RESEARCH

ECONOMY WATCH

14 June 2018

bnz

Q1 GDP Preview – Downside Risks

- **We expect Q1 GDP expanded 0.5% (2.7% y/y)**
- **Versus RBNZ expectation of 0.7%**
- **Expenditure measure hints at disappointment**
- **Transitory drags for Q1 still stick out**
- **Pick-up mooted for Q2, albeit under question**
- **In any case, CPI inflation to firm up**

For a good while now, we have been wary about how this year's Q1 GDP will go. We remain so. The reasons for this still stick out. And moribund business confidence and cooled consumer sentiment, since the change in government, obviously haven't helped.

Having said this, the partials to hand suggest that GDP, overall, probably hung in there in the March quarter. Our workings point to a real production-based expansion of around 0.5% (verging on 0.4%, mind you). This would deliver annual growth of 2.7% (providing there is no material revision to recent history, that is, when, in fact, there are reasons to suspect manufacturing might be upgraded in Q4 GDP).

As we write, we haven't seen any published polling on the market's (median) expectation for Q1 GDP. But some of the locals have indicated growth estimates in the vicinity of 0.4/0.5%. So, close to where we are. But thus below the 0.7% quarterly increase the Reserve Bank factored into its May Monetary Policy Statement (MPS).

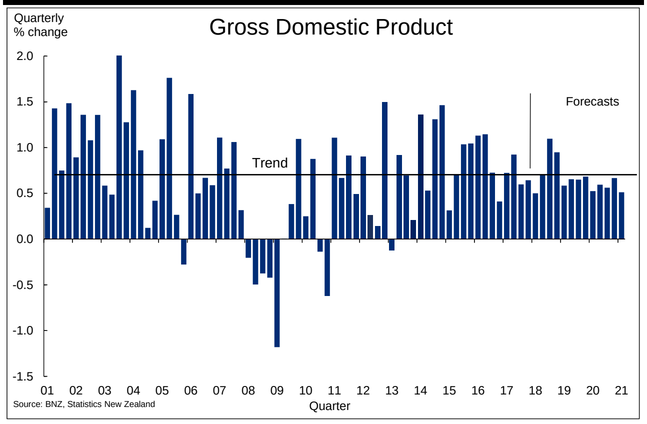
In putting together our estimate, the last of the main partial indicators, Monday's Quarterly Survey of Manufacturing, was the one we were sweating on the most. We expected it to hold up. However, specific factors were threatening to dunk it. These included a weather-related dent to dairy and meat production, an ease in building work, and a correction in forestry activity after a long surge.

While these factors remain relevant, and evident, it turned out that other elements of manufacturing came to the rescue. Overall, the industry looks to have expanded moderately in the March quarter. Still, this isn't to say the quarterly manufacturing survey nails the industry's outcome as per the GDP accounts. In fact, it leaves plenty of room for surprise.

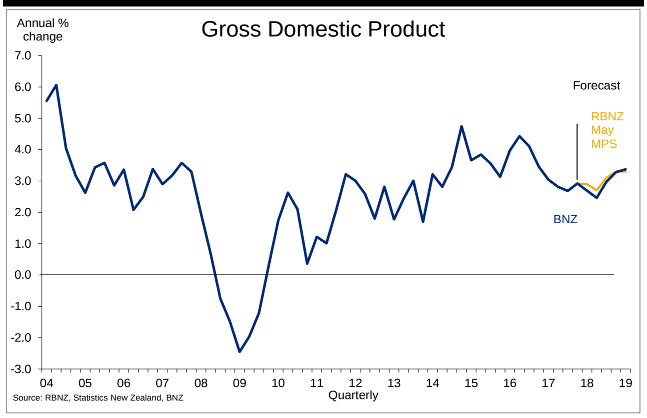
Base case, however, we get a picture of Q1 GDP growth being stymied by (transitory) weakness in primary production, a pause in wholesaling and retailing, and a virtual stalling in construction's expansion. The services sector, meanwhile, provides the backbone to our Q1 GDP calculations (once again), albeit with ongoing variability in its detail.

Our expenditure-GDP estimate is having greater trouble in generating growth. Indeed, it's a bare +0.1% for Q1 - albeit enough for annual growth to be 3.0%. While this involves solid quarterly growth in private consumption (+0.6%, better than retail alone) and chunky investment (ex-building), a big negative from net exports spoils the show, related mainly to the aforementioned weakness in primary goods.

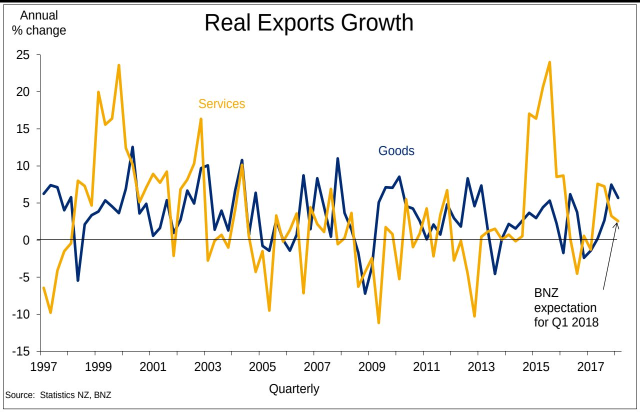
A Wobbly Start?



Seemingly Disappointing



Off the Boil



On exports, we should also note that we don't expect any bounce-back in their services component, after this slipped for the second successive quarter, in Q4. To be sure, international tourist arrivals remain strong as a level. But their spending impulse looks to have waned in the early part of 2018.

Of course, New Zealand's expenditure-based GDP series is a hard rabbit to corner (partly because of quarterly inventory swings). However, it can help to convey the stories. And, in struggling to produce any growth at all in Q1, it alludes to the direction of risk we see to our production GDP growth estimate, of 0.5%. And even that is barely anything in per capita terms (given New Zealand's still-strong rate of population growth).

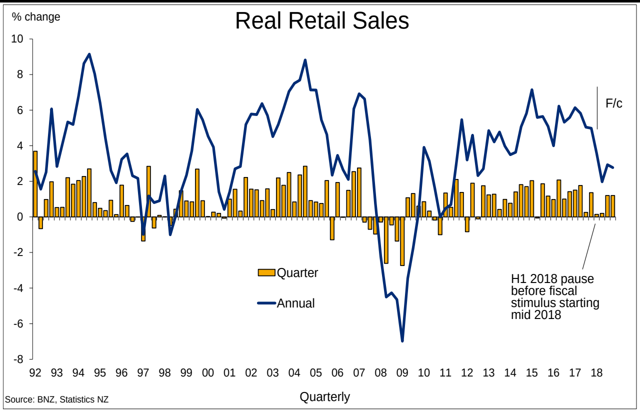
Other more-identifiable factors that could have undermined March quarter economic activity more than we judge include;

- The vicious storms of February (reason for the reduction in building activity and drop in forestry harvesting?)
- The disruption to vehicle imports, after "stink bugs" were discovered on vessels destined for NZ ports. This seemed a feature in wholesaling's weakness in the March quarter, for example
- The early Easter this year, compromising business days late-March (albeit benefitting other forms of activity and spending)

Certainly, one of the key things to figure out in the Q1 GDP outturn is to what extent it is limited by one-off factors. This will help to gauge the degree to which a rebound can be reasonably expected for Q2.

In this vein, we still expect Q2 GDP to register a robust increase, in the order of 0.7% (before stronger expansion over H2 2018, as the fiscal stimulus kicks in proper). While nothing has put us off this view, we do need to monitor what might frustrate it.

Something to Watch

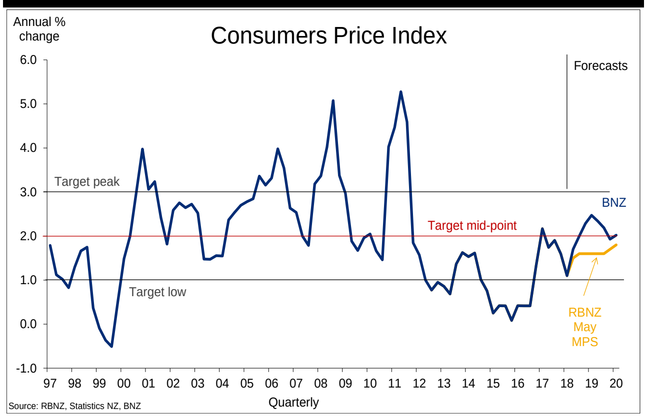


Household expenditure is one. This is especially after May's electronic card transactions (ECT) posted a half-hearted rebound, after falling in April. This left us struggling to compute much, if any, growth in Q2's real retail trade. Having said this, we draw attention to the increasing difficulty in measuring electronic spending these days. The methods of payment are mushrooming. The ECT data, for instance, do not cover tap-and-go (Pay-wave) card transactions.

Also, we are conscious of some elements of industrial production that may struggle to rebound in Q2, including gas production and oil refining, for idiosyncratic reasons. Then again, the official statistics on energy production, from the Ministry of Business Innovation and Employment, are often not available before the GDP release itself anyway (we certainly haven't seen them yet regards Q1 2018).

The other area we continue to observe carefully is business investment. To date, its expansion has held up as much as business confidence has weakened. But the potential for a slowdown in investment, as well as hiring, is something to watch.

Upside



In thinking about the June quarter, and the potential for a pick-up in GDP pace, it's also worthwhile recalling that the Reserve Bank's May MPS anticipated a gain of 0.8%.

But while there remain risks of NZ GDP growth disappointing to the slow side over the first half of calendar 2018, there is likely to be a pickup in inflation almost regardless. At least in terms of the headline CPI, that is. Even with the recent tab-down in local petrol pump prices, we expect the Q2 CPI to increase 0.6%. This would lift its annual inflation to 1.7%, from the 1.1% it bowed to in Q1.

From there we expect annual CPI inflation to move up to 2.0% in Q3, 2.3% in Q4 and 2.5% in Q1 of 2019. The latter is significantly stronger than the 1.6% that the RBNZ last forecast. If you think we might end up closer to the money on this than the Reserve Bank, then it would suggest the Bank can't stay so open-ended with its stated policy biases. And any weakness in New Zealand's real economy data over the immediate term might provide even better opportunity to set some trades along these lines.

craig_ebert@bnz.co.nz

Contact Details

BNZ Research

Stephen Toplis
Head of Research
+64 4 474 6905

Craig Ebert
Senior Economist
+64 4 474 6799

Doug Steel
Senior Economist
+64 4 474 6923

Jason Wong
Senior Markets Strategist
+64 4 924 7652

Nick Smyth
Interest Rates Strategist
+64 4 924 7653

Main Offices

Wellington
Level 4, Spark Central
42-52 Willis Street
Private Bag 39806
Wellington Mail Centre
Lower Hutt 5045
New Zealand
Toll Free: 0800 283 269

Auckland
80 Queen Street
Private Bag 92208
Auckland 1142
New Zealand
Toll Free: 0800 283 269

Christchurch
111 Cashel Street
Christchurch 8011
New Zealand
Toll Free: 0800 854 854

National Australia Bank

Peter Jolly
Global Head of Research
+61 2 9237 1406

Alan Oster
Group Chief Economist
+61 3 8634 2927

Ray Attrill
Head of FX Strategy
+61 2 9237 1848

Skye Masters
Head of Fixed Income Research
+61 2 9295 1196

Wellington

Foreign Exchange	+800 642 222
Fixed Income/Derivatives	+800 283 269

Sydney

Foreign Exchange	+61 2 9295 1100
Fixed Income/Derivatives	+61 2 9295 1166

London

Foreign Exchange	+44 20 7796 3091
Fixed Income/Derivatives	+44 20 7796 4761

New York

Foreign Exchange	+1 212 916 9631
Fixed Income/Derivatives	+1 212 916 9677

Hong Kong

Foreign Exchange	+85 2 2526 5891
Fixed Income/Derivatives	+85 2 2526 5891