

A not so bad look

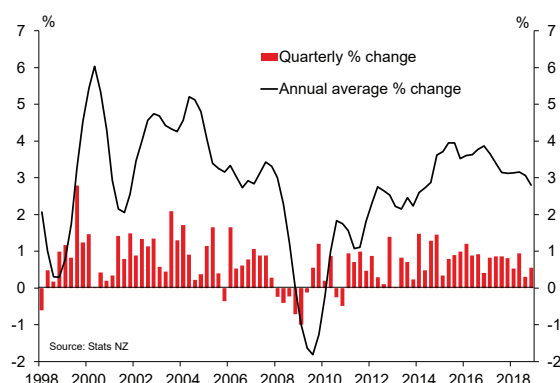
NZ GDP, December quarter 2018

Michael Gordon, Senior Economist +64 9 336 5670

- GDP rose by 0.6% in the December quarter, a stronger rebound than we expected after a weak 0.3% rise in September.
- Household spending and construction were highlights for the quarter, while personal and business services were mixed. Energy sector disruptions were a temporary drag on growth.
- Today's results give us more comfort around our view that growth will regain some momentum over 2019.
- Growth was a little below the Reserve Bank's forecast, but not enough to warrant a change of tone in next week's OCR review.

Key results	Dec 2018	Sep 2018	Westpac f/c	Market f/c
GDP qtr %	0.6	0.3	0.3	0.6
GDP ann %	2.3	2.6	2.2	2.5
GDP ann avg %	2.8	3.1	2.7	2.8

Annual average GDP growth



New Zealand's GDP rose by 0.6% in the December quarter, a result that was stronger than we expected but was in line with market forecasts. Growth for the year as a whole slowed to 2.8%, slipping below the 3% mark for the first time since September 2014.

Today's GDP figures come as something of a relief. It's clear that the economy lost some momentum over the second half of last year – just not as much as we thought, and in particular the weak 0.3% gain in the September quarter looks to have understated the true picture. That gives us a bit more comfort about our view that the pace of growth will pick up again in 2019, with support from government spending, construction, and rising household incomes.

The results also provide some food for thought ahead of next Wednesday's Reserve Bank OCR review. Previously we'd said that the RBNZ was 'preloaded' for a dovish shift in its language in March, given the downside risks that were already apparent at the February *Monetary Policy Statement*. But that's no longer shaping up to be the case. GDP was only modestly below the RBNZ's forecast of 0.8%, and other recent developments – softer house prices, stronger commodity prices – have been more balanced. It seems more likely now that the RBNZ will hold its line in next week's statement.

The GDP figures are even more of a challenge to financial markets, which have gone beyond anticipating a change of tone from the RBNZ and have been pricing in the possibility of OCR cuts over the next year. There certainly has been a dovish shift among central banks around the world in recent months. But ultimately the RBNZ sets monetary policy based on local conditions, not what the rest of the pack is doing. There just isn't a strong case for interest rate cuts in an economy that is trundling along at about its potential.

Details

The production measure of GDP rose by 0.6%, following a 0.3% increase in the September quarter. There were some minor revisions to previous quarters, which affected the annual growth rate a little but made no real difference to the level of GDP.

As expected, strong gains in retail spending (up 2.5%) and construction (up 1.8%) were among the highlights for the

quarter. Government services (up 1.8%) and healthcare (up 0.9%) also made solid contributions.

Relative to our forecast, the main surprise was a strong rebound in transport (up 3.2%) and communications (up 1.6%). Both of these sectors were surprisingly soft in the September quarter, and we expected some rebound this time – it just proved to be even larger than we anticipated.

On the weaker side, the disruptions in the energy sector over the quarter were apparent. Supply disruptions from the Pohokura gas field weighed on mining, chemical manufacturing and electricity generation. The latter was also affected by low hydro lake levels during the quarter. These disruptions will eventually disappear, although the Pohokura field saw a further maintenance shutdown during the March quarter.

Growth in the service sectors was mixed. As mentioned above, retail, transport and healthcare saw strong gains. But there were declines in finance, wholesaling, recreation and personal services. Real estate services recorded strong growth in both of the last two quarters, though that seems out of step with house sales which were broadly flat over that time.

The expenditure measure of GDP rose by 0.5%. While this measure is considered less reliable on a quarterly basis, it perhaps sheds more light on the nature of the slowdown in growth over the second half of last year.

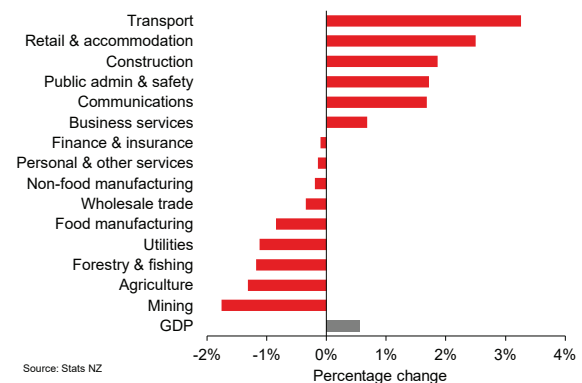
Household spending has continued to grow at a robust pace, supported by Government transfers from the Families Package and rising household incomes. Spending was boosted further by the easing in petrol prices during the December quarter. Construction activity grew modestly, though it's likely that capacity constraints have been an ongoing factor.

In contrast, the slowdown has largely been a business-led one. Investment in capital equipment rose strongly over 2017, but more or less flatlined over 2018. This may be a delayed reflection of low business confidence after the change of government in late 2017; if so, we don't expect it to be a lasting drag on activity.

The growth slowdown also partly reflects the fact that government consumption hasn't stepped up in the way that we would have expected, given the fiscal projections. We still expect spending to ramp up as planned, and that plays an important role in our forecasts of GDP growth for the next couple of years.

Michael Gordon
Senior Economist

Q4 GDP changes by sector



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

Past performance is not a reliable indicator of future performance. The forecasts given in this document are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The ultimate outcomes may differ substantially from these forecasts.

Disclaimer

Things you should know

Westpac Institutional Bank is a division of Westpac Banking Corporation ABN 33 007 457 141 ("Westpac").

Disclaimer

This material contains general commentary, and market colour. The material does not constitute investment advice. Certain types of transactions, including those involving futures, options and high yield securities give rise to substantial risk and are not suitable for all investors. We recommend that you seek your own independent legal or financial advice before proceeding with any investment decision. This information has been prepared without taking account of your objectives, financial situation or needs. This material may contain material provided by third parties. While such material is published with the necessary permission none of Westpac or its related entities accepts any responsibility for the accuracy or completeness of any such material. Although we have made every effort to ensure the information is free from error, none of Westpac or its related entities warrants the accuracy, adequacy or completeness of the information, or otherwise endorses it in any way. Except where contrary to law, Westpac and its related entities intend by this notice to exclude liability for the information. The information is subject to change without notice and none of Westpac or its related entities is under any obligation to update the information or correct any inaccuracy which may become apparent at a later date. The information contained in this material does not constitute an offer, a solicitation of an offer, or an inducement to subscribe for, purchase or sell any financial instrument or to enter a legally binding contract. Past performance is not a reliable indicator of future performance. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The ultimate outcomes may differ substantially from these forecasts.

Country disclosures

Australia: Westpac holds an Australian Financial Services Licence (No. 233714). This material is provided to you solely for your own use and in your capacity as a wholesale client of Westpac.

New Zealand: In New Zealand, Westpac Institutional Bank refers to the brand under which products and services are provided by either Westpac or Westpac New Zealand Limited ("WNZL"). Any product

or service made available by WNZL does not represent an offer from Westpac or any of its subsidiaries (other than WNZL). Neither Westpac nor its other subsidiaries guarantee or otherwise support the performance of WNZL in respect of any such product. The current disclosure statements for the New Zealand branch of Westpac and WNZL can be obtained at the internet address www.westpac.co.nz. For further information please refer to the Product Disclosure Statement (available from your Relationship Manager) for any product for which a Product Disclosure Statement is required, or applicable customer agreement. Download the Westpac NZ QFE Group Financial Advisers Act 2008 Disclosure Statement at www.westpac.co.nz.

China, Hong Kong, Singapore and India: This material has been prepared and issued for distribution in Singapore to institutional investors, accredited investors and expert investors (as defined in the applicable Singapore laws and regulations) only. Recipients in Singapore of this material should contact Westpac Singapore Branch in respect of any matters arising from, or in connection with, this material. Westpac Singapore Branch holds a wholesale banking licence and is subject to supervision by the Monetary Authority of Singapore. Westpac Hong Kong Branch holds a banking licence and is subject to supervision by the Hong Kong Monetary Authority. Westpac Hong Kong branch also holds a license issued by the Hong Kong Securities and Futures Commission (SFC) for Type 1 and Type 4 regulated activities. This material is intended only to "professional investors" as defined in the Securities and Futures Ordinance and any rules made under that Ordinance. Westpac Shanghai and Beijing Branches hold banking licenses and are subject to supervision by the China Banking Regulatory Commission (CBRC). Westpac Mumbai Branch holds a banking license from Reserve Bank of India (RBI) and subject to regulation and supervision by the RBI.

UK: The contents of this communication, which have been prepared by and are the sole responsibility of Westpac Banking Corporation London and Westpac Europe Limited. Westpac (a) has its principal place of business in the United Kingdom at Camomile Court, 23 Camomile Street, London EC3A 7LL, and is registered at Cardiff in the UK (as Branch No. BR00106), and (b) authorised and regulated by the Australian Prudential Regulation Authority in Australia. Westpac is authorised in the United Kingdom by the Prudential Regulation Authority. Westpac is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by

Disclaimer continued

the Prudential Regulation Authority are available from us on request. Westpac Europe Limited is a company registered in England (number 05660023) and is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.

This communication is being made only to and is directed at (a) persons who have professional experience in matters relating to investments who fall within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "Order") or (b) high net worth entities, and other persons to whom it may otherwise lawfully be communicated, falling within Article 49(2)(a) to (d) of the Order (all such persons together being referred to as "relevant persons"). Any person who is not a relevant person should not act or rely on this communication or any of its contents. The investments to which this communication relates are only available to and any invitation, offer or agreement to subscribe, purchase or otherwise acquire such investments will be engaged in only with, relevant persons. Any person who is not a relevant person should not act or rely upon this communication or any of its contents. In the same way, the information contained in this communication is intended for "eligible counterparties" and "professional clients" as defined by the rules of the Financial Conduct Authority and is not intended for "retail clients". With this in mind, Westpac expressly prohibits you from passing on the information in this communication to any third party. In particular this communication and, in each case, any copies thereof may not be taken, transmitted or distributed, directly or indirectly into any restricted jurisdiction. This communication is made in compliance with the Market Abuse Regulation (Regulation(EU) 596/2014).

Investment Recommendations Disclosure

The material may contain investment recommendations, including information recommending an investment strategy. Reasonable steps have been taken to ensure that the material is presented in a clear, accurate and objective manner. Investment Recommendations for Financial Instruments covered by MAR are made in compliance with Article 20 MAR. Westpac does not apply MAR Investment Recommendation requirements to Spot Foreign Exchange which is out of scope for MAR.

Unless otherwise indicated, there are no planned updates to this Investment Recommendation at the time of publication. Westpac has no obligation to update, modify or amend this Investment Recommendation or to notify the recipients of this Investment Recommendation should any information, including opinion, forecast or estimate set out in this Investment Recommendation change or subsequently become inaccurate.

Westpac will from time to time dispose of and acquire financial instruments of companies covered in this Investment Recommendation as principal and act as a market maker or liquidity provider in such financial instruments.

Westpac does not have any proprietary positions in equity shares of issuers that are the subject of an investment recommendation.

Westpac may have provided investment banking services to the issuer in the course of the past 12 months.

Westpac does not permit any issuer to see or comment on any investment recommendation prior to its completion and distribution.

Individuals who produce investment recommendations are not permitted to undertake any transactions in any financial instruments or derivatives in relation to the issuers covered by the investment recommendations they produce.

Westpac has implemented policies and procedures, which are designed to ensure conflicts of interests are managed consistently and appropriately, and to treat clients fairly.

The following arrangements have been adopted for the avoidance and prevention of conflicts in interests associated with the provision of investment recommendations.

- (i) Chinese Wall/Cell arrangements;
- (ii) physical separation of various Business/Support Units;
- (iii) and well defined wall/cell crossing procedures;
- (iv) a "need to know" policy;
- (v) documented and well defined procedures for dealing with conflicts of interest;
- (vi) steps by Compliance to ensure that the Chinese Wall/Cell arrangements remain effective and that such arrangements are adequately monitored.

U.S.: Westpac operates in the United States of America as a federally licensed branch, regulated by the Office of the Comptroller of the Currency. Westpac is also registered with the US Commodity Futures Trading Commission ("CFTC") as a Swap Dealer, but is neither registered as, or affiliated with, a Futures Commission Merchant registered with the US CFTC. Westpac Capital Markets, LLC ("WCM"), a wholly-owned subsidiary of Westpac, is a broker-dealer registered under the U.S. Securities Exchange Act of 1934 ("the Exchange Act") and member of the Financial Industry Regulatory Authority ("FINRA"). This communication is provided for distribution to U.S. institutional investors in reliance on the exemption from registration provided by Rule 15a-6 under the Exchange Act and is not subject to all of the independence and disclosure standards applicable to debt research reports prepared for retail investors in the United States. WCM is the U.S. distributor of this communication and accepts responsibility for the contents of this communication. All disclaimers set out with respect to Westpac apply equally to WCM. If you would like to speak to someone regarding any security mentioned herein, please contact WCM on +1 212 389 1269. All disclaimers set out with respect to Westpac apply equally to WCM.

Investing in any non-U.S. securities or related financial instruments mentioned in this communication may present certain risks. The securities of non-U.S. issuers may not be registered with, or be subject to the regulations of, the SEC in the United States. Information on such non-U.S. securities or related financial instruments may be limited. Non-U.S. companies may not be subject to audit and reporting standards and regulatory requirements comparable to those in effect in the United States. The value of any investment or income from any securities or related derivative instruments denominated in a currency other than U.S. dollars is subject to exchange rate fluctuations that may have a positive or adverse effect on the value of or income from such securities or related derivative instruments.

The author of this communication is employed by Westpac and is not registered or qualified as a research analyst, representative, or associated person under the rules of FINRA, any other U.S. self-regulatory organisation, or the laws, rules or regulations of any State. Unless otherwise specifically stated, the views expressed herein are solely those of the author and may differ from the information, views or analysis expressed by Westpac and/or its affiliates.