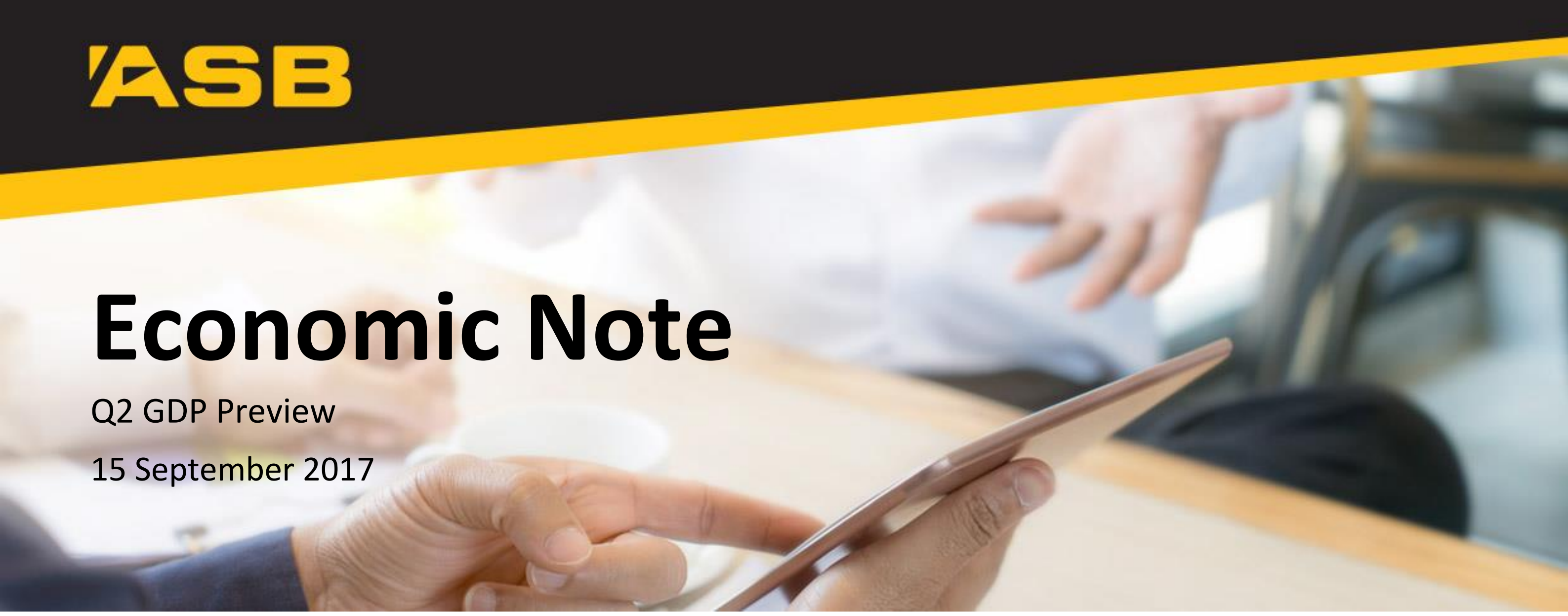


Economic Note

Q2 GDP Preview

15 September 2017

Another sub-trend GDP outturn for the RBNZ to ponder

- We expect Q2 GDP growth of just 0.6% qoq, which if correct, will mark the third consecutive outturn in which growth has been sub-trend and the third consecutive undershoot of the RBNZ forecasts.
- Our Q2 pick is surprising given the Lions Tour boost and in light of robust levels of confidence, near-record highs for the Terms of Trade, low interest rates and strong population growth. However, capacity constraints and headwinds from the slowing housing market are proving to be influential.
- A sluggish GDP growth backdrop and the potential for election-related volatility to impact forthcoming data readings suggest a prolonged period on the side lines for the OCR.

Summary

We expect Q2 GDP growth of just 0.6% qoq, the third consecutive quarter in which growth has been running at a sub-trend rate (roughly 0.7%-0.8% per quarter at present). Elevated readings for confidence currently suggest the economy does not lack for key supports. Despite a strong demand backdrop, however, the economy may be running into capacity constraints and the economic expansion remains patchy. While a weaker-than-expected outturn may prompt more questions at No.2 The Terrace, there are limits to what monetary policy can do at this juncture and it may be more prudent to save monetary policy ammunition.

The Details

We expect a 0.6% qoq increase for production-based GDP, which is weaker than the 0.8% qoq market consensus and the 0.9% qoq RBNZ pick. Annual and annual average growth is expected to slow to 18-month and 12-month lows respectively.

GDP - June 2017	Previous	ASB	RBNZ	Market
quarterly % growth	0.5	0.6	0.9	0.8
annual % growth	2.5	2.4	2.6	2.5
annual average % growth	3.0	2.7	2.8	

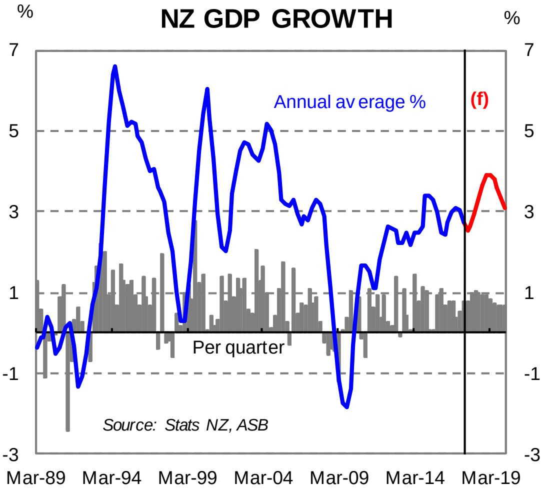
Our 0.6% pick for GDP is based off:

- **A 2% increase in primary value added (+0.15ppt contribution)**. Rising milk production and rebounding fishing and forestry export activity are the key drivers.
- **A 0.7% increase in services value added (+0.45ppts).** The Lions Tour and World Masters Games should boost retail and accommodation spending, with professional and support services benefitting from strong growth in paid hours and strengthening export activity supporting wholesale and transport GDP. However, tepid employment growth in pockets is expected to deliver some falls amongst the wider services sector.
- **A flat outturn for the goods sector.** Small declines for both electricity value added, ex-primary

Nick Tuffley – Chief Economist (649) 301 5659 nick.tuffley@asb.co.nz
Mark Smith – Senior Economist – 649 301 5657 – mark.smith2@asb.co.nz

manufacturing activity, residential and non-residential construction are expected to offset stronger meat & dairy manufacturing volumes and the boost to other construction provided by Kaikoura earthquake repairs.

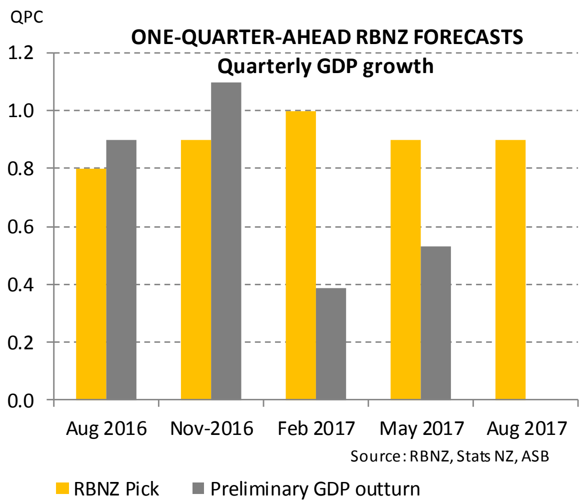
Our forecasts point to a 1%+ qoq outturn for expenditure-based GDP, with the rebound from the tepid 0.2% qoq Q1 outturn being driven by a large positive contribution for net exports and robust quarterly outturns for private consumption and non-residential investment. Tempering the increase in expenditure-based GDP, will be a large rundown in stocks and declining residential investment. Courtesy of the rising Terms of Trade, a strong outturn is on the cards for nominal expenditure-based GDP.



Risks around our +0.6% qoq pick for production-based GDP are tilted to the upside. Our components add-up for production-based GDP is on the cusp of a 0.7% quarterly outturn, whilst the expenditure-based split also suggests some potential upside.

Implications

Given that we are less than three weeks away from the beginning of Q4 and the election is less than two weeks away, the **Q2 GDP figures will have an historical feel to them, particularly in light of recent local and global developments.** As elevated levels of consumer and business confidence attest to, the economy is the beneficiary of a number of supports, including strong population growth, the (near) record Terms of Trade, historically-low interest rates, with the prospective loosening of the fiscal purse strings soon to be added to that list. **For some reason, however, the economy is not kicking on.** Increasing capacity constraints and the headwinds generated by the slowing housing market could be two factors tempering the expansion, with the tightening election race likely to contribute to future mixed readings to GDP over the remainder of the year.



If our GDP pick is in the ballpark, it will mark the third consecutive quarter in which quarterly growth has undershot RBNZ forecasts and may raise some questions at No.2 The Terrace. However, it debateable at this juncture whether a lower OCR would significantly advance growth prospects. It may be more prudent for the RBNZ to wait until the dust settles and preserve some OCR ammunition to call upon in case events take a turn for the worse.

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 5957
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
Economist	Kim Mundy	kim.mundy@asb.co.nz	(649) 301 5661
Data & Publication Manager	Judith Pinto	judith.pinto@asb.co.nz	(649) 301 5660

www.asb.co.nz/economics

@ASBMarkets