Not bad at all

Preview of Q2 GDP (20 Sep, 10.45am) and current account (19 Sep, 10.45am)

13 September 2018

- We're expecting a 0.9% rise in June quarter GDP, a marked improvement from the subdued growth in previous quarters.
- In part, our forecast reflects some big one-off gains in particular sectors that are unlikely to be repeated.
- However, there are also some temporary negatives. Shutdowns in fuel and methanol production will subtract from growth in the June quarter, but boost in in the September quarter.
- The underlying story is of an economy that is trundling along slowly but steadily.
- Our forecast is higher than the Reserve Bank's low forecast of 0.5% growth – an important difference, given the increasing market speculation about OCR cuts.
- We expect the annual current account deficit to widen a little in the latest quarter. However, revisions are likely to narrow the deficit over the last few years, further highlighting how New Zealand's international position has improved in recent times.

	Mar-18 actual	Jun-18 Westpac f/c
GDP		
Quarterly % chg	0.5	0.9
Annual % chg	2.7	2.7
Annual average % chg	2.7	2.7
Balance of Payments		
Current account balance $m, s.a.	-2,970	-2,070
Annual balance $m	-7,643	-8,030
Annual balance % of GDP	-2.7	-2.8

After a few quarters of patchy, subdued growth, the stars seem to have aligned for the New Zealand economy during the June quarter. That's certainly not the message you might get from broad-brush indicators such as business confidence, which have fallen further in recent months. But as the data on real activity has rolled in, it has revealed growth ranging from modest to strong across a wide range of sectors. We're expecting next Thursday's GDP release to show a 0.9% rise for the quarter.

We would point out that our forecast is boosted by one-off factors to some degree. And it's still the case that growth has slowed quite a bit from its peak in 2016. But the underlying picture is of an economy that has trundled along slowly but steadily over 2018, rather than slowing further. Indeed, we expect the momentum to pick up a little over the next year, albeit temporarily, as increased government spending kicks in.

A stronger GDP result could be significant for financial markets on the day. We're likely to be at or near the top of the range of market forecasts, and more importantly, we're well ahead of the 0.5% increase that the RBNZ expected in its August *Monetary Policy Statement*. At the RBNZ's prompting, markets have been increasingly pricing in the possibility that the next move in the OCR is a cut rather than a hike. We do think there's a serious chance of a rate cut within the next year. But a much stronger than expected starting point for the economy (along with a lower exchange rate, and near-term inflation also likely to exceed the RBNZ's forecasts) would make difficult to justify cutting the OCR in the near future.

The other major data release next week, the balance of payments, is not usually a market mover and is even more likely to get lost in the mix this time. However, it does highlight one of the economy's good news stories. With the terms of trade reaching an all-time high and exports of services growing strongly, New Zealand's current account deficit has stayed low relative to history and the overseas debt position has improved significantly. We're expecting a slight widening of the deficit in the June quarter, but revisions could make the picture over the last few years look even more favourable.

Q2 GDP, 20 September

Our forecast of a 0.9% rise in production GDP follows three quarters of growth between 0.5% and 0.6%. This result would see the annual rate of growth hold steady at 2.7%.

As always, some aspects of our GDP forecast are more certain than others. The things that we're more confident about generally relate to the sectoral surveys that have released in recent weeks. Retail spending rose by 1.1%, building work was up 0.8%, and wholesale trade rose an estimated 1.6% after adjusting for prices. There was a strong lift in hours worked in the Quarterly Employment Survey, which is a direct input for some of the services sectors. And milk collections rose by about 8% in seasonally adjusted terms, although the actual figures are at a low ebb at this time of the season.

The manufacturing survey was more mixed. Food manufacturing was up overall, with a rise in dairy production and a rebound in meat processing after a weak March quarter, but a drop in production of beverages. There was a second quarter of strong growth in machinery and equipment manufacturing, which suggests that businesses are still prepared to invest.

Unfortunately, where we don't have a lot of clarity is in petroleum and chemical manufacturing – the manufacturing survey isn't used to calculate GDP in this case. Output is likely to have dropped sharply over the quarter, due to a planned maintenance shutdown at the Marsden Point refinery, and an unplanned shutdown in methanol production due to gas shortages. Our forecast assumes that these will knock 0.2% off total GDP for the quarter, but we've added this back into our September quarter forecast.

Another likely weak spot is in mining – we've assumed a 4% decline. That's not an unusually large drop for this small and volatile sector, and largely reflects the natural run-down of output from existing oil fields. However, we don't have an indicator for oil exploration, which anecdotally has been picking up again as oil prices have rebounded.

A few sectors are likely to get a significant boost from non-repeating factors, though the scale of their impact is uncertain. First, we expect a 4% rise for utilities, an unusually large but not unprecedented increase for this sector. Electricity generation rose sharply after a low March quarter, and there was also a sharp rise in the share generated by hydro, which is lower-cost and therefore higher value-added.

The next sector of note is transport. Rail freight in the South Island was severely disrupted by the Kaikoura earthquake in November 2016. But rail volumes rose sharply in the June quarter (we estimate +16% seasonally adjusted), back to pre-earthquake levels. Other measures of transport activity were generally positive as well, with air travel up and road user charges for heavy vehicles up strongly (though we only have two months of data for this).

The final area is the public sector, which has already seen some strong growth in recent quarters. Our main indicator here is government employee costs, deflated by the Labour Cost Index. As with road user charges, we only have data for the first two months, but April and May rose strongly and were well ahead of the Treasury's forecasts. Even if we conservatively assume that the June month was back on track, we're still looking at a rise of 2.5% for the quarter. This isn't a one-off factor per se, but we'd be very surprised if that rate of growth could be maintained from quarter to quarter.

Q2 current account, 19 September

We expect a current account deficit of 2.8% of GDP for the year to June. This represents a slight widening of the deficit from what we expect to be a revised March figure, as we'll discuss shortly.

The goods trade deficit for the June quarter was an estimated $1.24bn in seasonally adjusted terms – an improvement on the March quarter blowout, but still weaker than the same time a year ago. The terms of trade moved in New Zealand's favour, with export prices rising more than import prices. Export volumes recovered from their March quarter decline, which appears to have had more to do with the timing of shipments than with the strength of overseas demand. Imports remain elevated, particularly for plant and machinery.

In contrast to goods, New Zealand's trade in services is in substantial surplus, and improved further in the June quarter. However, the major point of note here is a series of revisions to the data.

Firstly, annual revisions have resulted in a huge lift in services exports over the last few years. Estimates of spending by international students have bene updated, information on spending by cruise ship passengers has been improved, and earnings from film and TV production have been revised up sharply. At their peak, these revisions add about $1bn to export earnings for the year to March 2017. The data for the last year hasn't been revised up by as much, but this will be subject to future rounds of revisions. (The tables and charts shown here are based on our estimates of the impact of these revisions on the current account.)

The other notable change is to the calculation of tourism earnings. The quality of the international visitor spending survey has been under question for some time, resulting in an extensive review of how it is constructed and recommendations for improvements. Those recommendations are starting to be put into place, and they appear to have resulted in a sharp step-up in the level of visitor spending – as much as 20% in the June quarter. We don't believe this is a genuine increase, but nevertheless it's what will go into the national accounts.

This will also enter the expenditure measure of GDP, although it only affects the composition rather than the total. If growth in spending by tourists is overstated, then growth in spending by New Zealand households will be understated by the same amount.

We expect the investment income deficit to widen a little to $2.4bn for the June quarter, mainly due to higher profits for overseas-owned firms in New Zealand. We note that investment income will also be subject to annual revisions in the June quarter release, although history shows that the balance of revisions can go in either direction.

Michael Gordon
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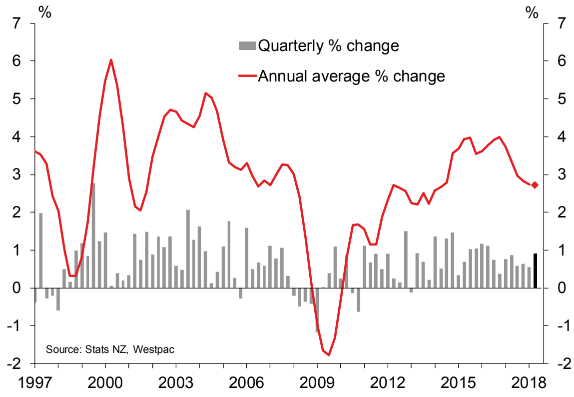
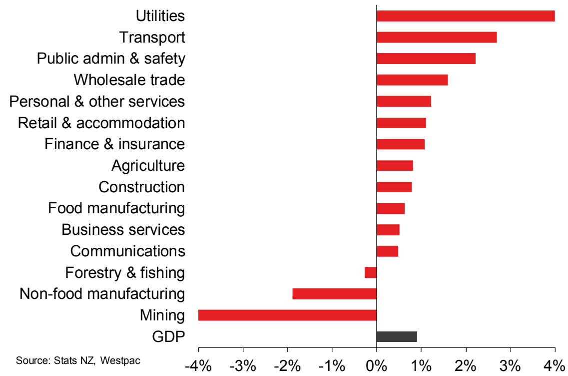
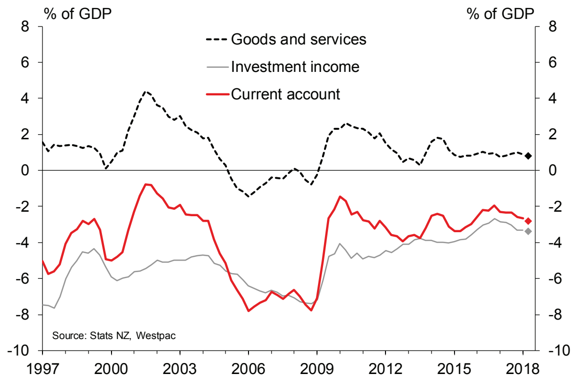
GDP growth



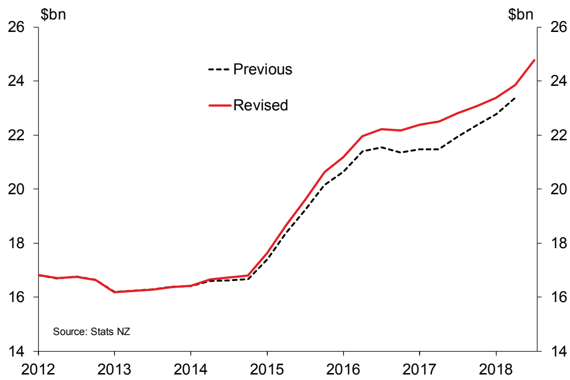
Q2 GDP changes by sector



Annual current account balance



Exports of services, annual total



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