ASB

Economic Note

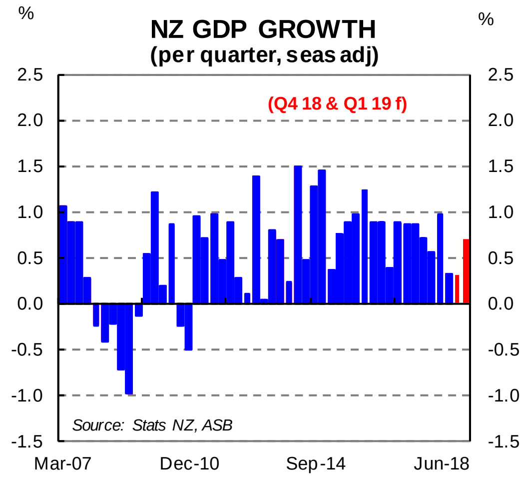
Q4 2018 GDP Preview

15 March 2019

Finishing 2018 on a whimper

- We expect Q4 2018 GDP growth to be reported as 0.3% qoq, weighed down by soft services activity.
- Our core view is weak growth over H2 2018 was temporary, with the NZ economy enjoying many tailwinds.
- But our conviction in this view is wavering and Q1 NZIER business confidence results will be pivotal in shaping our H1 2019 GDP forecast.

GDP - December 2018	Previous	ASB	RBNZ
quarterly % growth	0.3	0.3	0.8
annual % growth	2.6	2.2	2.7
annual average % growth	3.0	2.7	



Summary & implications

December quarter GDP estimates are released by Statistics NZ on Thursday 21st March at 10.45am. **We expect Q4 GDP will be reported as 0.3% qoq**, seeing annual growth slump to 2.2% yoy with momentum weighed down by soft services and goods production growth. The muted Q4 lift follows soft GDP growth in Q3 (also rising just 0.3% qoq). **Our long-held view is that the slowdown over H2 2018 will be temporary.** The NZ economy enjoys a number of tailwinds, including high Terms of Trade, strong population growth and a strong labour market. **However, our conviction in this view is starting to waver, as early 2019 economic indicators are mixed.** In particular, the monthly ANZ business outlook survey indicates business confidence remained low in February. However, we continue to place more emphasis on the NZIER Quarterly Survey of Business Opinion as the more accurate guide to underlying GDP growth trends: the April report will be pivotal in forming our view for H1 2019 GDP growth.

Primary and goods production mixed

We expect primary production to lift on the back of dairy production growth. **Goods production was likely mixed** and we expect modest growth after a contraction in Q3. **Electricity generation was likely a drag on GDP in Q4,** as low lake levels limited hydro production. Manufacturing production growth was likely muted. Meanwhile, **construction activity growth was much stronger than expected** – led by an unexpectedly strong lift in non-residential construction (particularly in Auckland and Waikato). Looking beyond Q4, we expect future growth from manufacturing and construction to be limited, as construction demand is close to a peak and the global growth slowdown will weigh on

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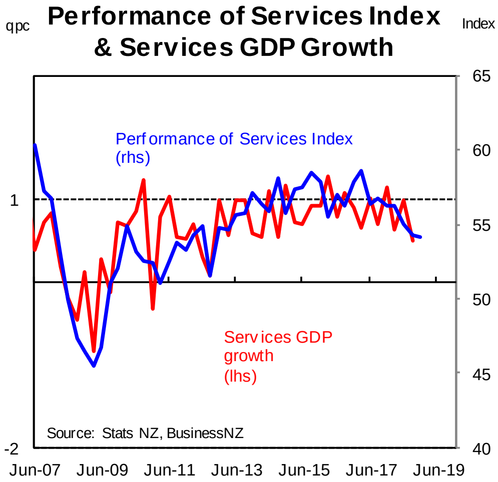
manufacturing export growth.

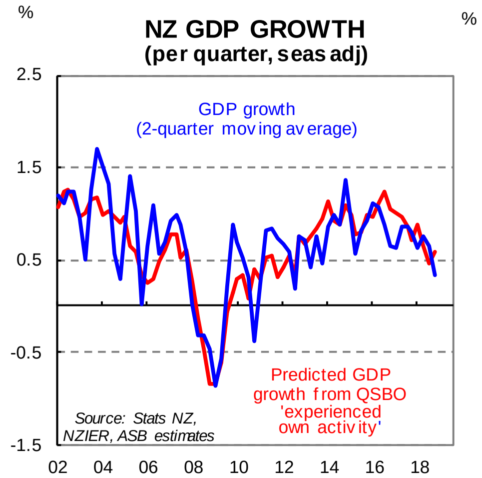
Services set back

Services activity growth will remain sub-trend for the second consecutive quarter. The Selected Services Survey and Quarterly Employment Survey figures both indicate declines in key services components. Furthermore, wholesale trade activity was soft. Looking back to Q3, soft services growth was primarily centred in different areas of services production including transport, postal and warehousing along with information, media and telecommunications services. We lack strong indicators for these sectors and have low conviction in our expectation that these sectors will have bounced back in Q4. Accordingly, we see some risk that these sectors are even weaker than our already-muted view of services growth.



Recovery in H1 2019?

Looking ahead, **a recovery in services sector growth is critical for our forecast that GDP growth will recover over H1 2019.** Persistently-low business confidence remains a key risk to this view. Over the second half of the year, **profitability reportedly contracted** with a growing proportion of firms reporting increased costs that they have not recouped through higher selling prices. For the services sector, labour remains a key source of cost and it is our expectation that the tight labour market will trigger stronger wage growth. However, it is also our expectation that firms will be able to pass on some of this increased cost. With demand soft over H2, passing costs on may have been challenging. **The BusinessNZ Performance of Services tentatively points to some recovery in services-sector confidence in January.** Other positive indicators include the booming start to the year for electronic card spending and Treasury's reports of an above-forecast income tax take in January (implying strong labour earnings). We have found the NZIER Quarterly Survey of business Opinion to be a good guide to the underlying trend in GDP growth over the past year or so, and the early April release of the Q1 survey results will be pivotal in forming our view of growth in H1 2019.



Slowing global growth in key trading partners, such as China and Australia, add an addition dimension to growth risks, with the possibility our strong export performance also starts to wane.

RBNZ likely set for yet another downside surprise

From the Reserve Bank of New Zealand's perspective, it is likely to face another substantial downside surprise to GDP growth given its surprisingly bullish 0.8% qoq forecast in the February Monetary Policy Statement (in contrast, we have expected for some time that Q4 production growth would likely be modest). The market has now almost fully priced in a rate cut in NZ, although some of this move is likely to be influenced by market pricing for a Reserve Bank of Australia rate cut.

Assuming Q4 indeed registers weak growth, whether or not the RBNZ actually cuts the OCR will depend a lot on how confident it remains that growth will recover over 2019. The RBNZ's take will be revealed on March 27.

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