Payback

Preview of Q3 GDP and current account

12 December 2018

- We're expecting a 0.5% rise in September quarter GDP, as some of the factors that boosted growth last quarter are unwound.
- Agriculture, electricity generation and tourism declined or grew at a slower pace in the September quarter.
- We expect to see some rebound in mining activity, though the extent is uncertain.
- The underlying picture remains of an economy that has trundled along slowly but steadily over 2018.
- We expect the annual current account deficit to widen to 3.6% of GDP. New Zealand's trade performance has deteriorated over the last year, but we suspect that some of the drivers of this are temporary.

	Jun-18 actual	Sep-18 Westpac f/c	Sep-18 RBNZ f/c
GDP			
Quarterly % chg	1.0	0.5	0.7
Annual % chg	2.8	2.7	2.9
Annual average % chg	2.7	2.8	2.8

Balance of Payments			
Current account balance $m, s.a.	-2,666	-2,380	-2,590
Annual balance $m	-9,536	-10,450	-10,500
Annual balance % of GDP	-3.3	-3.6	-3.6

The flow of economic data for New Zealand is set to end the year on a softer note, with the release of the September quarter national accounts next week. We expect a modest 0.5% increase in GDP, a step down from the 1% rise in the June quarter. We also expect the current account deficit to widen further to 3.6% of GDP, which would be the largest deficit in five years.

We noted at the time of the previous GDP result that it reflected "some big one-off gains in particular sectors that are unlikely to be repeated" and that "more recent data suggests an economy that is trundling along rather than accelerating". Subsequent data has confirmed that view, and in fact has been on the weaker side of our initial forecast of 0.7% GDP growth.

The degree of uncertainty around our GDP forecast is higher than usual, for two reasons. The first is that it's unclear how much of a rebound that we'll see in the mining sector, after a sharp drop in activity in the June quarter. The second reason is that this quarter will include the regular annual revisions to the GDP data, which can alter our understanding of how the economy has performed in recent times.

A 0.5% GDP outturn would be a disappointment to the Reserve Bank, which was forecasting a 0.7% gain – though this would only partly counteract the big upside surprise in the June quarter. What will be of more concern to the RBNZ is that the New Zealand dollar has risen sharply in recent weeks with little data to support it. We're still of the view that GDP growth will pick up next year, supported by a stronger housing market and government spending. But we suspect that financial markets are getting overly bullish about the economy's starting point.

Q3 GDP, 20 December

Quarterly GDP growth is often thrown around by temporary factors that either reverse or aren't repeated in the next quarter. This time is no exception. The 1% rise in June quarter GDP almost certainly overstated the true picture of the underlying economy, and our forecast of a 0.5% rise in the September quarter probably understates the case. That said, the temporary factors aren't all in one direction.

We've known for some time about some of the factors that will weigh on September quarter GDP, including agriculture and electricity. Milk production was significantly above trend in the June quarter; it was only modestly above trend in the September quarter. Electricity demand fell in the September quarter, and lower hydro lake levels meant a greater reliance on higher-cost methods of generation.

Other downsides have been revealed by recent data, including declines in manufacturing and tourist spending. Machinery and equipment manufacturing was particularly soft in the September quarter, although it had been surprisingly strong in the June quarter; this sub-sector is still up 3% on a year ago, outpacing growth in the wider economy. Tourist spending fell back after a sharp rise in the June quarter, which appears to have been most keenly felt in hospitality spending.

On the positive side, we should see some rebound in mining and processing. A shutdown of the Pohokura offshore oil well saw mining output plunge by 20% in the June quarter. The well reopened in late July, though there have been other disruptions since. But we don't have good data on this sector, so it's not clear how big the rebound will be in the September quarter. Oil processing was also affected by a maintenance shutdown of the Marsden Point refinery during the June quarter, but that's now back to full capacity.

Another expected positive is central government services. Government spending fell well short of Budget projections in June, but the more recent fiscal accounts suggest that there was a substantial catch-up over the September quarter. Note that this refers only to public services, not the fiscal stimulus from the Families Package that went directly into consumers' pockets from 1 July.

Elsewhere in the economy, 'trundling along' still seems to be an apt description. We expect to see solid growth in healthcare and other personal services, wholesaling, finance, transport, communications and forestry. Construction has continued to pick up, but is not the driver of growth that it once was.

Q3 current account, 19 December

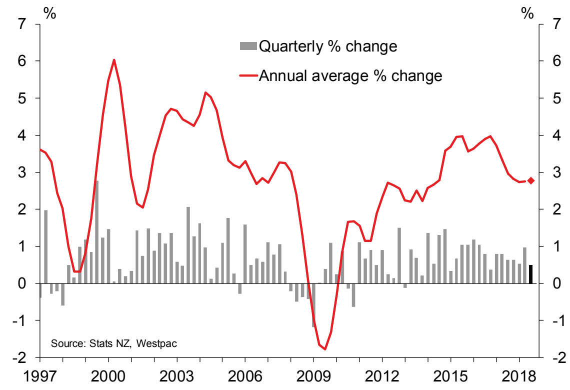
We expect the annual current account deficit to widen from 3.3% to 3.6% of GDP. While the quarterly balance for September should see some improvement compared to June, the deficit has widened in the last couple of years, and on our forecast will reach a five-year high.

To some extent, the current account deficit follows the economic cycle: when the economy is strong, demand for imports rises and the outflows of interest and profit increase. However, temporary factors have also played a part. Milk production has been lower and oil prices have risen over the past few years, but these are set to reverse course. The current account remains on a path that we'd consider to be sustainable over the long term.

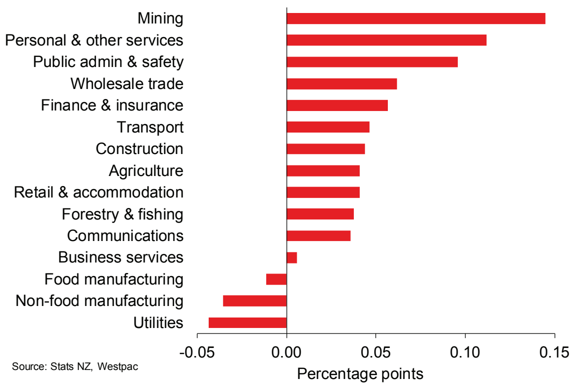
In seasonally adjusted terms, the goods trade deficit narrowed to around $900m in the September quarter, with a strong lift in export volumes and a drop in import volumes. However, the improvement in the goods balance was largely offset by a fall in the services surplus, as tourist spending reversed its June quarter gains. We expect little change in the investment income deficit, with profits of overseas-owned firms and interest paid on overseas debt relatively flat over the past year.

Michael Gordon
Senior Economist

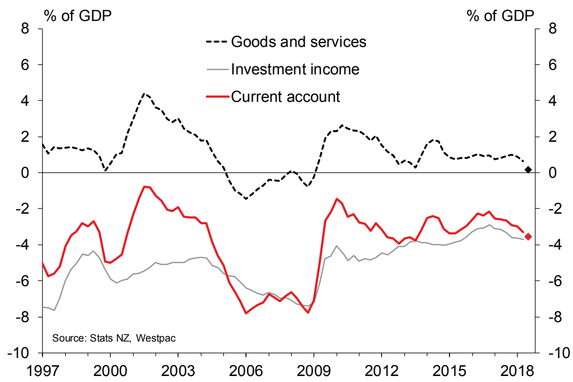
GDP growth



Forecast contributions to Q3 GDP



Annual current account balance



Contact the Westpac economics team

Dominick Stephens, Chief Economist +64 9 336 5671

Michael Gordon, Senior Economist +64 9 336 5670

Satish Ranchhod, Senior Economist +64 9 336 5668

Anne Boniface, Senior Economist +64 9 336 5669

Paul Clark, Industry Economist +64 9 336 5656

Any questions email: economics@westpac.co.nz

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