ASB

Economic Note

Q3 GDP Preview

21 December 2017

Christmas miracle: revisions fill in growth's potholes

- Historical revisions steal the show, with growth materially higher over the past three years.
- Q3 growth largely in line with market expectations, although a touch stronger than we expected.
- RBNZ has some time to consider the implications of today's revisions, although we do expect the RBNZ will likely bring its view for OCR hikes closer to our own (early 2019).

Summary & implications

Q3 GDP growth was in line with market expectations, only slightly weaker than the RBNZ's November MPS forecast but stronger than our own view. **However, the key area of surprise was the material upward revisions to growth over the past three years.** The weakness in previously published per-capita growth estimates was always surprising, particularly given the strength of economic supports including low interest rates, strong labour market and a robust export performance (particularly from tourism and fruit).

The key question going forward is what will be the **implications for future growth and inflation**, although that may take some further analysis. Nonetheless, the **stronger economic momentum should boost the RBNZ's confidence of inflation picking up** and the **RBNZ may bring forward the timing of its forecast rate hikes** at the February MPS (the RBNZ currently does not expect rate hikes until roughly late 2019). We currently expect the RBNZ to start lifting interest rates in early 2019, although early next year we will be **closely assessing the impact of stronger growth and its relationship with inflation.**

GDP - Sep 2017	Previous	Actual	ASB	RBNZ	Market
quarterly % growth	1.0	**0.6**	0.4	0.7	0.6
annual % growth	2.8	**2.7**	2.2	2.6	2.4
annual average % growth	3.3	**3.0**	2.4		

Revisions paint a rosier economic picture of the past three years

The key takeaway from the Q3 GDP release is that growth over the past three years has been substantially stronger than previously reported (see chart on Page 2). Over the past few years, we have been underwhelmed by the growth performance. NZ's population growth has surged, but per-capita spending growth remained low. However, thanks to improvements in methodology and more accurate annual benchmark data, annual production GDP for the June 2017 year is now a whopping 3% higher than previously estimated.

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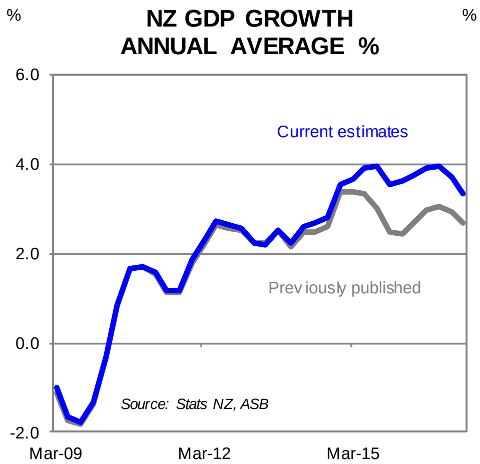
Nonetheless, one story remained intact: economic growth did slow over 2017. Annual per-capita GDP growth had hovered around a relatively healthy 2% per annum over 2015 and 2016 (September years) only to slow to 'just' 0.8% growth over the past 12 month. This is still a dramatic improvement on the previously published picture of flat per-capita growth.



Forecasts now under review

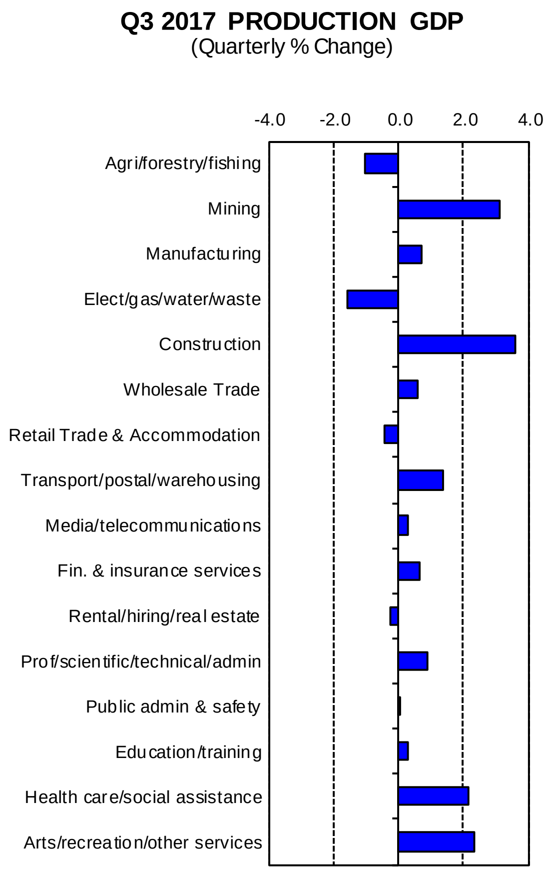
The key question is where is the inflation? GDP growth was growing consistently stronger than thought over the past three years, implying that potential growth (i.e. the pace of growth that is not inflationary or deflationary) was also higher than previously thought. In saying that, it is now **more conceivable that after a number of years of strong growth, that the economy is likely hitting some material capacity constraints**. The upshot is that we can feel more confident that inflation pressures will be stronger over the coming year.

The **magnitude of the revisions to growth is material,** so to properly understand the implications it is wise to take some further time and careful analysis. Indeed, ASB has been surprised by the persistently weak growth over the past few years despite relatively favourable economic supports, which has led us to challenge our own assumptions on the economy and what that means for growth and inflation going forward. The upward revisions suggests that perhaps we had been on the right track after all, so **we will need to take a step back ourselves and consider if this changes our medium-term forecasts.**

The **RBNZ's next OCR update is not until the February Monetary Policy Statement**, so fortunately also has some time to consider the implications of this year's revisions. However, the **RBNZ is a relative outlier with its OCR view and in the November MPS did not expect the OCR to increase until around late 2019.** In contrast, we still expect the RBNZ will be hiking by early 2019. At face value, today's GDP numbers suggest there is scope for the RBNZ to move its interest rate view closer to our own and the market view.

Key source of revisions

According to StatsNZ, **the key source of revisions was a higher value-add in the business sector** (with income growth outperforming inputs) **and incorporating unconsented repair work from the Canterbury earthquake rebuild**. Meanwhile, dairy production's value-add contribution to the economy has been revised considerably lower (possibly reflecting the increased use of supplementary inputs by the industry, i.e. feed). But there was some offset from dairy manufacturing activity having a higher value add than previously estimated.



Q3 growth in line with expectations

GDP growth was slightly stronger than we expected in Q3, although largely in line with the market median expectation and the RBNZ's November MPS forecast. As expected, **a strong lift in construction activity** (after a weak start to the year) and a **strong performance in some services sectors** led growth over Q3. The key areas of weakness include **below-trend growth in retail trade** (payback following Q2's Lions Tour boost), soft housing market activity and a fall in dairy production. Key areas of surprise for ASB included some recovery in mining activity, stronger transport activity than expected and surprising resilience in the finance and insurance sector.

We currently expect reasonable growth in Q4, particularly with signs of housing market activity and retail spending picking up in recent months. However, we are **mindful that the change in Government** and introduction of new policies brings some **near-term uncertainty which could delay business decision making.** Business confidence declined sharply over October and November, but has shown some partial rebound in December.

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