

Research Economy Watch

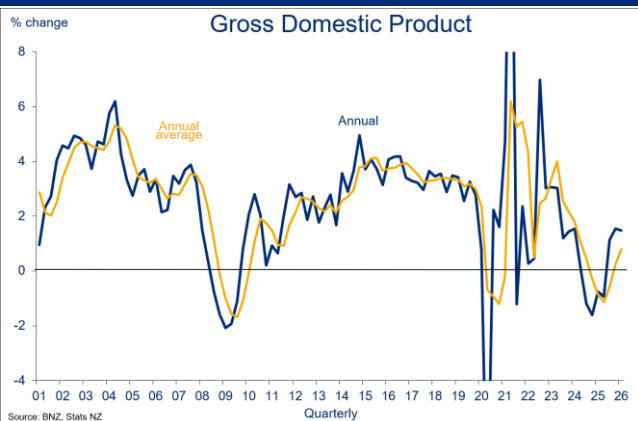
18 June 2026

Pre-war GDP stronger than believed

- GDP growth stronger than expectations
- As revisions push Q4, 2025 GDP higher
- Q2, 2026 looking increasingly negative
- But talk of recession is way premature
- Building sector in the dumps

The key data point in today's national accounts release was the annual growth in GDP. At 1.5% it was 0.3% higher than the RBNZ had pencilled in and 0.4/0.5% above the consensus. The quarterly outturn of 0.8% was indifferent to expectations but, as we had warned, revisions to historical data would be the key to understanding the economy's progress.

Momentum building



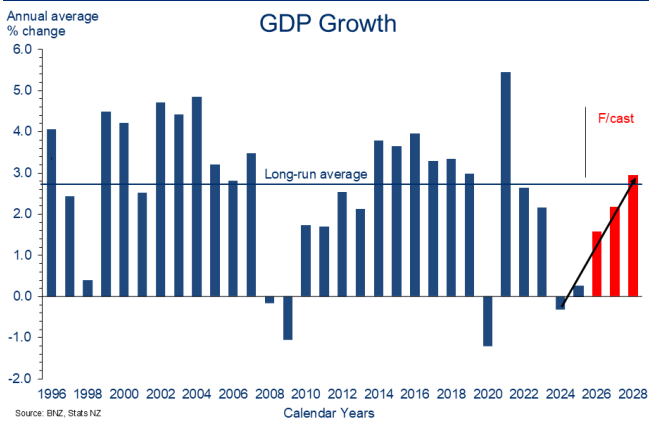
What all this means is that the economy was on a firmer footing going into the war than the RBNZ was expecting. Does this really matter? No. It's where to from here that will determine monetary policy outcomes. At the very margin it provides no reason for the doves to get more dovish but it doesn't exactly argue for more aggression either.

Nonetheless, it is very important to recognise the economic momentum that was inherent prior to the Middle East fiasco. Not only did the economy grow solidly in Q1 of 2026 but it built on a decent 0.5% improvement (previously published as 0.2%) in the fourth quarter of 2025. While it looks like the economy will stall through winter, we still think activity across calendar 2026 will be 1.6% up on the year prior and the pace of growth should then continue rising to 2.2% in calendar 2027 and 3.0% the year after.

Component	qtr % chg prev qtr	% pt cont to chg	ann avg %chg	ann % chg
Expenditure on gross domestic product - March 2026 quarter				
Final consumption expenditure				
Private	0.5	0.3	1.4	0.8
General government	1.5	0.3	3.8	5.5
Gross fixed capital formation				
Residential buildings	-3.1	-0.2	-3.7	-4.1
Other fixed assets	3.7	0.6	1.2	3.0
Exports of goods and services	3.1	0.8	3.3	5.4
Imports of goods and services	4.2	-1.1	5.4	9.0
Change in inventories and balancing ite	..	0.4
Expenditure on gross domestic product	1.0	1.0	1.3	2.1

Industry	qtr % chg prev qtr	% pt cont to chg	ann avg %chg	ann % chg
Gross domestic product by industry – March 2026 quarter				
Agriculture, forestry, and fishing	1.2	0.1	1.1	1.7
Mining	-11.6	-0.1	-5.3	-10.9
Manufacturing	1.9	0.2	-0.7	1.3
Electricity, gas, water, and waste services	-0.3	0.0	2.5	3.8
Construction	-1.0	-0.1	-4.5	-3.8
Wholesale trade	2.4	0.1	4.2	7.7
Retail trade and accommodation	1.2	0.1	3.2	4.4
Transport, postal, and warehousing	1.0	0.0	0.8	1.7
Information media and telecommunication	-1.4	0.0	-0.9	0.1
Financial and insurance services	-0.8	0.0	-0.3	0.3
Rental, hiring, and real estate services	0.1	0.0	1.8	1.3
Prof, scientific, technical, admin, and supp	1.1	0.1	1.8	2.0
Public administration and safety	-0.7	0.0	1.6	2.3
Education and training	0.1	0.0	-0.5	-0.4
Health care and social assistance	1.0	0.1	1.2	0.9
Arts, recreation, and other services	-0.4	0.0	-0.3	2.5
Unallocated ⁽²⁾	2.2	0.2	1.4	2.2
Balancing item ⁽³⁾	..	0.2
Gross domestic product	0.8	0.8	0.8	1.5

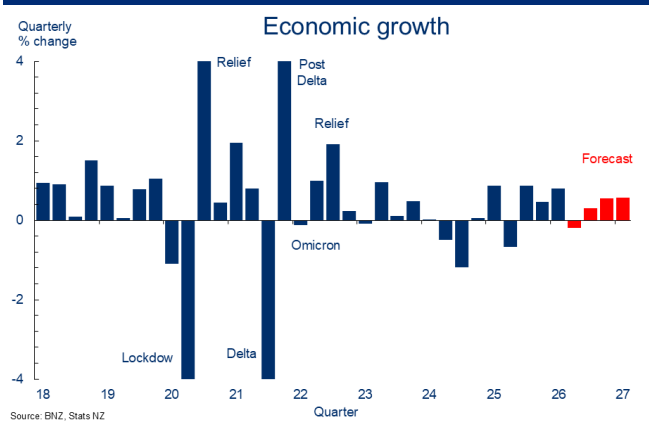
Better times ahead



And it is fair to say that we are probably underestimating the potential for the economy to expand if confidence bounces as conditions in the Middle East settle. Assuming, of course, that it does. Also, even as our forecasts stand, when you consider that the economy went a cumulative nowhere in 2023 and 2024 then the outlook really isn't that bad.

That said, our forecasts had assumed previous data were understating economic growth in the economy so we had built in some bounce back. We are now more comfortable with the historical track so we have reduced the bounce back. As a consequence, we have lowered our expectation for Q2 to a small negative from a small positive. We are quick to point out that the negative number should be seen as transitory not the beginning of a technical recession.

A temporary fall



In terms of the sectoral data provided with the Q1 data release, there were no real surprises. We were well aware from the partial data released last week, the information contained in the Performance of Manufacturing Index, and agriculture sector processing figures that manufacturing would be a major contributor to activity in the quarter. And so it was with production up 1.9%.

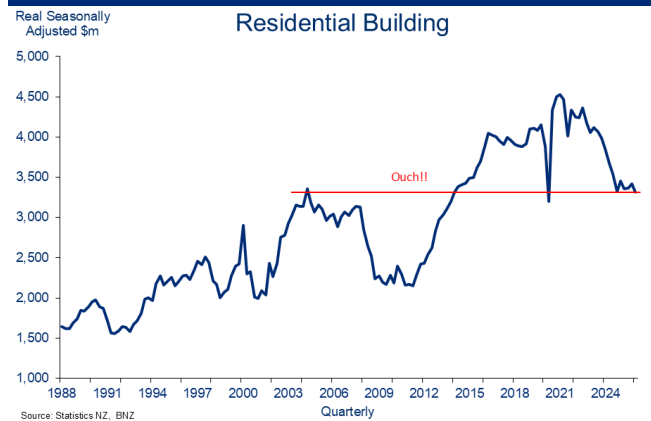
Core retail sales volumes rose 1.0% in the quarter helped by improving local demand conditions, a modest increase in net migration inflows and rising tourism expenditure. This resulted in retail trade and accommodation GDP rising 1.2% for the quarter.

With rural sector activity running hot and a pick up in domestic demand, generally, wholesale trade also performed well rising 2.4%.

The hit to all these sectors from the war will be the major factor constraining Q2 activity.

The big underperformer for Q1 was construction. On a production basis construction declined 1.0% for the quarter to be down 3.8% for the year. A glance at the breakdown of the investment component of expenditure on GDP reveals that residential construction fell 3.1% for the quarter to be down 4.1% on year earlier levels while non-residential fell 3.4% and 12.6% respectively. These are very sick sectors. Excluding one COVID quarter, the level of residential construction is at its lowest since December 2013 and non-residential the lowest since September 2017. Strong building consents data suggest better days are ahead for residential builders but not so for non-residential.

Simply awful?



Perhaps the only redeeming feature is that there is some evidence infrastructure construction is having a very positive impact. Other construction rose 4.8% in the quarter to be up 10.8% on a year earlier.

From a monetary policy perspective there is nothing in today's data that should generate a significant shift in view. The key issues that remain are:

- How much damage to growth has the war generated?
- And, more importantly for the Bank, will any such softening lower price pressures or will those pressures remain elevated given the wide-reaching impact on prices of this supply shock.

But, in addition to this, the Bank must also start pondering just what might happen to inflation if there is a sentiment driven pickup in demand. A modicum of demand-pull inflation at a time when there is a cost-push inflation hangover could make things very interesting indeed.

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