Loss of momentum

Preview of Q1 GDP (21 Jun, 10.45am) and current account (20 Jun, 10.45am)

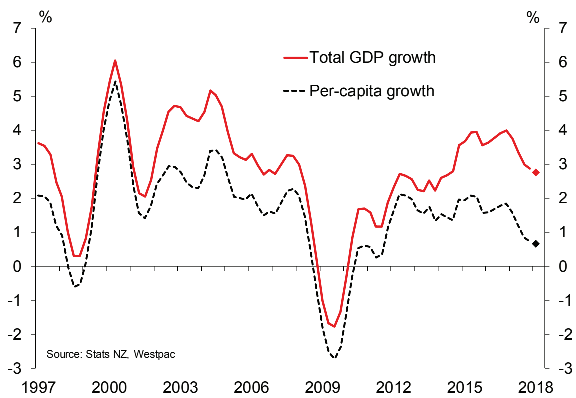
15 June 2018

- We expect a 0.4% rise in March quarter GDP. This would mark a third consecutive quarter of subdued growth in activity.
- We have long been highlighting the prospect of a soft patch in growth over the first half of this year. In contrast, we think the Reserve Bank and the Treasury have been too optimistic on near-term growth.
- The current account deficit is expected to widen slightly, due to some softness in exports that may prove to be temporary.

	Dec-17 actual	Mar-18 Westpac f/c
GDP		
Quarterly % chg	0.6	0.4
Annual % chg	2.9	2.6
Annual average % chg	2.9	2.8

Balance of Payments		
Current account balance $m, s.a.	-1,950	-3,200
Annual balance $m	-7,700	-8,100
Annual balance % of GDP	-2.7	-2.8

Annual average GDP growth



In recent times we've been highlighting that New Zealand's economic cycle has now entered a more mature phase, with earlier drivers of growth such as house prices and construction activity having passed their prime. The March quarter national accounts, released next week, are likely to demonstrate a further loss of momentum.

We are forecasting a 0.4% rise in GDP for the March quarter, slightly lower than our initial estimate of a 0.5% rise. We have been warning for some time of the likelihood of a soft patch in growth over the first half of this year, as uncertainty around the new Government's policies weighs on firms' expansion plans and households' willingness to spend. A lift in government spending will help to support growth, but this is more of a prospect for next year's growth rate.

In contrast, the Reserve Bank and the Treasury have been anticipating a re-acceleration in growth this year, with both of them expecting a 0.7% rise in March quarter GDP in their most recent forecasts. A softer outturn, as we're expecting, would put some pressure on the Government's revenue and spending projections, and would reinforce the message that Official Cash Rate hikes are quite a way off.

Our GDP forecast appears to be in a similar range to other market forecasters. An outcome in line with our view is not likely to have a significant impact on market interest rates or the exchange rate.

The current account deficit is expected to widen a little in the March quarter, albeit remaining historically low at 2.8% of GDP. The widening of the deficit provides mixed messages about the state of the economy: exports have been soft recently, though perhaps due to temporary factors, but imports of capital equipment and profits of overseas-owned firms have been strong.

Q1 GDP, 21 June

Our forecast of a 0.4% rise in the production measure of GDP represents a further slowdown from the modest 0.6% gains seen in the previous two quarters. On an annual basis, we expect growth to slow to 2.8%, the lowest since the September 2014 quarter.

Our estimates also raise some concerns about the breadth of growth. Sectors that touch on a wide range of economic activity – such as transport, retail, wholesaling, and business and personal services – are expected to show weak growth at best, or even outright declines. Manufacturing activity is expected to be up overall, but most of this comes from the machinery and equipment subsector.

We expect the strongest growth to be in the public sector. We should note, however, that the main indicator for this in the national accounts is the government's personnel expenses – a measure of inputs, which doesn't necessarily translate into more outputs. We think that a lift in the delivery of public services is more a story for 2019 and beyond.

We expect a lift in agriculture, and a related lift in food manufacturing, as dairy production began to recover from a weak start to the season. Forestry output is expected to fall, but this largely reflects the industry taking a breather after a rapid expansion in 2017; our forecast would still see production up 10% on a year earlier.

Q1 current account, 20 June

We expect the annual current account deficit to widen slightly to 2.8% of GDP. New Zealand's export performance worsened in the first quarter due to a drop in both prices and volumes. This decline is likely to be short-lived: commodity prices have since improved, and we suspect that the drop in volumes was due to the timing of shipments.

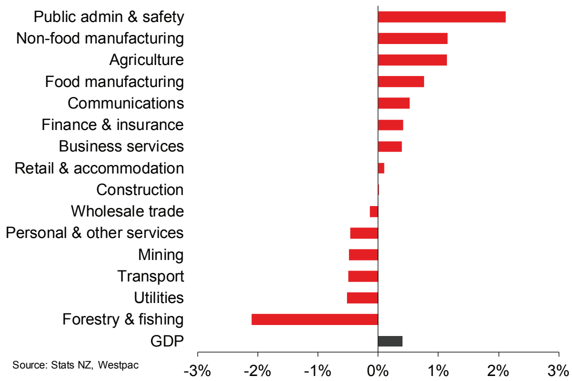
Goods imports remained high through the March quarter. Plant and machinery imports rose strongly for a second straight quarter, in contrast to the gloomy sentiment seen in recent business confidence surveys. Oil import volumes were also sharply higher, some of which may have been stockpiling ahead of a maintenance shutdown of the Marsden Point refinery in May.

Trade in services improved slightly in seasonally adjusted terms, with gains in tourist numbers and spending.

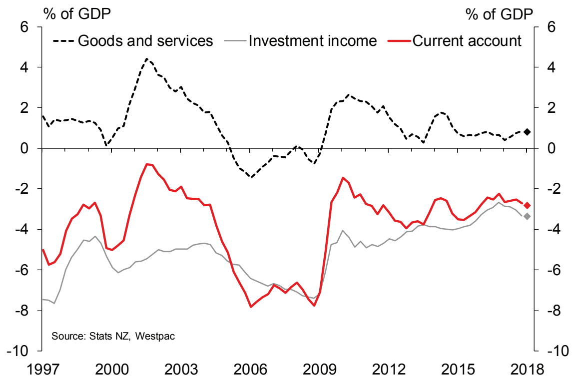
We expect a slight narrowing of the investment income deficit for the March quarter, with a pullback in profits of overseas-owned firms after a few unusually strong quarters. However, the deficit is still likely to be larger than it was a year ago, contributing to a widening of the annual current account deficit.

Michael Gordon
Senior Economist

Q1 GDP changes by sector



Annual current account balance



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