Institutional
Bank

15 September 2016

Better balance

NZ GDP growth 0.9% in Q2

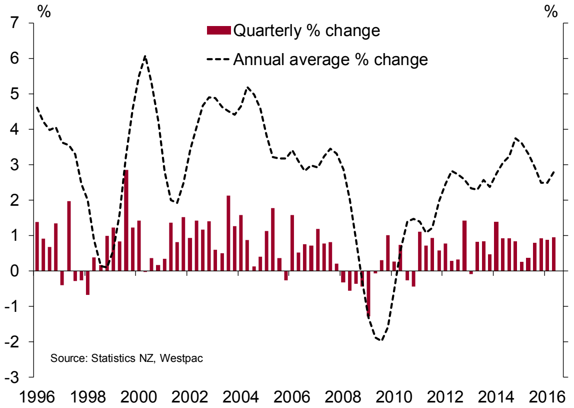
- GDP rose by 0.9% in the June quarter, a touch below forecasts.
- However, the downside surprise was offset by an upward revision to Q1 growth, meaning annual GDP growth of 3.6% was in line with expectations.
- The biggest contribution to growth this quarter came from the construction sector, while activity associated with the rampant housing market is also being reflected in strong growth in real estate services.
- Growth is becoming increasingly broad based, with momentum in the New Zealand economy likely to be maintained for the next year or two. But ultimately, the wind-down of the Canterbury rebuild and slower population growth is expected to drag growth lower in the latter part of the decade.

Key results

	Actual	Previous	Q2 forecasts	
	Q2	**Q1**	**Westpac**	**Market**
GDP Q/Q	0.9	0.9	1	1.1
GDP Ann % Chg	3.6	3	3.5	3.6
GDP Ann Avg %Chg	2.8	2.5	2.7	2.8

The New Zealand economy continued trucking along at a solid pace in the June quarter, growing 0.9%. While this headline was a touch below market expectations, the surprise was offset by upward revisions to Q1 GDP growth (now estimated at 0.9%, up from 0.7% originally), meaning growth over the first half of the year is tracking at about the pace we expected.

Production-based GDP growth



Source: Statistics NZ, Westpac

That said, it's clear that over the last few months, momentum in the New Zealand economy has improved. Growth is being driven by very strong growth in the construction sector, increasing activity in real estate services on the back of a buoyant housing market, and population driven growth in the service sector (health and retail particularly stood out in the June quarter).

There were even hints in today's data that the traditional link between house prices and consumption growth is starting to reassert itself. Historically, strong house price growth has been associated with a pickup in consumer spending, as home owners spend some of the wealth they are accumulating. But over the past year or two, this traditional aspect of the NZ growth story has been notably absent. Private consumption growth has been somewhat weaker than what we might have expected to see given historical relationships. But there were hints of this relationship reasserting itself in today's data. House prices have risen 11% over the first half of the year while household consumption has grown 2.3%. That's up from 1.6% growth in the 6 months prior.

Looking ahead, we expect many of these drivers of growth to linger for a while yet. Residential building activity in Auckland has a long way to go before it makes decent inroads into an estimated 30,000 dwelling shortfall. What's more, the brightening outlook for the dairy sector lessens one of the bigger risks to growth that had been weighing on local prospects.

But while the going looks pretty respectable in the near term (we expect annual GDP growth to hover around 3% over the next couple of years), a material slowdown in activity is waiting in the wings. By the latter part of this decade the wind down of the Canterbury rebuild, combined with slower population growth will weigh heavily on growth prospects.

For the Reserve Bank, today's data is a little stronger than they anticipated in the *August MPS*. However, when combined with other developments over the last few weeks (most notably the higher NZ dollar and improved export prices) the outlook for interest rates and inflation is likely to be much the same as in August. Accordingly, we think the RBNZ will leave the OCR on hold next week, but continue to signal that a rate cut is likely in November.

Details

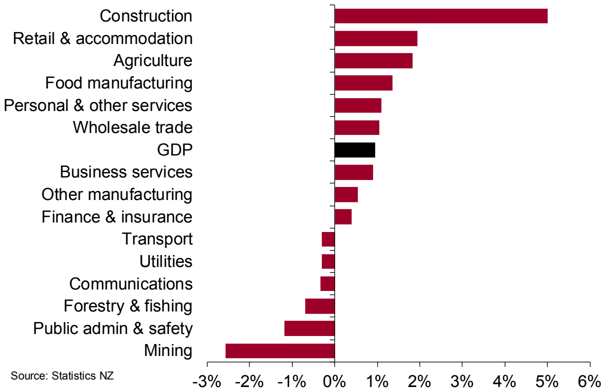
The breakdown of production GDP growth was broadly in line with our expectations. Most sectors in the economy expanded, with the biggest contributions to quarterly growth coming from the construction sector, real estate services, retail spending and health – all sectors where New Zealand's expanding population has plausibly played an integral role in the pickup in activity.

The biggest drag on activity in the June quarter was from mining production. While this can be volatile from quarter to quarter, low oil prices have been discouraging exploration and activity in the sector for much of the last year. We're unlikely to see a strong turnaround while oil prices linger below $50/barrel.

Meanwhile the expenditure measure of GDP, which can be more volatile from quarter to quarter, grew 1.2% in the June quarter, following upwardly revised growth of 0.7% in Q1. Annual expenditure GDP growth is now running at 3.1%. Looking at the economy through the expenditure lens, very strong growth in exports (as foreshadowed by yesterday's current account data) was a key feature. Indeed, the 7.6% lift in exports of goods for the quarter was the strongest in 18 years.

Anne Boniface
Senior Economist

Production-based GDP growth



Source: Statistics NZ

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