Economic Note

Q1 2018 GDP Preview

15 June 2018

Dip into the danger zone

- We expect Q1 2018 GDP grew 0.4%, with soft activity likely to be seen across a number of industries.
- But a strong bounce-back is possible in Q2, which would mean underlying growth is merely average rather than mediocre.
- Weak post-election business confidence threatens to derail growth outlook, despite firm fundamentals.

Summary & implications

We expect GDP growth of 04% in Q1 2018, which would see a further deceleration in annual GDP growth. However, many forward-looking indicators are positive for Q2 and we do expect some payback from a weak number. Our forecasts for Q1 and Q2 GDP growth is only 0.1% weaker than the RBNZ's May Monetary Policy Statement forecast. **Our key concern is not so much soft growth in Q1 but the prospect for the underlying pace of growth to weaken further if business confidence remains low into the second half of 2018.**

GDP - March 2018	Previous	ASB	RBNZ	Market
quarterly % growth	0.6	0.4	0.7	0.5
annual % growth	2.9	2.5	2.9	2.7
annual average % growth	2.9	2.7		

We expect Q1 GDP growth of 0.4%

We expect soft Q1 GDP growth of just 0.4%, which follows the sub-par growth performance over the second half of 2017. As a result, annual growth will continue to decelerate and fall to 2.5% (from 2.9%) and annual average growth will ease to 2.7% (from 2.9%). This outcome would be weaker than the RBNZ's May Monetary Policy Statement forecast of 0.7%. However, **we also have some payback penciled in for Q2** and as a result **we forecast annual growth to be only slightly weaker than the RBNZ expects by the end of Q2.**

Widespread Q1 weakness, albeit temporary in many industries

The **subdued nature of Q1 growth is likely to be broad based across industries**. But there is also a recurring theme of forward-looking indicators suggesting the weakness in Q1 is likely to be temporary. It's hard to say why so many industries saw weaker than average growth. It's possible that the volatile weather in Q1 may have played a part, with storms and king-tide flooding possibly causing some disruption in activity, but this is mere speculation.

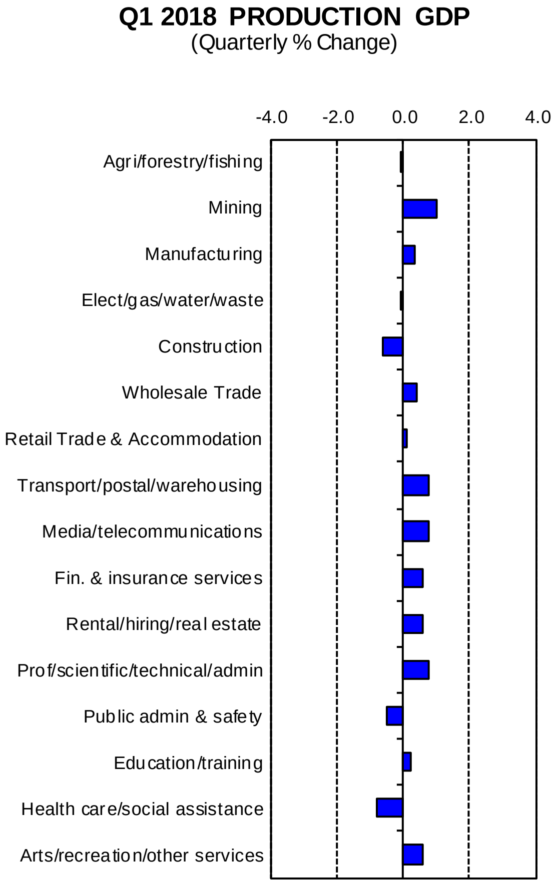
The primary sector is likely to be weighed by **a fall in livestock slaughter and fall in forestry activity**. In Q2 we expect to see some payback due to a recovery in both livestock slaughter and forestry, with additional support from a

Jane Turner – Senior Economist (649) 301 5853 jane.turner@asb.co.nz
Nick Tuffley – Chief Economist (649) 301 5659 nick.tuffley@asb.co.nz

recovery in dairy production over Q2 (as production returns to normal levels after a weather-impacted season).

Activity in goods-producing industries is likely to remain fairly flat over Q1, with **small dip in construction** sector activity. **Manufacturing activity** is likely to provide some offset with **relatively modest growth**. Forward-looking indicators point to stronger growth in both these sectors in Q2. Activity indicators for electricity and wholesale trade also point to soft Q1 production growth. The **Q1 retail trade survey was weak, but this looks to be temporary as vehicle sales fell** on disruptions to vehicle imports.

Meanwhile, the **services sector also looks to have only grown modestly**. Our indicators are largely based off the Quarterly Employment Survey (QES) (which is the main reason for some weak services forecasts in Q1) so there is always potential for stronger outcomes in services.



Weak exports, household spending and construction to weigh on expenditure.

From the expenditure side, the economy also looks weak. The retail trade survey suggests Q1 household spending growth was soft. Weak construction activity will weigh on investment – although indicators suggest investment in plant and machinery equipment may have grown on top of Q3's strong lift (which would be encouraging to see if proves correct). Trade data point to a fall in exports, resulting in a substantial drag on GDP growth.

Weak business confidence suggests underlying growth to remain soft

Some of the weakness in Q1 growth is temporary, and we do expect some pay back in Q2 – with a 1% qoq increase currently penciled in. **Nonetheless, if our H1 2018 forecasts prove correct, the underlying pace of growth over these two quarters remains slightly underwhelming given that population growth remains strong.**

Furthermore, the **post-election slump in business confidence has lasted longer than we had initially expected** (in particular, measures of businesses' expectations for their own activity along with employment and investment intentions). Low confidence in commercial construction and agriculture reflect challenges facing these particular industries, but beyond these sectors the broad-based nature of low confidence is surprising and concerning.

NZ's economic fundamentals are strong. Global demand for NZ exports of goods and services is strong. Our export prices are high and our import prices are low. Interest rates remain low and stimulatory. The labour market is gradually tightening. Net migration is running close to record highs, and the mix of migrants has shifted away from thrifty students and towards those on working visas (who are likely to spend more on goods and services in NZ). Soft GDP growth and weak business confidence are somewhat of a conundrum.

Regardless of the outcome for Q1, we expect the RBNZ will continue to champion the strong fundamentals for growth outlook and continue to play its part by holding interest rates at low levels for at least another year to come.

ASB Economics & Research			Phone
Chief Economist	Nick Tuffley	nick.tuffley@asb.co.nz	(649) 301 5659
Senior Economist	Jane Turner	Jane.turner@asb.co.nz	(649) 301 5957
Senior Economist	Mark Smith	mark.smith4@asb.co.nz	(649) 301 5657
Senior Rural Economist	Nathan Penny	nathan.penny@asb.co.nz	(649) 448 8778
Senior Economist, Wealth	Chris Tennent-Brown	chris.tennent-brown@asb.co.nz	(649) 301 5915
Economist	Kim Mundy	kim.mundy@asb.co.nz	(649) 301 5661
Data & Publication Manager	Judith Pinto	judith.pinto@asb.co.nz	(649) 301 5660

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