled in some quarters as "more pessimistic" with our below-market forecast. By the time we finalise our forecast, we have a substantial amount of the data that goes into GDP; our view was not based on pessimism or otherwise, but on the facts. Indeed, for a long time we were with the rest of the market in picking a 0.8% increase, up until the soft manufacturing survey that was released last week.

It is true, however, that we are more downbeat than many on the outlook for the coming year. New Zealand's economic upturn appears to have already lost some momentum (notwithstanding the possibility of future revisions to the GDP data). Annual growth peaked at 4% in 2016, but slowed to 2.9% by the end of 2017. Since population growth was just over 2% in both years, this represents a marked slowdown in the rate of per-capita GDP growth.

We expect an even more subdued pace of growth this year. Our judgement is that the new Government's mix of policies – particularly those aimed at cooling the housing market – will dampen growth, at least initially. Uncertainty among businesses may also lead to delays in hiring and investment decisions. The effects of higher fiscal spending are more likely to be felt in 2019 and beyond, when we expect annual GDP growth to return to around 3%.

December quarter GDP was only slightly below the Reserve Bank's forecast, so is unlikely to prompt a change in the tone of next Thursday's OCR review statement. But it does support our view (and the RBNZ's) that OCR hikes are further away than the market has been pricing in. The RBNZ needs to see a strong period of growth in order to generate more home-grown inflation pressures, since imported inflation has been missing in action. If that revival in growth doesn't eventuate, interest rates will need to remain low for even longer.

Details

The production measure of GDP rose by 0.6% in the December quarter. The biggest drag on growth was the unusually hot and dry weather during the quarter, with agricultural production down by 2.7% and food processing consequently down 0.1%. This is unlikely to reverse in the March quarter, as milk collections so far have remained well down on last season.

The other goods-producing sectors were also subdued. Non-food manufacturing fell by 0.3%, in part a reversal of some unsustainably large gains in the previous quarter. Construction activity rose by 0.7%, with gains in residential and non-residential buildings but a decline in non-building work. The construction sector has a significant pipeline of work ahead of it, but capacity constraints are likely to limit the rate of growth compared to previous years.

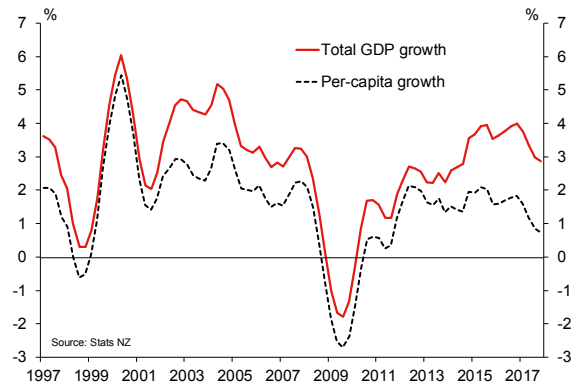
The service sectors were a bit more lively, with strong gains in retail, wholesaling, transport and business services. However, personal services such as healthcare and recreation were soft. Overall, services were up by 1.1%; since these sectors are largely domestically-focused, we should expect them to benefit from high population growth.

The expenditure measure of GDP is considered less reliable as a measure of growth on a quarterly basis, but the details are sometimes of interest. Expenditure GDP rose by 0.4% for the quarter, a surprisingly soft outcome (we thought it might be the stronger of the two measures). Household spending and business investment recorded solid gains for the quarter. However, the rise in investment drew heavily from a surge in imports of capital equipment. Services exports were weaker than we expected, reflecting the fact that while tourist numbers were up for the quarter, real (price-adjusted) spending fell.

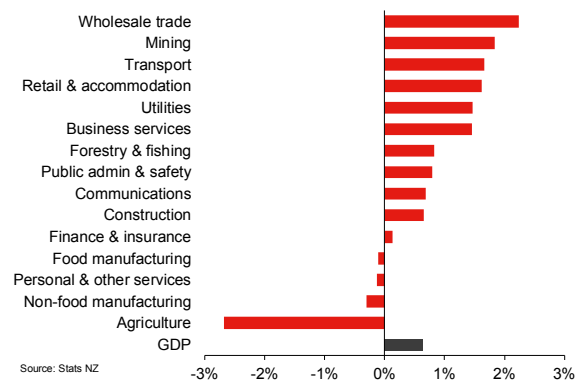
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Annual average GDP growth



Q4 GDP changes by sector



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