ASB

Economic Note

Q4 GDP Review

21 March 2019

The good, the bad and the ugly

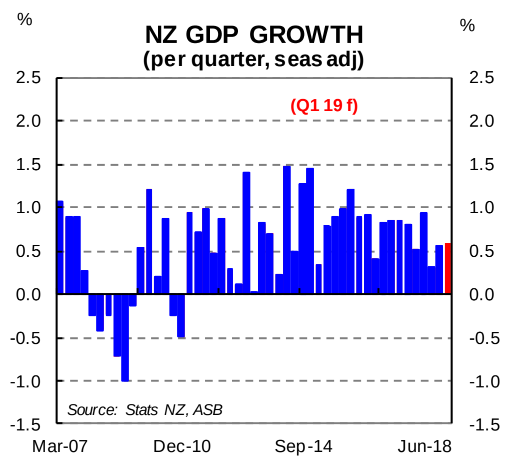
- The good news is that Q4 GDP growth was more resilient than we had forecast, rising 0.6% qoq and in line with market expectations.
- The bad news is that annual growth was much weaker than expected, particularly from the RBNZ perspective, due to downward revisions to H1 2018 growth.
- And the GDP growth picture starts to look a little ugly, as we get increasingly wary about our view that GDP growth will recover over 2019.

GDP - December 2018	Previous	Actual	ASB	RBNZ	Market
quarterly % growth	0.3	**0.6**	0.3	0.8	0.6
annual % growth	2.6	**2.3**	2.2	2.7	2.5
annual average % growth	3.1	**2.8**	2.7		

Summary & implications

Q4 GDP rose 0.6% qoq, in line with market expectations but below the RBNZ's February Monetary Policy Statement (MPS) forecast of 0.8% growth. **But annual growth in Q4 was materially weaker than the RBNZ was expecting**, due to downward revisions to H1 2018 GDP growth. Furthermore, we are see an **emerging downside risk to our 2019 GDP forecast,** which if confirmed (later this year) would suggest growth momentum is struggling to lift off.

We expect the RBNZ to leave the OCR on hold over 2019 and 2020, and the next likely move is a hike in 2021. This expectation rests on the view that GDP growth picks up over 2019, with strong wage growth supporting household spending and triggering a lift in inflation pressures. With GDP growth slowing over 2018 by more than the RBNZ had expected and with downside risks to 2019 growth accumulating, there is still the risk of an OCR cut in 2019.



Services boosted by transport, tourists and communications

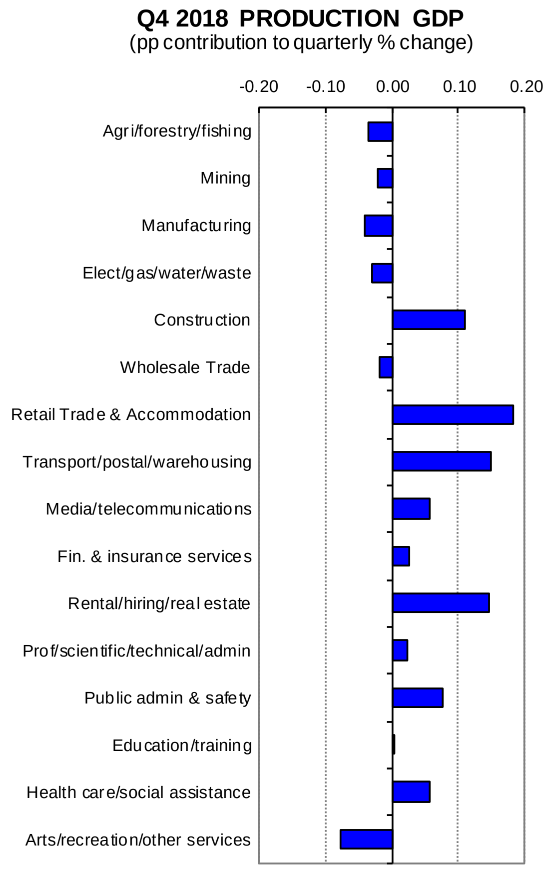
Q4 GDP growth was slightly more resilient than we expected, **lifting 0.6% qoq, supported by much stronger than expected growth in the services sector.** Much of the positive surprise (relative to our own muted expectation of 0.3% qoq growth) was due to exceptionally strong growth in areas where we don't have reliable indicators.

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

There was a whopping 3.2% lift in transport, postal and warehousing services and a very strong 1.8% lift in information media and telecommunications services. StatsNZ reports that transport activity was up across the board, with strong contributions from both rail and road. Given the extent of these lifts, some reversal over early 2019 is possible.

Retail trade and accommodation activity was also very strong, lifting 2.5% qoq, with StatsNZ noting it is the strongest lift in this category since the 2011 Rugby World Cup. This suggests the tourism sector was performing well at the end of 2018, despite tight accommodation capacity acting as a head wind to this sector.

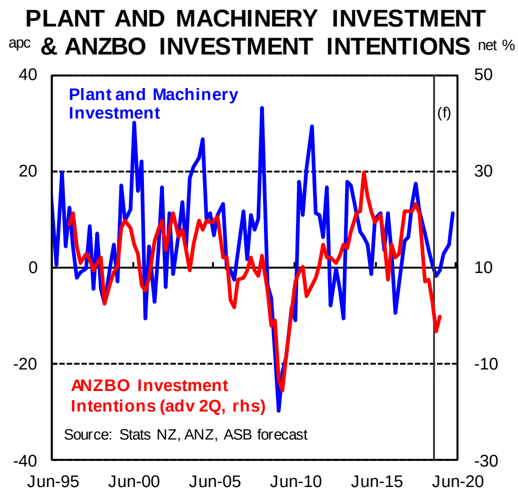
As we expected, there were also some soft spots in services growth, with arts, recreation and other services contracting sharply, along with a mild decline in wholesale trade. In addition, growth in business services (professional, scientific, technical, admin and support services) was also soft.



Primary and goods production soft

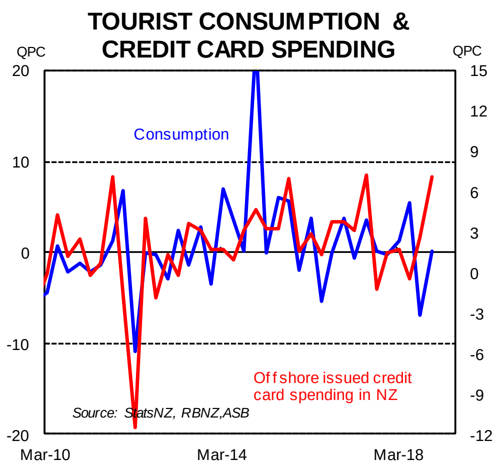
Primary production was weaker than expected, down 0.8% qoq, with **falls in livestock production and mining activity** weighing down activity.

Goods production was mixed, up just 0.2% with **gains in construction activity offset by declines in electricity production** (due to low hydro lake levels) and manufacturing activity.



Business investment stages surprising lift in Q4

From the expenditure perspective, one pleasing development is how well plant and machinery investment has held up. Although growth in business investment has slowed, it has held up better than some business confidence surveys had suggested. One of our fears over the past year was that bleak business confidence would become a self-fulfilling prophecy, as firms slashed investment and employment despite very supportive economic fundamentals. The **resilience in business investment is one reason to remain optimistic that economic growth can recover over 2019**, with economic demand supported by strong labour market, high terms of trade and export demand and low interest rates.



Tourist vs NZ household spending momentum in question

StatsNZ estimates household consumer spending remained robust, up 1.3% qoq. Meanwhile, StatsNZ estimates exports of services increased 1.4% qoq (which is weaker than we expected and follows a contraction of 4.4% qoq in the previous quarter). A large driver of exports of services is overseas visitor spending. **We believe that the strength in retail and accommodation spending was more likely**

driven by tourist demand over Q4, than NZ household consumption. Indeed, short-term visitor arrivals and spending on overseas credit cards both increased very strongly over Q4. As a result, StatsNZ may be overestimating the strength of domestic demand and underestimating the contribution from exports. This is something to be mindful when assessing the strength of domestic demand – **we believe underlying domestic demand (NZ household spending and investment) slowed over 2018 but we expect stronger domestic demand growth to drive a recovery in GDP growth over 2019.**

RBNZ Implications

Although Q4 GDP growth was slightly lower than the RBNZ's 0.8% forecast, **downward revisions to activity in H1 2018 leave annual growth 0.4 percentage points below the RBNZ's expectation.** This is a material downside surprise. Furthermore, with early confidence surveys remaining subdued in Q1 2019, we are seeing emerging downside risks to GDP growth for 2019 (the RBNZ had 0.8% qoq pencilled in for 2019Q1 GDP). **The key question ahead of the March OCR review is how much longer can the RBNZ tolerate material downside surprises to its GDP forecasts?**

We expect the RBNZ to leave the OCR on hold over 2019 and 2020, and the next move in the OCR is most likely a hike in 2021. Our economic view rests on the assumption that GDP growth picks up over 2019, with strong wage growth supporting household spending and triggering a lift in inflation pressures. However, with GDP growth slowing over 2018 by more than the RBNZ expected, and with downside risks to the domestic and global outlook accumulating, we do see the risk of a rate cut in 2019.

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 5853
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
Data & Publication Manager	Judith Pinto	judith.pinto@asb.co.nz	(649) 301 5660

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