15 March 2018

NZ Growth Dip Of Little Concern

- **GDP growth modestly below expectation**
- **But near RBNZ expectation**
- **More of the same for the immediate future**
- **But Government will provide a boost as the year wears on**
- **And monetary policy remains super-supportive**

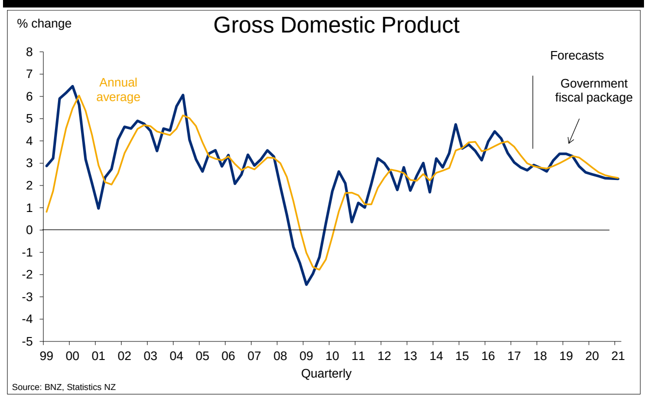
The New Zealand economy grew 0.6% through the fourth quarter of 2017. Compared with year earlier levels activity was up 2.9%. The quarterly outturn was modestly below expectations and resulted in a 30 pip fall in the NZD. In our opinion, the market response was probably unwarranted as: the data are very dated; the outcome was only 0.1% below that of the RBNZ's expectations; and the figures are highly unlikely to result in any significant shift in forecasters' views of the future.

All that said, we were a little surprised that the dry weather of late last year had as big an impact on the agriculture sector as it did, and we had reason to believe that the manufacturing sector was more robust than the GDP data intimates. The good news, though, is that it has done nothing but rain since and manufacturing indicators, generally, remain positive. Accordingly, we have modestly bumped up our expectation for Q1, 2018 GDP to 0.6% from 0.5%.

From our perspective, the economy remains in generally good nick supported, in particular, by ongoing strength in household spending, the services sector (especially tourism) and a strong terms of trade. Moreover, while we may be going through a relatively flat patch at the moment, the economy is soon to be buoyed by a significant fiscal injection starting with free tertiary education for many and then moving on to a myriad of benefit and assistance packages around mid-year. We thus still see GDP growth averaging around 3.0% per annum over calendar 2018 and 2019.

The current economic expansion is being driven by domestic demand rather than net exports. This is not surprising given the extent of New Zealand's population and employment growth, low interest rate settings, real wage expansion and need for significant investment activity. What is surprising, however, is that the pace of

GDP Down But Not Out



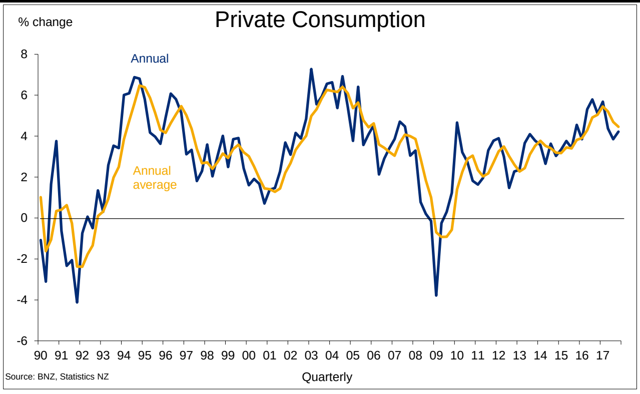
GDP by Industry - December 2017 quarter	qtr % chg prev qtr	% pt cont to chg (1)	ann avg % chg	ann % chg
Agriculture, Forestry & Fishing	-3.2	-0.1	1.2	2.3
Mining	1.8	0.0	-1.9	-2.4
Manufacturing	-0.1	0.0	2.1	2.0
Electricity Gas, Water & Waste Services	1.5	0.0	1.9	2.0
Construction	0.7	0.0	1.6	1.2
Wholesale Trade	2.2	0.1	3.9	5.4
Retail, Accom. & Restaurants	1.6	0.1	6.4	6.2
Transport, Postal and Warehousing	1.7	0.1	3.5	5.4
Information Media & Telecommunications	0.7	0.0	1.4	2.9
Financial and Insurance Services	0.7	0.0	2.0	0.8
Rental, Hiring, Real Estate Services	0.8	0.1	0.9	1.0
Prof, Scientific, Technical, Admin	2.3	0.2	4.4	4.6
Public Admin and Safety	0.8	0.0	3.3	3.6
Education & Training	0.3	0.0	1.7	1.3
Health Care and Social Assistance	0.3	0.0	5.3	4.3
Arts, Recreation and Other	-1.9	-0.1	3.5	-1.0
Unallocated (2)	2.0	0.2	3.1	4.1
Balancing Terms (3)	..	-0.2	..	..
Gross Domestic Product	**0.6**	**0.6**	**2.9**	**2.9**

(1) Includes the change in inventories and the seasonal adjustment balancing item
(2) Includes unallocated taxes on production and imports, and bank service charge
(3) The seasonal adjutment balancing item

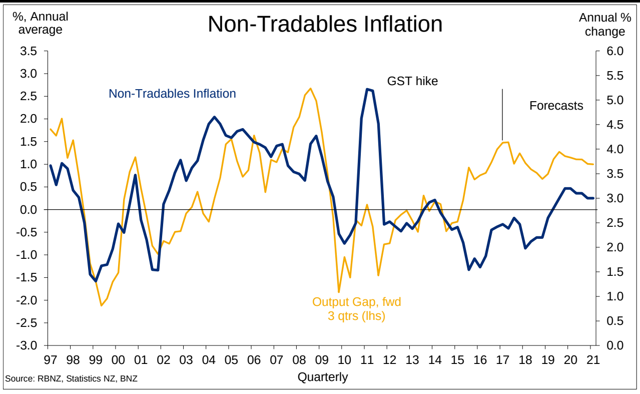
Expenditure on GDP - December 2017 quarter	qtr % chg prev qtr	% pt cont to chg (1)	ann avg % chg	ann % chg
Final Consumption Expenditure				
Private	1.2	0.7	4.5	4.2
General Government	-0.1	0.0	4.7	4.8
Gross Fixed Capital Formation				
Residential Buildings	0.5	0.0	0.6	1.3
Other Fixed Assets	3.7	0.6	4.5	6.6
Exports of Good and Service	0.0	0.0	2.5	6.0
Imports of Goods and Services	3.9	-1.0	6.6	8.4
Change in Inv & Bal. Item (4)	..	0.1	..	..
Expenditure on GDP	**0.4**	**0.4**	**3.0**	**3.2**

(4) Includes the change in inventories and the seasonal adjustment balancing item.
Source: Statistics New Zealand

Household Spending Robust



Inflation Not Derailing Expansion



domestic demand has not resulted in inflationary pressure sufficient to cause the RBNZ to raise interest rates. The longer this remains the case, and there is good reason to assume that this will be so, the longer the expansion can keep rolling on unaffected by tighter monetary conditions.

The other surprise is that New Zealand's current account balance has remained so well contained. Typically in such periods of expansion, net exports deteriorate substantively as import volume growth soars to meet the needs of domestic demand. When domestic demand took off between 2002 and 2005, for example, the current account deficit blew out from around 1% of GDP to peak at almost 8% of GDP. This time around the deficit sits at just 2.7% and looks set to rise only modestly. We can thank the soaring terms of trade for this as well as the strength in tourism earnings. The lack of a current account blow out is another reason to believe that the expansion will not be cut short prematurely.

For now, then, the New Zealand economy continues to expand favourably. Near-trend GDP growth is accompanied by strong employment growth, rising real wages, asset price appreciation and next-to-no CPI inflation. One of these days this will inevitably all come unstuck but the good news is that, as things stand, there is little in the immediate horizon that looks likely to bring this all to an end. The world economy looks strong, climatic conditions are not disastrous, the Reserve Bank won't be tightening any time soon and the Government will be pumping in plenty of money.

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