18 June 2015

Q1 GDP Undermined by Drought, Tech Wreck

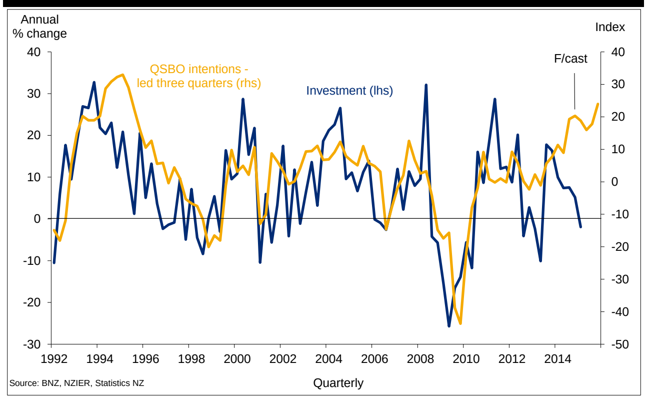
- Q1 GDP growth lowballs with 0.2% (2.6% y/y)
- Partly on clear one-offs, some of them curious
- We bump up our Q2 growth estimate to 0.8%
- July cut affirmed, debate shifts to September
- But in slower-growth, rising-inflation context

The 0.2% increase in New Zealand's Q1 GDP, reported by Statistics NZ this morning, was obviously a negative surprise to the vast majority. The market was expecting a 0.6% gain. So were we. And so was the RBNZ (as per its June Monetary Policy Statement). The quarterly result dragged the annual rate of expansion down to 2.6%, from 3.5% in Q4. This was the slowest since late 2013.

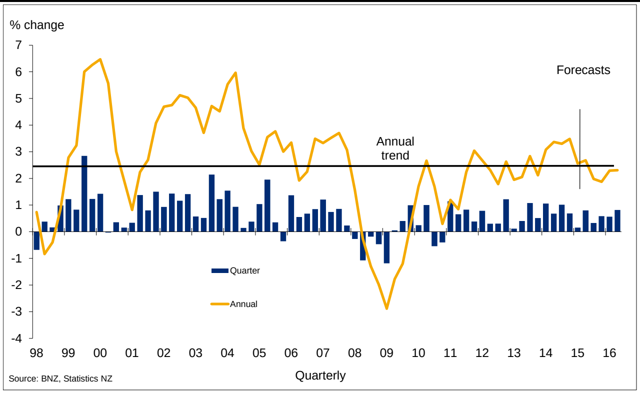
Why the surprise? For us, on the production side, it was mostly the 2.8% plunge in Information, Media and Telecommunications (IMT). This category has a weighting slightly higher than each of construction, wholesaling, retailing, total primary, and is about half the size of the manufacturing sector. Statistics New Zealand said the drop in IMT activity was "driven by broadcasting and Internet publishing, and motion picture and sound recording".

From the expenditure GDP side (with its bare 0.1% increase, overall), it was principally quarterly falls in investment in plant, machinery equipment (-11%), transport equipment (-11%) and intangibles (-12%) that had us scratching our heads. While "real", in a sense, these can be very bumpy series. Their Q1 results were certainly at odds with investment indicators from the recent business surveys, which are sky high. This sets New Zealand apart from the Australian story, where business investment indicators are genuinely soft.

Plant and Machinery Intentions and Investment



Gross Domestic Product



Primary production fell 1.4% in the March quarter, as agriculture output shrank a seasonally adjusted 2.3%. As negative as this was, it was very close to what we expected. And because this partly reflected drought at the time, we expect a bounce back in Q2 primary sector activity following the rains over recent months. As for the 7.8% fall in mining output in Q1, a lot of that was owing to a pullback in oil exploration (which is measured as an output in the GDP accounts these days, having not so long ago been treated as an input).

On the positive side, the construction sector expanded anew, with 2.5% in Q1. The increases in retailing (+2.2%) and accommodation (+2.6%) did not disappoint. And while the services sector registered a variation in growth in its various components, overall it was about as robust as we expected. Export volumes were up, despite some big falls in forestry and resources.

With all of the above in mind, we have nudged up our Q2 GDP growth estimate to 0.8% (2.7% y/y). But this still leaves us net down a few decimal points on Q2 GDP levels, compared to what we were thinking before this morning's GDP report.

The good thing about today's GDP report is that it surely settles the debate as to whether the RBNZ will cut again in July. We are feeling more comfortable in our expectation of such, to 3.00% – a position we moved to in response to the Bank's June missive.

But whether this means a further cut, to 2.75%, in September, we are not so sure. While GDP growth slowed in Q1, the extent of it was very likely overstated. And even if the data on economic growth don't return to a trend-like pace this year (as remains a risk, in our view), it's still likely that CPI inflation will pick up to a firm annual pace during 2016. It's the same slower-growth (2015), rising-inflation (2016), framework we've been promulgating for a while.

As disappointing as this morning's GDP data were, they are also a reminder that if there is evidence of a slower economy – meaning less pressure on inflation – then NZD has heaps of scope to respond to this. NZD fell about half a cent, to 0.6910, in response to the slow Q1 GDP figure. Our forecasts for tradables inflation are increasing by the day, as the currency's long influence of price suppression begins to reverse. Keep an eye on this as a cost pressure for the economy.

Of course, counter to this, today's GDP outcome can only increase the Reserve Bank's nervousness about spare capacity in the economy. Sure, the big pull-back in Q1 business investment won't help the supply-side growth story that the Bank has been pushing, as reason for surprisingly muted domestic inflation. Nonetheless, a rudimentary run of the new GDP track can only further muffle the Reserve Bank's "output gap" estimates – with these having been scaled back already at the June MPS. While we'll be conscious of this, we'll also be supplementing with more direct measures of capacity pressures, including anecdotal evidence. We're still hearing plenty of stories about skill shortages, for example, even though the official unemployment rate looks to be struggling to fall any further.

It will be interesting to see how the RBNZ deals with the potential for slower growth in 2015 yet rising CPI inflation forecasts for 2016/17. If it's to be consistent with its strict 2.0% inflation mid-point focus, there should be limits to how far it can cut its cash rate this year. But given the Bank's recent actions we wouldn't be surprised to see the Bank react more to this year's growth data than next year's likely CPI strength.

	qtr % chg prev qtr	% pt cont to chg (1)	ann avg % chg	ann % chg
GDP by Industry - March 2005 quarter				
Agriculture, Forestry & Fishing	-1.4	-0.1	2.6	0.8
Mining	-7.8	-0.1	1.8	-9.2
Manufacturing	-0.3	0.0	2.2	2.1
Electricity Gas, Water & Waste Services	-0.5	0.0	0.7	-2.2
Construction	2.5	0.2	10.2	3.6
Wholesale Trade	-2.1	-0.1	2.6	0.2
Retail, Accom. & Restaurants	2.4	0.2	6.1	8.3
Transport, Postal and Warehousing	2.5	0.1	1.5	2.2
Information Media & Telecommunications	-2.8	-0.1	2.4	2.6
Financial and Insurance Services	1.2	0.1	3.8	4.2
Rental, Hiring, Real Estate Services	0.1	0.0	1.8	2.2
Prof, Scientific, Technical, Admin	2.1	0.2	2.2	4.7
Public Admin and Safety	-0.3	0.0	3.1	3.1
Education & Training	0.1	0.0	0.7	0.6
Health Care and Social Assistance	0.6	0.0	3.9	3.0
Arts, Recreation and Other	2.4	0.1	2.1	3.4
Unallocated (2)	-0.6	-0.1	3.9	2.5
Balancing Terms (3)	…	-0.1	…	…
Gross Domestic Product	0.2	0.2	3.2	2.6

(1) Includes the change in inventories and the seasonal adjustment balancing item
(2) Includes unallocated taxes on production and imports, and bank service charge
(3) The seasonal adjutment balancing item

	qtr % chg prev qtr	% pt cont to chg (1)	ann avg % chg	ann % chg
Expenditure on GDP - March 2015 quarter				
Final Consumption Expenditure				
Private	0.7	0.4	3.7	4.1
General Government	0.2	0.0	3.0	2.2
Gross Fixed Capital Formation				
Residential Buildings	0.6	0.0	12.3	5.3
Other Fixed Assets	-2.8	-0.5	4.6	1.5
Exports of Good and Service	1.5	0.5	3.9	4.9
Imports of Goods and Services	1.0	-0.3	7.5	7.1
Change in Inv & Bal. Item (4)	…	0.0	…	…
Expenditure on GDP	0.1	0.1	3.3	3.0

(4) Includes the change in inventories and the seasonal adjustment balancing item.
Source: Statistics New Zealand

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