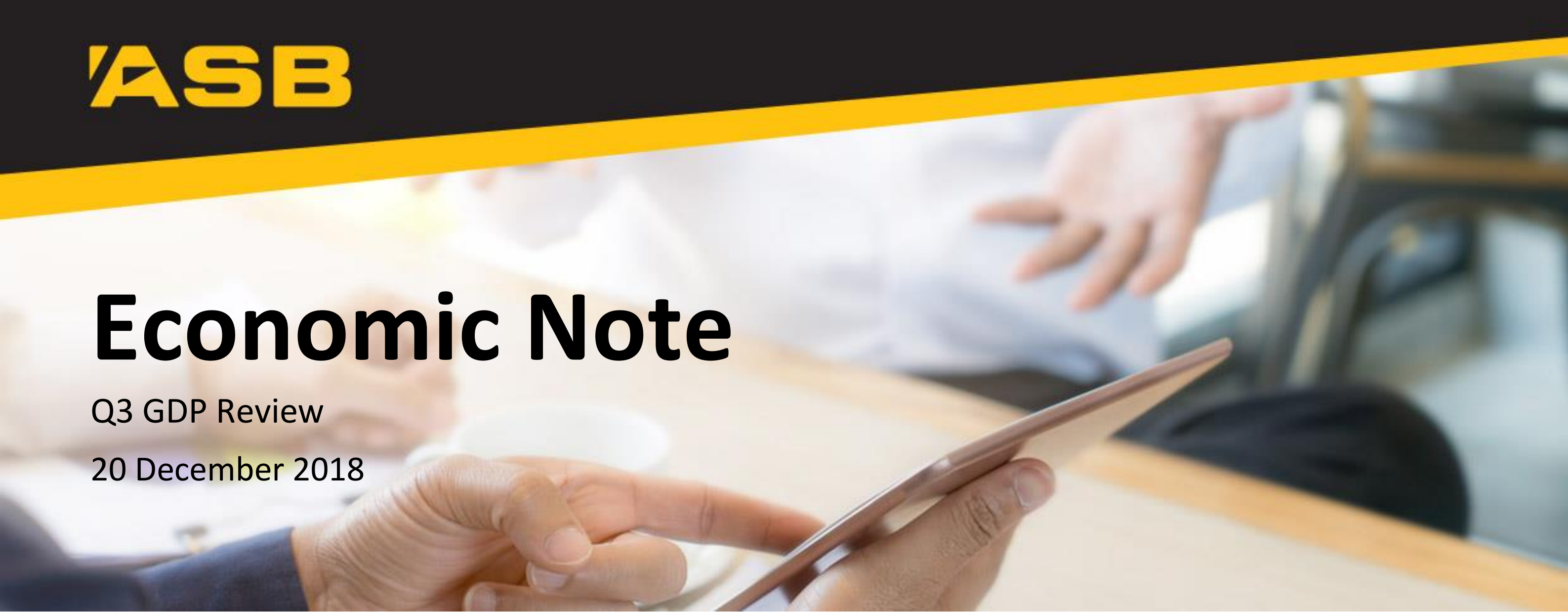


Economic Note

Q3 GDP Review

20 December 2018

Economy temporarily offline

- Q3 GDP grew 0.3% qoq, weaker than our own forecast of 0.5% and market expectations of 0.6%, and significantly weaker than the RBNZ November MPS forecast of 0.7%.
- But partially offsetting some of the negative surprise, growth over 2017 was revised higher, implying more momentum in the economy until recently.
- The source of soft growth in Q3 was reasonably broad-based across most industries, as we had expected, but with activity in some sectors proving even weaker than we had anticipated.

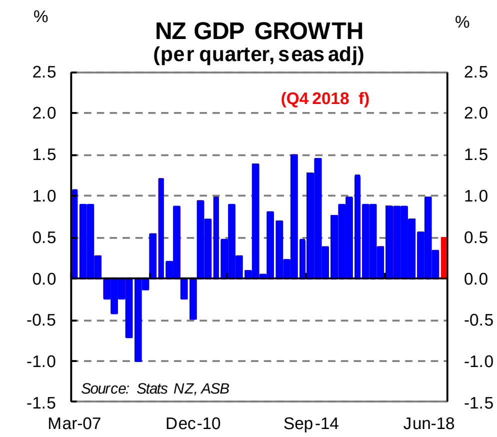
GDP - September 2018	Previous	Actual	ASB	RBNZ	Market
quarterly % growth	1.0	**0.3**	0.5	0.7	0.6
annual % growth	3.2	**2.6**	2.7	2.9	2.8
annual average % growth	3.1	**3.0**	2.8		

Summary & implications

Q3 GDP lifted 0.3% qoq, weaker than ASB's forecast of 0.5% growth and market expectations of 0.6% growth and **much weaker than the RBNZ's November Monetary Policy Statement (MPS) forecast of 0.7% growth**. **Growth over 2017 was revised higher (by around 0.4%).** As a result, today's figures paint a picture of an economy which had very good momentum, which then slowed quite sharply into the second half of 2018.

We expect GDP growth likely remained muted over Q4, but we are optimistic that economic momentum will lift in early 2019. The recent fall in petrol prices will come as a relief to squeezed household budgets (with discretionary spending starting to bounce back) and business confidence has shown tentative signs of improvement in the final month of 2018.

The RBNZ will weigh the weak Q3 outcome (0.4% below expectation) vs. the upward revisions to growth over 2017 (+0.4%). **With history revised, the weak Q3 outcome looks more like an outlier and recent data tentatively point to a temporary slowdown.** At this point, we **continue to expect the RBNZ to wait until August 2020 before lifting the OCR.**



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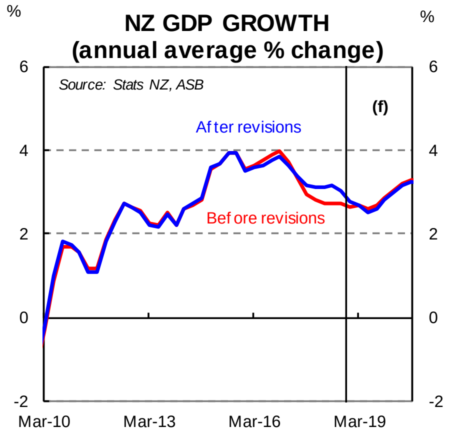
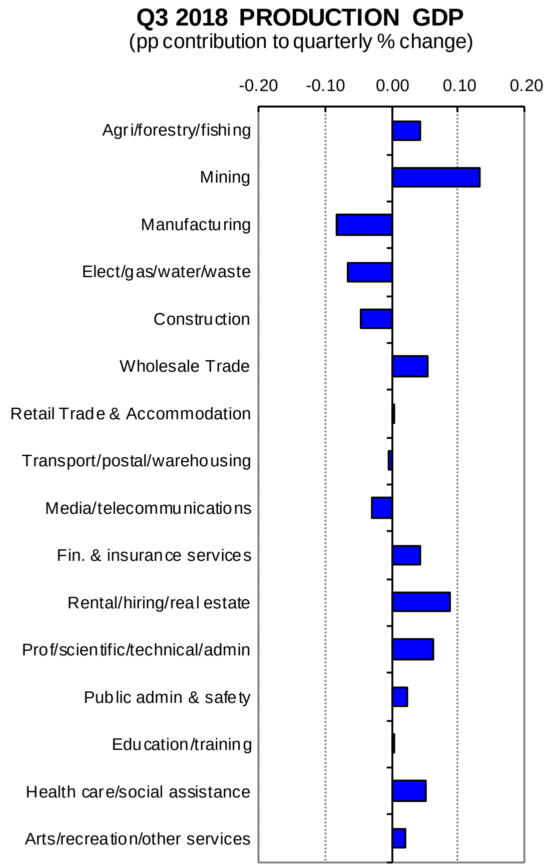
Revisions

Growth over 2017 was revised higher, with annual growth in the year to March 2018 was revised up by 0.4% to 3.1% annual average growth, from 2.7%. As a result, between Q1 2017 to Q2 2018 the average pace of quarterly growth was a relatively respectable 0.8%. The revisions also paint a prettier picture on a per-capita basis, with growth around 1% per annum. **The revisions suggest a considerable amount of momentum remained in the economy, up until very recently.** The NZ economy is benefiting from strong fundamentals such as high Terms of Trade, low interest rates, strong population and labour market growth.

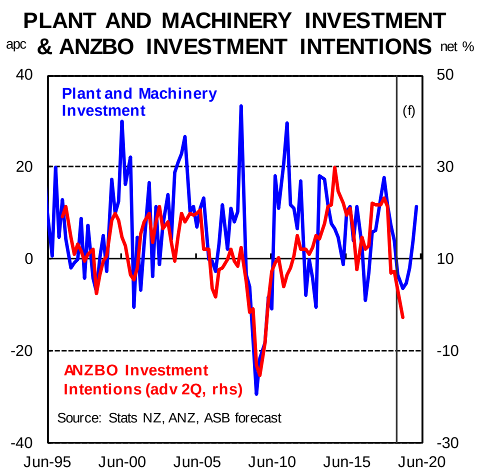


Q3 growth weak across the board

Q3 growth was weak, lifting just 0.3%, with soft activity relatively broad-based. Activity in the goods-producing industries fell 1%, while services growth was below trend at 0.5%. We had expected growth to be soft and had seen some downside risks ahead of the release. The weaker-than-expected result was largely due to some of this downside risk materialising and activity in some industries proving even weaker than we had anticipated.



- **Some of the weaker-than-expected result reflects only a partial bounce-back in mining**. StatsNZ noted that the Pohokura gas field was still operating at limited capacity after an unplanned shutdown in Q2. To what extent capacity was limited was unclear ahead of the release of today's figures. Also, we had expected more offset from a recovery in oil production.
- Activity in **manufacturing and electricity generation was also weaker than we had anticipated**. Surprisingly, the weak manufacturing result was due to soft food-related manufacturing (whereas non-food manufacturing held up better than expected).
- **Transport, postal and warehousing was also weaker than expected**, with activity contracting 0.1% over the quarter. **Information, media and telecommunications sector was also much weaker than expected**, down 0.9%. We have no strong indicators for these industries, and **these are very weak results relative to the trend in growth over the past year for these industries.**
- **Growth in other service areas was soft,** but not as weak as some earlier indicators had suggested. In particular, growth in business services held up better than expected. The upside surprise in this sector is encouraging as strong services growth is key to GDP growth recovering over H1 2019.



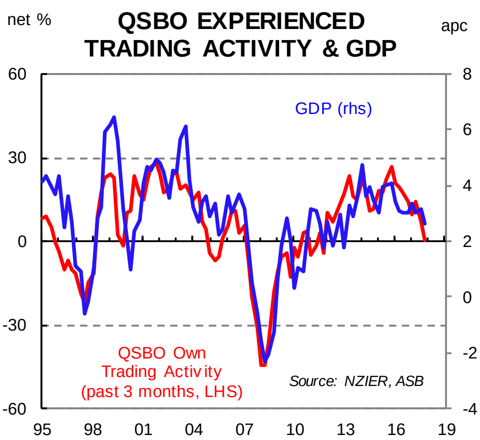
Investment was weaker than expected, led by a decline Other Construction and Plant, Machinery & Equipment. The fall in Other Construction occurred as **repair work from the Kaikoura earthquake continued to wind down**. The fall in Plant, Machinery and Equipment was in line with the recent decline in investment intentions (although weaker than import data had suggested). **We do expect investment to remain weak over the coming year** as businesses react to increased uncertainty from the change in Government and delayed investment decisions reducing the pipeline of investment activity for the coming year.

Meanwhile, **household consumption was stronger than expected**, with a strong lift in durables and services spending. StatsNZ reported that households spent more on clothing and AV equipment. This lift is surprising given the soft growth in the Retail Trade Survey and the impact of high petrol prices on household budgets over the quarter.

RBNZ Implications

On one hand, the **stronger momentum in the economy over 2017 may be encouraging for the RBNZ**, as it implies underlying inflation pressures are likely to continue to build. **On the other hand, the economy slowed more sharply in Q3 than expected. We expect weak growth over H2 2018 is likely to prove temporary**, and if the RBNZ shares our view it may choose to look through the impact of the weaker result somewhat. Nonetheless, the **RBNZ will remain highly cautious and sensitive to the downside risks to growth.**

Business confidence stabilised over the fourth quarter of the year, albeit at low levels, and in the December month showed some tentative signs of recovering. In particular, the services sector sentiment appears to have improved in December, which reinforces our view that the slowdown in business services demand is likely to be temporary. **Nonetheless, the low level of sentiment remains a material downside risk to the economic outlook if business decisions are altered on the back of pessimistic perceptions.** While employment demand has held up well to date, business investment appetites appear to have slowed**. We will continue to watch economic developments closely.** With core inflation still below the inflation target band mid-point, the RBNZ will remain mindful of the downside risks to growth and will be in no rush to remove monetary stimulus. We continue to expect the RBNZ will wait until late 2020 until lifting the OCR from its current level of 1.75%.



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