Better this time

NZ GDP, June quarter 2018

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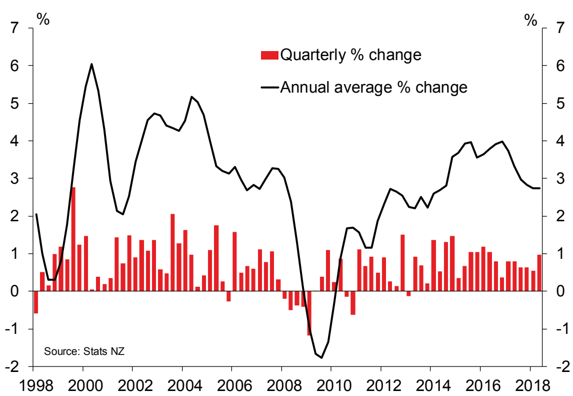
- GDP rose by 1% in the June quarter, even stronger than we and the market expected.
- There were some one-offs that boosted growth for the quarter, but these played less of a role than we expected.
- The underlying picture was strong, with growth spread across a broad range of industries. The economy is trundling along, not falling into the dark hole that business confidence surveys might suggest.
- The result was much stronger than the Reserve Bank's forecast of a 0.5% increase, and diminishes the case for OCR cuts in the near term.

Key Results	Jun 2018	Mar 2018	Westpac f/c	Market f/c
GDP Q/Q %	**1.0**	0.5	0.9	0.8
GDP Ann %	**2.8**	2.6	2.7	2.5
GDP Ann Avg %	**2.7**	2.7	2.7	2.7

Annual average GDP growth



The New Zealand economy fared substantially better in the June quarter, with a 1% rise in GDP following gains of 0.5-0.6% in each of the previous three quarters. Growth is still some way off the peaks seen in 2015-16, when the economy regularly grew by 1% or more each quarter. But the latest figures will help to soothe any concerns that the economy is heading into a slump.

The June quarter result was ahead of the median market forecast of 0.8% growth, and even beat our 0.9% forecast which was at the upper end of the range. What's more, the details show that the growth was widespread across industries, with one-off gains playing less of a role than we expected. This bodes well for the sustainability of GDP growth over the second half of the year.

Today's result has been a long time coming. It's been apparent to us for some time that June quarter GDP growth would be stronger than in the periods surrounding it – we predicted a 1% rise back in our August *Economic Overview*, and subsequent data releases only reinforced that view.

Yet around the same time, the Reserve Bank had forecast a rise of just 0.5% for the quarter, and commented that if it didn't see an acceleration in growth then it would need to consider cutting the OCR. Financial markets took those comments to heart, and speculation about rate cuts has been mounting in recent weeks ahead of next Thursday's OCR review.

Today's result doesn't take OCR cuts off the table completely – June quarter figures are arguably a little dated, and more recent data suggests an economy that is trundling along rather than accelerating. Nevertheless, with a much stronger starting point for the economy than the RBNZ expected, the case for an OCR cut in the near future has diminished. Financial markets reacted accordingly, with the New Zealand dollar rising half a cent and the two-year swap rate rising by five basis points after the GDP release.

Details

The 1% rise in GDP was the biggest quarterly increase in two years. Annual average growth for the year to June was unchanged at 2.7%, still well short of the 4% peak seen in 2016.

The growth was shared widely across the economy, with only one major industry – mining – reporting a decline (though it was a big fall, as we detail below). The biggest contributors to growth included agriculture (up 4.1%, with milk production up and forestry rebounding from a sharp drop last quarter), electricity generation (up 3.7%), retail trade (up 1.5%), transport (up 1.8%) and recreational and other services (up 3.5%).

We'd expected a solid underlying picture of activity in the June quarter, but overlaid with some one-offs in certain industries that would temporarily boost the growth rate on balance. In particular, we noted that hydroelectricity generation had risen sharply after a low March quarter, rail freight had jumped back up to pre-Kaikoura quake levels, and that public sector employment had risen sharply.

As it turns out, these one-offs played less of a role than we expected. Electricity generation was strong, but the lift in transport activity was only around half of our estimate, and the public sector saw only a 0.3% gain in the production measure of GDP (though the separate expenditure measure saw a whopping 2.2% rise). With less impact from one-offs, there's less scope for payback in the form of weaker growth next quarter, compared to what we were expecting (though there will still be some impact).

We should also note that not all of the one-offs were positive. During the quarter there was a planned maintenance shutdown at the Marsden Point refinery, and an unplanned shutdown in methanol production due to a shortfall in gas supplies. Together, these knocked about 0.2% off GDP growth for the quarter, as we expected – although the latter showed up more in the mining sector, which saw a 20% drop in production, rather than in the manufacturing sector as we'd assumed. With both operation now back in action, they should provide an equivalent boost to GDP growth in the September quarter.

Elsewhere, were was a broad range of industries that reported modest growth. Manufacturing overall was up 0.4%, with gains in food and machinery offset by a 5% drop in fuel processing. Construction, previously one of the star drivers of growth, eked out a 0.6% rise, as capacity issues continue to hinder the industry's ability to step up from already-high levels of activity. Finance, communications and business services all saw solid but not exceptional gains.

The expenditure measure of GDP is considered to be more volatile and less reliable on a quarterly basis, but the details help to provide some colour around the economy's performance. Expenditure GDP rose by 1.2% in June quarter, following a weak 0.4% rise in the March quarter.

Household spending rose by 1%, rebounding after a flat result in March. As noted earlier, government expenditure rose strongly, and residential and non-residential building were up slightly. Exports of both goods and services saw strong gains.

One possible note of caution from the expenditure figures is that investment in plant and machinery was down by 1.3% for the quarter. This is one area where weak business confidence could have real consequences for the economy. For now it looks more like business investment has plateaued at a high level – there was a sharp lift in investment in the December quarter last year that hasn't been unwound yet. Nevertheless, this is an area that we'll be keeping an eye on.

Michael Gordon
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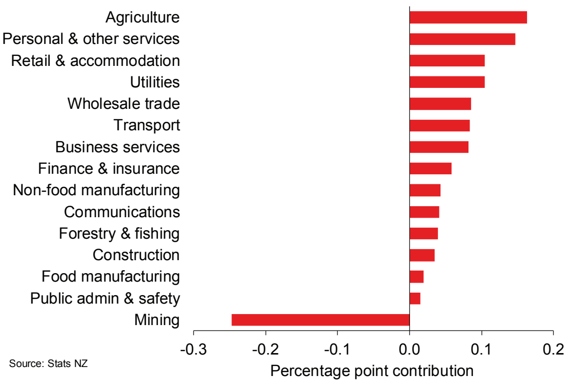
Q2 GDP changes by sector



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