21 December 2017

GDP stirs but may yet be Shaken

- **Q3 shows economic momentum maintained**
- **Headwinds for next six months**
- **Before fiscal stimulus bites**
- **Investors are nervous**
- **Here's hoping for a Happy New Year**

Yesterday the NZD took a dive following the release of a set of current account and trade figures that were only marginally weaker than the consensus. Today the currency spiked following a GDP release that was just a tad stronger than expected. Neither move was justified by the data, especially given its very much historical nature. One can only assume that this volatility is symptomatic of an investor community that is increasingly nervous and unsure about New Zealand's prognosis – an uncertainty that has equally been reflected by the portfolio shift out of the NZD since the September 23 General Election.

What today's data do show us is that the New Zealand economy was in fine fettle through the middle of 2017. It grew 0.6% for the September quarter and activity was 2.7% higher than year earlier levels. Moreover, the expansion is being shared by a wide number of industries. All 17 of the major industry groups that Statistics New Zealand reports on recorded growth between September 2016 and September 2017. Eleven of those industries grew in excess of 2.0%. Similarly, when looked at on an expenditure basis, consumption, investment and exports all did well.

Be that as it may, the more important question is: where to from here? We have long warned that growth might moderate through the end of this year and into early next. We maintain that view. In our opinion a swathe of factors will adversely impact the expansion. Amongst other things:

- Net migration inflows are slowing;
- Construction growth has moderated;
- Climatic conditions are worrisome;
- House price inflation has declined;
- Dairy prices are down and it looks increasingly likely that Fonterra will be forced to lower its payout projections further;
- Political uncertainty is resulting in some postponement of investment and hiring.

Some of these factors will have an immediate impact; others will take longer to feed through the system. Over the last four years growth has averaged around 0.9% per quarter. We think that we are moving into an environment where "core" growth will settle in a 0.4 - 0.6% range. The next two quarters are likely to be at the lower end of that range as climate and uncertainty have an immediate impact. Then there is likely to be a period, of around a year, when substantial fiscal stimulus returns the economic expansion towards the 1.0% a quarter mark. But as the marginal impact of that stimulus wanes it will be back to that 0.4% – 0.6% range.

GDP Production

	% chg prev qtr	ann avg % chg	ann % chg
GDP by Industry - September 2017 quarter			
Agriculture, forestry, and fishing	-1.0	-0.1	3.4
Mining	3.2	-1.8	1.4
Manufacturing	0.7	1.7	1.8
Electricity, gas, water, and waste services	-1.6	1.7	0.7
Construction	3.6	4.1	1.9
Wholesale trade	0.6	3.0	2.9
Retail trade and accommodation	-0.4	5.7	5.5
Transport, postal, and warehousing	1.4	3.3	3.0
Information media and telecommunications	0.3	0.5	2.2
Financial and insurance services	0.7	2.7	2.1
Rental, hiring, and real estate services	-0.3	1.1	0.6
Prof, scientific, technical, admin, and support	0.9	4.9	3.6
Public administration and safety	0.1	2.8	3.0
Education and training	0.3	1.9	1.5
Health care and social assistance	2.1	6.0	5.8
Arts, recreation, and other services	2.4	6.0	4.2
Gross domestic product	**0.6**	**3.0**	**2.7**

Expenditure GDP

	% chg prev qtr	ann avg % chg	ann % chg
Expenditure on GDP - September 2017 quarter			
Final consumption expenditure			
Private	0.8	4.3	3.4
General government	2.5	4.1	6.0
Gross fixed capital formation			
Residential buildings	3.3	2.5	1.4
Other fixed assets	0.3	4.2	3.5
Exports of goods and services	0.8	0.6	3.7
Imports of goods and services	2.1	6.2	5.7
Expenditure on gross domestic product	**0.9**	**2.7**	**3.0**

Source: Statistics New Zealand

Our forecasts are unaffected by today's release and remain below those of the RBNZ and Treasury. The difference between our forecasts and the RBNZ's only matter to the extent that the lower growth profile drives a lower inflation profile. We don't think it will so we remain comfortable with our assumption that interest rates are eventually hiked more aggressively than the RBNZ has postulated. The big caveat here is that the dairy sector withstands the current combination of dry weather and weaker international prices. If a full blown drought hits and/or dairy prices continue to tumble then this could yet see us revising lower both our growth and inflation forecasts.

Potentially the bigger issue is faced by government in the event that sub-forecast growth means that revenues fail to keep pace with expectations. Were this to be the case, we doubt this would result in lower fiscal stimulus but, rather, a more relaxed approach to getting net crown debt to 20% of GDP.

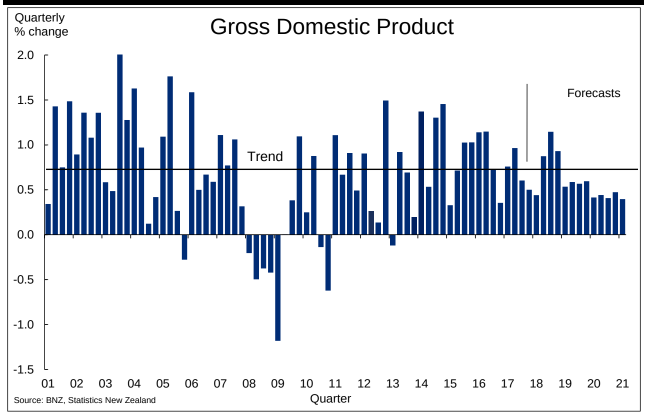
In short, then, the New Zealand economy continues to "hang in there". We remain cautiously optimistic that it can maintain this for some time to come. But the clouds are gathering and it will be imperative that: the weather treats us well; international commodity prices remain robust; and the government wins the confidence of business sooner rather than later.

New Zealand now goes into a data hiatus. The next significant piece of intel on the New Zealand economy comes by way of NZIER's Quarterly Survey of Business Opinion, due for release on January 16. This will set the scene for 2018 and give us deeper insight into the sentiment of businesses, their growth, employment and investment intentions and, importantly for markets, what they intend to do with their prices.

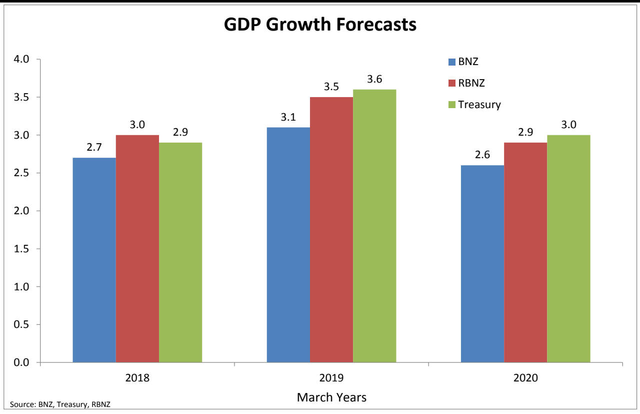
As such, and barring any outrageous developments, this is likely to be our last formal note until our Weekly of January 15 (though we will start producing our Markets Today on January 8).

On that note, we thank you for your readership and wish you all the very best for a restful and happy festive season.

Growth Moderating



Institutions Optimistic?



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