Not a good look

Preview of Q4 GDP and current account

13 March 2019

- We expect a 0.3% rise in December quarter GDP, less than market expectations or the Reserve Bank's forecast.
- There seems to have been a genuine slowdown in growth over late 2018, though it was exacerbated by some temporary disruptions in the energy sector.
- Both the New Zealand and Australian economies have slowed in recent times, but for different reasons. Household spending and construction were highlights for New Zealand in the December quarter.
- We expect the annual current account deficit to widen to 3.9% of GDP, a six-year high. The terms of trade fell over 2018 and import volumes have remained strong.

	Sep-18 actual	Dec-18 Westpac f/c	Dec-18 RBNZ f/c
GDP			
Quarterly % chg	0.3	0.3	0.8
Annual % chg	2.6	2.2	2.7
Annual average % chg	3.0	2.7	2.8
Balance of Payments			
Current account balance $m, s.a.	-2,666	-2,930	-2,280
Annual balance $m	-9,536	-11,470	-10,620
Annual balance % of GDP	-3.6	-3.9	-3.6

Next week is set to bring some unflattering figures on the New Zealand economy in the form of the December quarter national accounts. We expect GDP (Thursday) to rise by just 0.3%, following an equally soft gain in the September quarter. Meanwhile, the current account deficit (Wednesday) is set to widen further to 3.9% of GDP, which would be the largest deficit in six years.

Our forecast of GDP growth looks to be at the low end of the range of market forecasts, and is substantially less than the 0.8% rise that the Reserve Bank forecast in its February *Monetary Policy Statement* (which we noted at the time was too optimistic). The next Official Cash Rate review on 27 March, shortly after the GDP figures, will have to acknowledge that the balance of developments since February has been to the downside.

While growth slowed by more than we expected over the second half of 2018, we're still of the view that momentum will pick up over 2019, supported by higher government spending, a strong pipeline of construction work, and a lift in labour incomes.

It's also worth highlighting that while both New Zealand and Australia recorded similarly weak growth figures over the second half of last year, the reasons for their respective slowdown are quite different. Falling house prices in Australia have weighed on household spending and homebuilding, and could have a prolonged impact on activity. In contrast, retailing and construction were the star performers of the New Zealand economy in the December quarter, and we see scope for further growth over this year.

Q4 GDP, 21 March

We expect a 0.3% increase in the production measure of GDP, following a 0.3% increase in the September quarter. This would see growth for the 2018 calendar year drop to 2.7%, compared to 3.1% in 2017 and a peak of 3.9% in 2016.

Our view is that some of the recent slowdown in GDP growth is genuine, but for the December quarter this is likely to be exacerbated by some temporary factors. In particular, disruptions in the energy sector will show up in several ways:

- Ongoing disruptions to output from the Pohokura gas field will weigh on the mining sector directly.

- Reduced gas supplies will have weighed on methanol production, which uses natural gas as an input.
- Electricity generation was affected by both low hydro lake levels and reduced gas supplies, which led to a temporary surge in wholesale electricity prices. This in turn may have prompted some manufacturers to scale back.

Altogether, we think that these disruptions will knock between 0.1% and 0.2% off growth for the December quarter.

We also expect declines in other primary industries, but this is more a matter of coming off a very strong base. December quarter milk collections were up 5% on last season, but they were slightly off the pace compared to the September quarter. Similarly, the estimated 2% fall in forestry sector output only partly reverses a 7% jump in September.

The softness in business and personal services is not so easily dismissed, given that they make up a greater share of the economy – and a large share of the GDP growth in recent years. Our forecasts for these sectors reflect the weakness in hours worked in the Quarterly Employment Survey. That may also prove in time to be temporary; the growth in job advertisements suggests that the demand for labour remains strong. But this is an area that we will be watching closely.

On the positive side, there was a strong lift in retail spending, after a relatively subdued September quarter. Residential and commercial construction also saw solid gains, though we expect infrastructure work to be down a little as earthquake repairs continue to wind down. We expect the transport and communications sectors to pick up again after losing some ground in the previous quarter. Spending on government services has picked up the pace in the last year, and we expect this to make a sizeable contribution to GDP growth over the next couple of years.

Q4 current account, 20 March

We expect the annual current account deficit to widen to 3.9% of GDP in the December quarter, compared to 3.6% of GDP in September. This would match the deficit in the December 2012 quarter, which in turn was the highest since the Global Financial Crisis.

There has been a marked widening in the deficit over the last year. We're still a long way from the blowout in deficits that was seen in the years before the GFC. But it is starting to reach levels that would be associated with a worsening in New Zealand's net overseas debt position, after a decade-long trend of improvement.

The widening of the deficit has largely been driven by trade in goods and services. Some of that is due to prices: dairy export prices fell over 2018, while oil import prices rose over much of the year. Both of these factors have turned around in recent months, but have yet to be reflected in the trade figures.

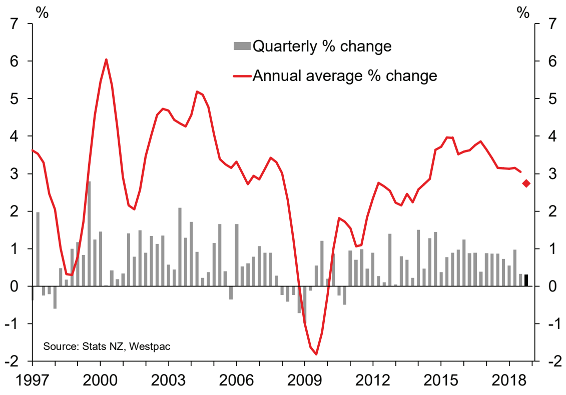
But it's also a volume story. In particular, import volumes rose sharply in late 2017 and have remained high since then. Some of this reflects imports of capital equipment, which should be a positive for growth over the longer term. But demand for imports has been persistently high across the board, which is unusual given that overall domestic demand overall hasn't taken a leg higher, and the lower New Zealand dollar should have favoured local production over imports.

For a time, the widening goods trade deficit was being offset by a growing surplus in services. But growth in inbound tourism has come off the boil in the last year, while outbound tourism has remained strong.

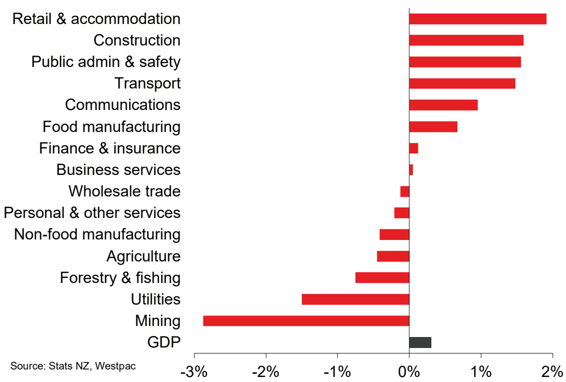
In contrast to the deteriorating trade balance, we don't expect much change in the investment income deficit. Profits of overseas-owned firms and interest payments on overseas debt have broadly gone sideways over the last year.

Michael Gordon
Senior Economist

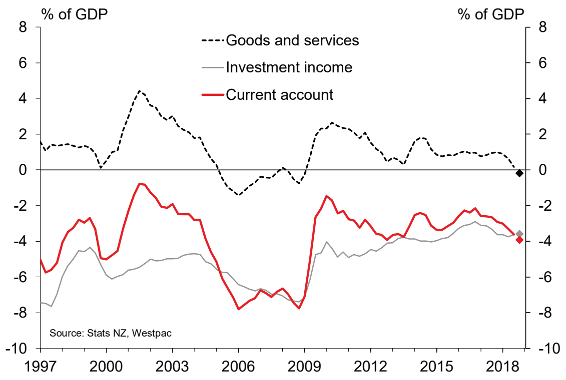
GDP growth



Q4 GDP changes by sector



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

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 license 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

Disclaimer continued

Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by 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 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.