Westpac

Institutional Bank

16 June 2016

Weight of numbers

GDP rose 0.7% in Q1

- GDP rose by 0.7% in the March quarter, slightly ahead of market expectations.
- Activity was boosted by a sharp rise in construction, and by rising demand for services from a rapidly growing population.
- The pace of per-capita GDP growth has slowed substantially over the past year, as dairy prices have fallen and the Christchurch rebuild has peaked.
- Strong population growth now accounts for most of the growth in GDP. But this also adds to the supply side, and doesn't point to an economy where capacity is becoming stretched.

Key results

	Actual	Previous	Q1 forecasts	
	Q1	Q4	Westpac	Market
GDP q/q	0.7	0.9	0.6	0.5
GDP ann % chg	2.8	2.3	2.7	2.6
GDP ann avg % chg	2.4	2.5	2.4	2.4

On the face of it, the New Zealand economy made a solid start to the year. GDP grew by 0.7% in the March quarter, above the median market forecast of 0.5% and slightly ahead of the 0.6% increase that we and the Reserve Bank were expecting. The surprise was balanced out by some mild downward revisions to growth over 2015, leaving us with a 2.4% pace of growth over the year to March, in line with expectations.

But take a step back and look at the record of the last few years, and a different story emerges. Not only is the pace of growth well off its peak in this cycle, but the slowdown has come at a time when sheer population growth should have been boosting the economy. Strong net migration has lifted population growth to around 2% over the last year, which means that per capita GDP growth has slowed to not much more than zero.

Over the last couple of years, the economy has been buffeted by the loss of two major sources of income growth: dairy export prices have gone from very high to very low, and the Christchurch earthquake rebuild has peaked and is no longer a source of growth. There have been some positive factors in the meantime, such as tourism and non-quake related construction, but neither is large enough to provide a complete offset. Instead, population growth has been the main driver of GDP growth.

From the Reserve Bank's point of view, we suspect that today's release won't constitute much of a surprise, after allowing for the small downward revisions to growth in 2015. We're still inclined to forecast one further OCR cut at the August Monetary Policy Statement – bearing in mind, the Reserve Bank's stated position is that a rate cut in August is more likely than not if things pan out as expected.

Details

The breakdown of activity by sector was similar to what we expected, and was consistent with the idea of population growth as a major driver. Domestically-oriented sectors (mostly services) recorded solid growth in demand, while export-oriented sectors continued to grapple with soft global conditions (with a few exceptions such as forestry).

The largest contribution, as expected, was a 4.9% increase in construction activity, led by the Auckland and Waikato regions. A surge in building consents late last year had already signalled that there was a strong pipeline of building work for 2016, and the consistently dry weather over the quarter may have also allowed work to progress faster than usual.

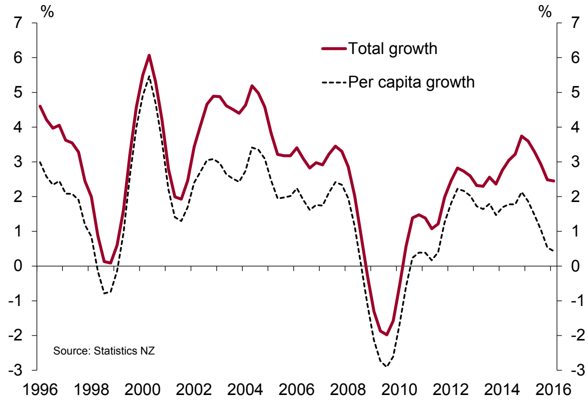
The sectors that appeared to benefit most from population growth were retailing and accommodation (also helped by strong growth in tourist numbers), transport and healthcare. The services sectors as a whole grew by 0.8%, on the back of 0.6% population growth over the quarter.

The main weak spot for the quarter was food manufacturing, particularly meat processing. To a large degree this was a timing issue – there was a greater than usual cull of sheep and cattle in the second half of last year, due to weak dairy prices and fears of a drought. This left fewer animals to process over the early part of 2016. However, the more recent processing figures appear to have returned to normal for this time of year.

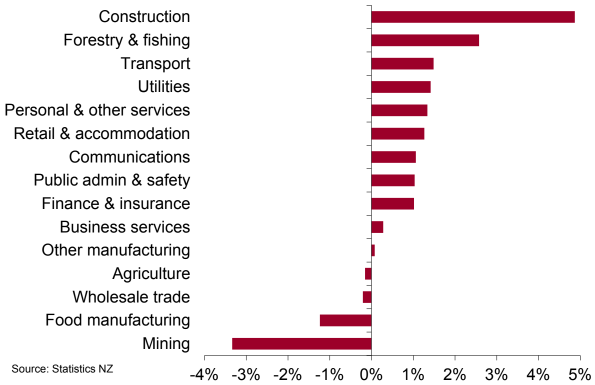
The expenditure measure of GDP, which is considered less reliable on a quarterly basis, saw a more modest 0.5% increase. There were also some sizeable downward revisions to growth over 2015. That helps to clear up one of the puzzles of the GDP figures, where annual growth was running at 3.6% on the expenditure measure but just 2.4% on the production measure. With expenditure GDP growth now running at a more moderate 3.1%, the two measures are now more consistent in pointing to slower per-capita growth.

Michael Gordon
Senior Economist

GDP, annual average % change



Q1 GDP growth by sector



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