21 September 2017

A Centrist GDP Outcome

- Q2 NZ GDP expands 0.8% (2.5% y/y)
- No real surprise (for RBNZ included)
- But nominal GDP growth "just" 5.4% y/y
- No great fodder for election debate
- As growth indicators remain robust in Q3
- But immigration falls again in August

New Zealand's economic activity remains bumpy in its componentry. However, overall, it continues to make its way forward at a creditable pace (as do the leading indicators of growth, going into Saturday's election). June quarter production GDP expanded 0.8%. This was in line with market expectations, and ours. As was the annual growth result, of 2.5% (even with a slight upgrade to March quarter growth itself – to 0.6%, from 0.5%).

As solid as this appeared, there will no doubt be those still questioning just how strong the GDP accounts really are. In this we acknowledge that per capita GDP growth in Q2, for instance, was 0.3%, and 0.4% at an annual rate. This was even with the one-off benefits from the major sports events that New Zealand hosted in the June quarter. And even the big increase in goods exports in Q2 was mainly catch-up from a poor run over prior quarters.

The 0.8% increase in Q2 GDP, overall, also harboured further slippage in construction activity, a reduction in on-farm output, a third successive fall in mining activity, and was aided by an outsized 1.8% expansion in central government services (+4.8% y/y).

But to come to the defence of the latest GDP report card, it also had to digest a big run-down in inventory in the June quarter, from manufacturing. Even with this, the expenditure measure of real GDP lifted 1.1% in the June quarter, none too shabby. Private consumption

GDP (Production) - 2017 Q2				
	Actual	Mkt Expected	Aug MPS	Previous
s.a qtr % chg	**+0.8**	+0.8	+0.9	+0.6R
qtr on qtr year ago %	**+2.5**	+2.5		+2.5
annual average % chg	**+2.7**			+2.9
R - revised				

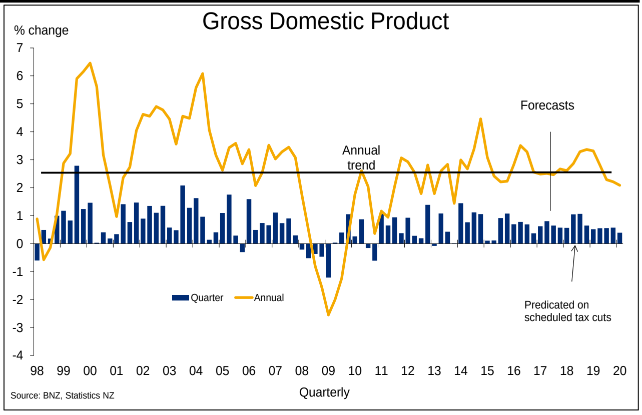
expenditure, meanwhile, kept chugging forth at +0.9% in Q2, to be 4.0% stronger than a year ago (nothing to do with tourist spending, by definition). And while investment in plant and machinery slipped 0.9% in Q2, this was after big gains in Q4 and Q1, such that annual growth came in near 10%.

To be sure, the housing market remains vulnerable to a correction, given the heights it has got to (in the context of very low interest rates). However, we don't believe the reported slippage in construction activity over the first half of 2017 confirms the start of a downturn, more a consolidation from a big leg up during 2015/16. There is, however, an underlying abatement occurring in Canterbury's reconstruction cycle that is important to recognise. This is weighing on the national total.

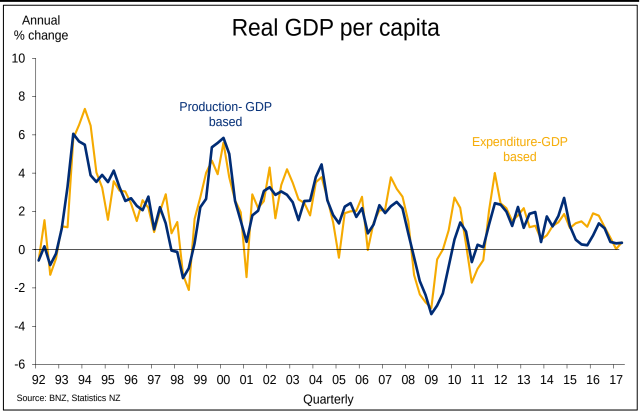
In many ways New Zealand's construction industry is also at the forefront of the capacity-constraint story we are pushing. It's hard to keep expanding when resources are being stretched, and when the marginal resources being employed, as the cycle matures, they are probably dragging the averages down. This process seems relevant to the productivity debate regarding the economy more generally. While CPI inflation might be slow in picking up, to our mind there are abundant signs that the economy is getting stretched on the supply side.

The GDP deflator also continues to lag. In fact, it fell 0.8% in the June quarter. We are still scratching our heads over

Still Poised for a Pick Up



Slow



this, as the price of the principal components of expenditure GDP – consumption, investment and net exports of goods and services – all rose, albeit not by much. The under-shoot of the GDP deflator was the reason annual nominal GDP growth chimed in at 5.4% in Q2, rather than the 8.0% we anticipated.

As for how Q2 GDP compared to Reserve Bank expectations, in real terms it was pretty close. The Bank expected 0.9% on Q2 GDP growth and the outcome was 0.8%; nothing to see there.

It's not as if there are signs of deceleration in the economy. If anything, the pointers are edging the other way, even with the election front of face. That GDP growth will probably pick up over the coming 6-12 months – at least on an annual basis. The BNZ/Business New Zealand PMI and PSI measures proved the latest cheerleaders of this.

Of course, there might yet be some important implications for New Zealand's economic outlook from Saturday's election. But with that race still looking very tight we cannot presume to amend our views on anything at this point. Today's Q2 GDP report certainly can't be considered fodder for one side of the election debate or the other, when it comes to arguing the underlying health of the economy.

Meanwhile, the economic data keep on being printed. Perhaps lost amid the spotlight on this morning's GDP account was the concurrent release of figures showing a second monthly drop in immigration. The seasonally adjusted 5,490 net inflow in August was down a bit further from July's 5,760, which was itself back from June's near record high of 6310. This has been entirely due to fewer arrivals (which have declined by 820) with the number of departures steady.

The coming months' data will be important to see if this is indeed the beginning of some moderation along the lines of what is built into our macroeconomic forecasts, including for the housing and labour markets. A marked slowdown in net migration may render both RBNZ and Treasury growth forecasts a bit optimistic in a headline sense, although implications for output gap assessments, and thus (core) inflation, would be equivocal.

Meanwhile, Statistics NZ also reported this morning that annual growth in visitor arrivals settled at 5.8% in August from 4.8% in July. This is after averaging more than 12% y/y through the period April-June boosted, as it was, by the hordes for the World Masters Games and Lions Rugby tour that New Zealand hosted. This points to an obvious unwind in tourism related activity in Q3 relative to Q2.

Nonetheless, there seems plenty of momentum in many other areas of the economy to keep GDP expanding at a respectable clip – and enough to keep pressure on the supply side of the economy.

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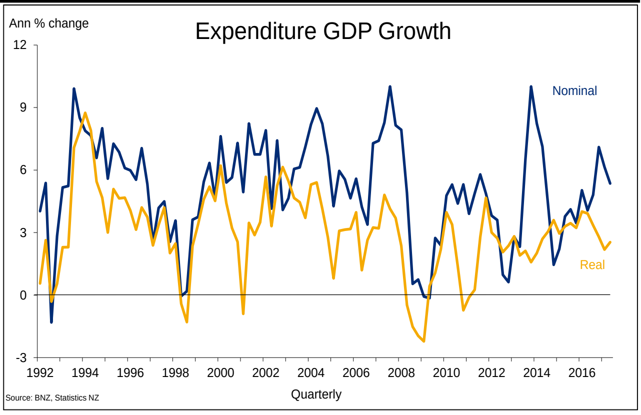
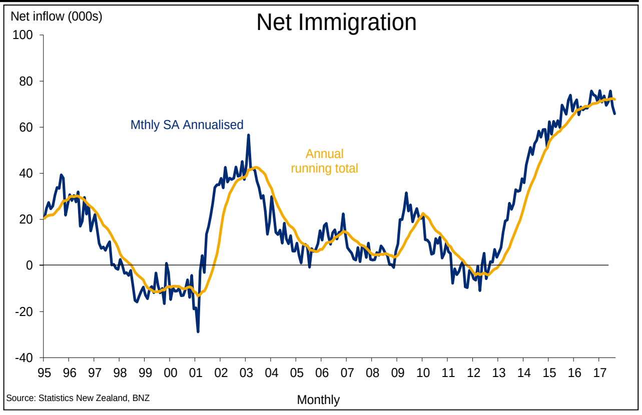
We Expected More on the Nominals



Rolling Over?



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