Q2 GDP Keeps the Wolves at Bay

- 0.5% Q2 GDP beats market but not the RBNZ
- Expenditure GDP up 0.7% (2.6% y/y)
- Historical revisions negligible
- Services and business investment provide backbone
- Q2 GDP consistent with RBNZ pause next week
- But GDP/OCR still vulnerable over time

The New Zealand economy lives to fight another quarter. With the market breathing down its neck, this morning’s June quarter GDP report proved resilient. It expanded a seasonally adjusted 0.5%, compared to market expectations of a 0.4% gain.

While there didn’t look to be much in this, the details tended to reinforce the tone of resilience, rather than the reality of slowdown (bearing in mind Q1 GDP growth was 0.6%, for an 2.5% annual, which slowed to 2.1% in Q1. This, by the way, confirmed that historical revisions instituted today were net-trivial for GDP overall).

Similarly, the expenditure measure of real GDP has slowed; but to 0.7% in Q2, from 0.9% in Q1. This made for annual growth of 2.6%, so well above the 2.1% registered in the production GDP measure. Such divergences are always worth keeping an eye on, in terms of reading the NZ economy (and wondering how this “gapping” will ultimately be reconciled, as it always is, in the fullness of time).

While we don’t judge the economy as being slack – as some seem keen to do – we didn’t expect today’s GDP accounts to print quite as positively as they did. We anticipated a 0.3% increase in production GDP (verging on 0.4% after we saw the exports and imports detail of yesterday’s Balance of Payments).

The drags we anticipated in construction and manufacturing panned out almost exactly as we thought. But services growth proved a touch more robust (albeit viciously mixed in its component details), with the likes of Central Government Administration jumping 2.3%, and Arts and Recreation up 2.8%, while retail activity was stronger than the earlier quarterly Retail Trade survey portrayed. There was also an expansion in agricultural output that defied our expectations of slight slippage.

On the expenditure side, the upward surprise in GDP for us seemed mainly a matter of business investment doing better than we imagined. While this was masked by a timing-related drop of 3.7% in non-residential building work, there was a 2.1% increase in investment in plant and machinery, and 2.3% with respect to transport goods. That was encouraging.

Broadly in line with our thinking, private consumption expanded a decent 0.5% in Q2, marking annual growth at 2.9%. The reported fall in goods exports was also no revelation to us. This was principally a timing issue around agricultural sales (rather than evidence the global slowdown is at last having its wicked way on these shores). The expenditure GDP accounts also fired no warning shot about bloated inventories at this stage of proceedings.
However, as encouraging as Q2 GDP was (relatively speaking), and as much as we forecast growth to continue along at a similar pace, we still think the risks are tilted toward disappointment, looking ahead.

Looking ahead is clearly what the Reserve Bank is attempting to do, in providing the “stimulus” it thinks it is. The idea in this is to keep growth up (lest annual CPI inflation fails miserably to be 2%).

The other reason to see today’s GDP report as no obstacle to further easing from the RBNZ, of course, is that it printed in line with what the August Monetary Policy Statement (MPS) figured on. And that MPS signalled another rate cut was still very much in the mix.

The trouble is that some folk are interpreting the Bank’s 50 point cut last month as a sign that something must be coming unstuck out there in the economy. Whatever the cause, consumer confidence is now looking a little shakier, under the hood, while business confidence and expectations continue to warn of slower economic growth ahead too.

With this, we wonder if our GDP growth forecasts are still not mild enough.

Having said this, we also wonder, will slower growth in GDP guarantee that slack will emerge in the economy anyway. In particular, would it mean for a loosening in the labour market and/or core wage and price inflation failing to be broadly consistent with Reserve Bank objectives as well?

Be that as it may, we suspect the Reserve Bank would interpret slower than anticipated GDP growth as justification for reducing its policy rate even further. And by slower we mean in prospect, not so much in known outcome. In this vein, GDP growth over the coming year is far more relevant than any sign of robustness that can be reasonably read into the June quarter just passed.

Suffice it say, then, that the August MPS forecast 3.0% growth in real GDP over the year to June 2020. We find this difficult to conceive of, especially from the economy’s current point of stretch. But the latter also means that even if annual GDP growth holds around 2.0% it might still be plenty enough to underpin inflation objectives.
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