

Economic Note

Q2 2018 GDP Preview

13 September 2018

Sparkle and fade

- We expect Q2 2018 GDP grew 0.9%, with activity bouncing back somewhat from a soft start to the year.
- Nonetheless, the underlying pace of growth has slowed since 2016.
- The continued slide in business sentiment suggests the trend pace of growth could slow further over H2 2018.

Summary & implications

Statistics NZ releases its estimate of Q2 GDP on Thursday 20th September, 10.45am NZT. **We expect strong quarterly growth of 0.9% over Q2**, which is **mild payback from the subdued 0.5% increase over Q1**. According to our forecasts, the **average pace of growth over the first half of 2018 was hardly spectacular**, particularly given of all the supports underpinning the economy such as low interest rates, high Terms of Trade and high rates of population growth. We expect annual GDP growth of 2.7%, a significant slowdown from the pace of growth recorded over 2015 and 2016. Furthermore, the **continued deterioration in business confidence** (in particular the change in business intentions over recent months) **materially increases the risk that trend growth slows further over the second half of the year**.

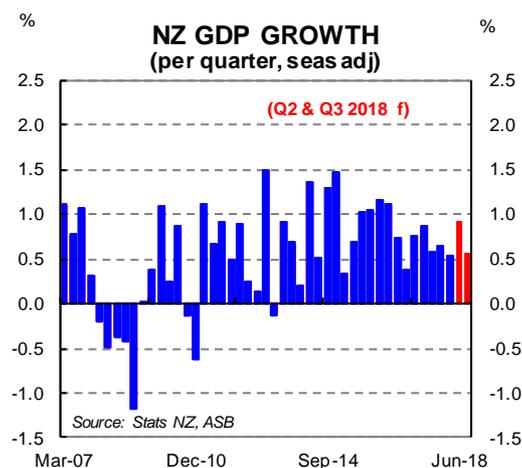
| GDP - June 2018 | Previous | ASB | RBNZ |
|-------------------------|----------|-----|------|
| quarterly % growth | 0.5 | 0.9 | 0.5 |
| annual % growth | 2.7 | 2.7 | 2.3 |
| annual average % growth | 2.7 | 2.7 | |

Q2 payback

A key theme of our Q2 GDP forecast is **payback**; with strong Q2 growth in certain industries following unusually weak growth over Q1. This includes:

- A strong lift in the GDP value-add from **electricity generation** (due to increased share of hydro generation as lake levels recovered);
- A bounce back in **agricultural and forestry production** (with dairy production recovering to normal levels during the low season, following production falls over the second half of 2017);
- A bounce back in **Retail Trade, Wholesale Trade and Arts, Recreation and Other Services**.

In addition, the **manufacturing sector** also looks to remain a key support for GDP growth over Q2, along with the **construction sector** (albeit to a lesser extent than the growth in dwelling consents since late 2017 would suggest).



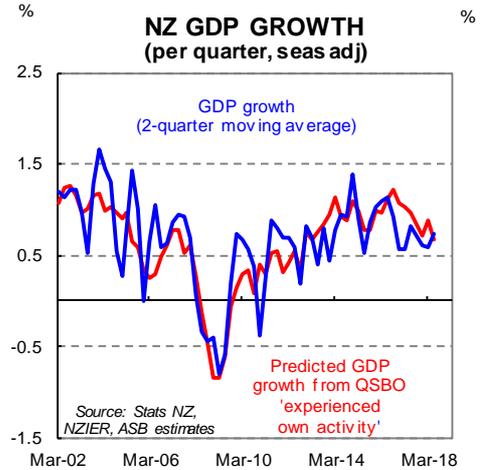
From an expenditure basis, a key support to GDP growth comes from **strong goods exports**, with commodities such as dairy, meat and kiwifruit all performing well in Q2. We also expect **household demand remained resilient**, based off the continued strength in the Retail Trade Survey. While **investment will remain supported by strong transport investment**, some cracks in the economy may start to show as we expect a small fall in plant and machinery investment.

Business confidence may weigh on Q3 growth

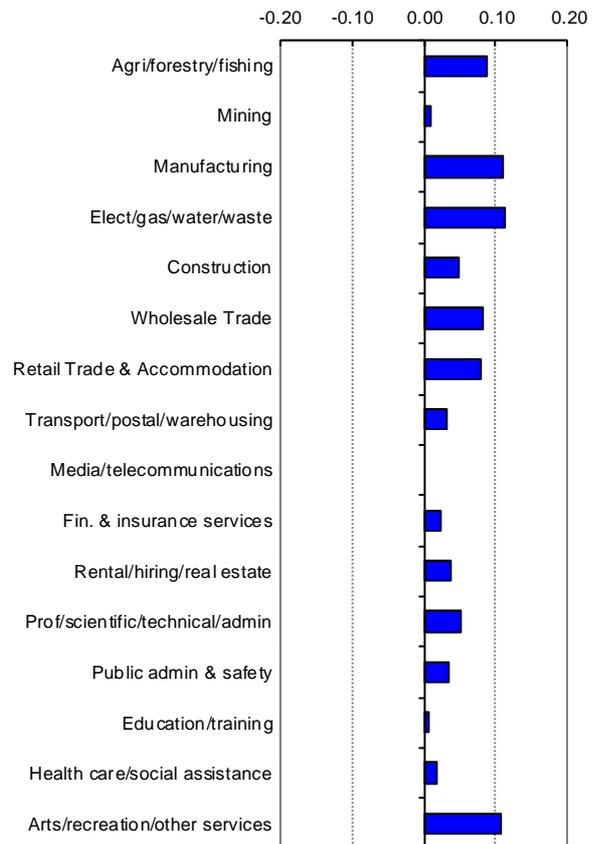
While the economy looks to have sparked over Q2, **forward-looking indicators suggest that momentum may have fizzled out over Q3**. We have 0.6% qoq growth pencilled in for Q3, but the skew of risks to the downside are growing. The key area of concern is the continued slide in business confidence in the ANZ monthly survey and the slump in business employment and investment intentions. The ANZ own activity measure (i.e. expectations for activity over the next year of the respondents' own business) suggests a quarterly underlying growth rate of just 0.4-0.5%. However, we continue to put more emphasis on the NZIER Quarterly Survey of Business Opinion (QSBO) measures, and over the first half of the year the QSBO survey was more upbeat than the ANZ survey. As such, we remain cautious about trimming our growth outlook by too much over H2 2018. Nonetheless, if business confidence does not improve from current levels soon, we will adjust our Q4 GDP growth forecast lower.

RBNZ Implications:

Given much of Q2's lift is really just catching up from Q1's underwhelming performance (and was reasonably well foreshadowed by indicators) we were surprised by the RBNZ's August Monetary Policy Statement Q2 GDP forecast of just 0.5% quarterly growth. **The RBNZ stands to see a significant positive surprise if growth posts close to our expectations. However, we are unsure how the RBNZ will respond to this surprise given the continued slide in business confidence, particularly business employment and investment intentions.** For example, we have just 0.6% growth pencilled in for Q3 (with a growing skew of downside risk), while the RBNZ has a more upbeat 0.8%. **It's likely that as the RBNZ considers its near-term GDP forecasts for the upcoming OCR review, a stronger Q2 outcome would be offset by downward revisions to the second half of 2018.** Regardless of what Q2 GDP growth does, we anticipate the RBNZ will instead focus on the outlook and continue to emphasise its readiness and willingness to act if weak business confidence does spill over into weaker economic output.



Q2 2018 PRODUCTION GDP
(pp contribution to quarterly % change)



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