

18 June 2015

Q1 GDP Undermined by Drought, Tech Wreck

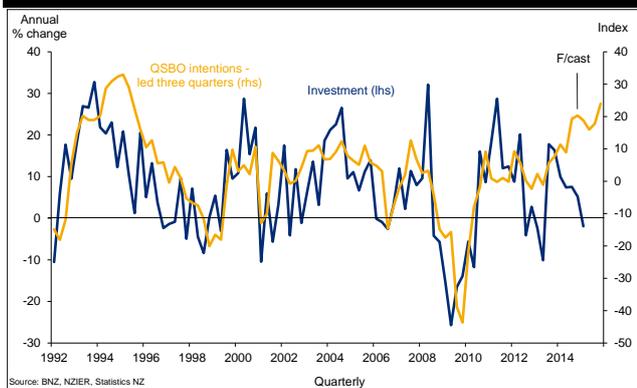
- Q1 GDP growth lowballs with 0.2% (2.6% y/y)
- Partly on clear one-offs, some of them curious
- We bump up our Q2 growth estimate to 0.8%
- July cut affirmed, debate shifts to September
- But in slower-growth, rising-inflation context

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.

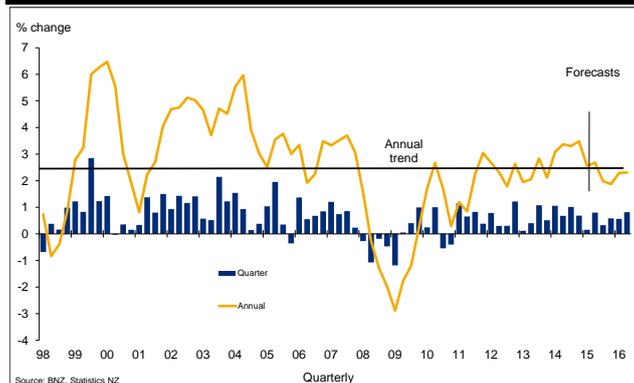
Why the surprise? For us, on the production side, it was mostly the 2.8% plunge in Information, Media and Telecommunications (IMT). This category has a weighting slightly higher than each of construction, wholesaling, retailing, total primary, and is about half the size of the manufacturing sector. Statistics 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 2015 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
<small>⁽¹⁾ Includes the change in inventories and the seasonal adjustment balancing item</small>				
<small>⁽²⁾ Includes unallocated taxes on production and imports, and bank service charge</small>				
<small>⁽³⁾ The seasonal adjustment balancing item</small>				
	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
<small>⁽⁴⁾ Includes the change in inventories and the seasonal adjustment balancing item.</small>				
<small>Source: Statistics New Zealand</small>				

craig_ebert@bnz.co.nz

Contact Details

BNZ Research

Stephen Toplis

Head of Research
+(64 4) 474 6905

Craig Ebert

Senior Economist
+(64 4) 474 6799

Doug Steel

Senior Economist
+(64 4) 474 6923

Kymerly Martin

Senior Market Strategist
+(64 4) 924 7654

Raiko Shareef

Currency Strategist
+(64 4) 924 7652

Main Offices

Wellington

60 Waterloo Quay
Private Bag 39806
Wellington Mail Centre
Lower Hutt 5045
New Zealand
Phone: +(64 4) 473 3791
FI: 0800 283 269

Auckland

80 Queen Street
Private Bag 92208
Auckland 1142
New Zealand
Phone: +(64 9) 976 5762
Toll Free: 0800 081 167

Christchurch

81 Riccarton Road
PO Box 1461
Christchurch 8022
New Zealand
Phone: +(64 3) 353 2219
Toll Free: 0800 854 854

National Australia Bank

Peter Jolly

Global Head of Research
+(61 2) 9237 1406

Alan Oster

Group Chief Economist
+(61 3) 8634 2927

Ray Attrill

Global Co-Head of FX Strategy
+(61 2) 9237 1848

Skye Masters

Head of Interest Rate Strategy
+(61 2) 9295 1196

Wellington

Foreign Exchange +800 642 222
Fixed Income/Derivatives +800 283 269

Sydney

Foreign Exchange +(61 2) 9295 1100
Fixed Income/Derivatives +(61 2) 9295 1166

London

Foreign Exchange +(44 20) 7796 3091
Fixed Income/Derivatives +(44 20) 7796 4761

New York

Foreign Exchange +1 212 916 9631
Fixed Income/Derivatives +1 212 916 9677

Hong Kong

Foreign Exchange +(85 2) 2526 5891
Fixed Income/Derivatives +(85 2) 2526 5891

ANALYST DISCLAIMER: The person or persons named as the author(s) of this report hereby certify that the views expressed in the research report accurately reflect their personal views about the subject securities and issuers and other subject matters discussed. No part of their compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in the research report. Research analysts responsible for this report receive compensation based upon, among other factors, the overall profitability of the Markets Division of National Australia Bank Limited, a member of the National Australia Bank Group ("NAB"). The views of the author(s) do not necessarily reflect the views of NAB and are subject to change without notice. NAB may receive fees for banking services provided to an issuer of securities mentioned in this report. NAB, its affiliates and their respective officers, and employees, including persons involved in the preparation or issuance of this report (subject to the policies of NAB), may also from time to time maintain a long or short position in, or purchase or sell a position in, hold or act as advisors, brokers or commercial bankers in relation to the securities (or related securities and financial instruments), of companies mentioned in this report. NAB or its affiliates may engage in these transactions in a manner that is inconsistent with or contrary to any recommendations made in this report.

NEW ZEALAND DISCLAIMER: This publication has been provided for general information only. Although every effort has been made to ensure this publication is accurate the contents should not be relied upon or used as a basis for entering into any products described in this publication. Bank of New Zealand strongly recommends readers seek independent legal/financial advice prior to acting in relation to any of the matters discussed in this publication. Neither Bank of New Zealand nor any person involved in this publication accepts any liability for any loss or damage whatsoever may directly or indirectly result from any advice, opinion, information, representation or omission, whether negligent or otherwise, contained in this publication.

US DISCLAIMER: If this document is distributed in the United States, such distribution is by nabSecurities, LLC. This document is not intended as an offer or solicitation for the purchase or sale of any securities, financial instrument or product or to provide financial services. It is not the intention of nabSecurities to create legal relations on the basis of information provided herein.

National Australia Bank Limited is not a registered bank in New Zealand.