13 December 2019

Q3 GDP: Steadying Growth, From a Much Stronger Base

- **We expect Q3 GDP expanded 0.5% (2.3% y/y)**
- **Firmer than the 0.3% the RBNZ expects**
- **Underpinned by recovered services**
- **Historical GDP revised up as much as 2%?**
- **Affecting views of productivity and potential GDP**
- **But ultimately positive news on the economy**

What if we were to say next Thursday's September quarter GDP will print near 2% higher than many people figure on? That's where our analysis is getting to, as substantial upward revisions to historical GDP data also come to pass. Sure, this will still leave a picture of a slowing economy, since a point of (increased) strength back in 2017/18. However, there is also a sense that the slowdown is now basing. Reflective of this, we anticipate a 0.5% (2.3% y/y) expansion in Q3 GDP.

To be sure, we had worried that GDP would begin to really struggle, as a number of leading growth indicators have slumped that way. It still might struggle, and for reasons besides an acute lack of resources.

However, all along, we have found it difficult to forecast a pronounced sag in GDP growth, when there were still a lot of macro tailwinds at play. Population growth remains one of these, running, as it is, around 1.7% per annum. The near record high in the terms of trade – in spite of much-slower global GDP growth – is another. There is also fiscal stimulus in the system (ahead of recent announcements of even more to come).

Yes, we did expect GDP growth to peter to 0.3% in Q3 2019, before it resumed a trend-like pace after that, of around 0.5/0.6% per quarter. However, we are now of the view Q3 GDP will expand 0.5%, for an annual increase of 2.3%.

This has been aided by the September quarter manufacturing sales and inventory statistics we saw on Monday. These inferred a decent increase in the industry's output, when we had been looking for a moderate decline. Processing of agriculture goods appeared positive in Q3. But it was more the signs of resilience in other aspects of manufacturing activity that shored up our expectations with respect to GDP.

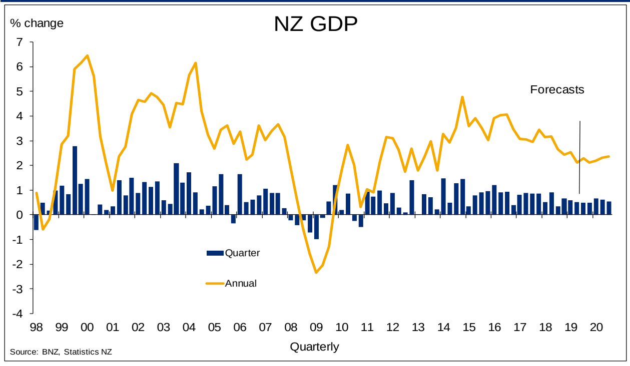
Having said this, there are still some negatives to look out for in next week's Q3 GDP accounts. Electricity generation is one. We've only just received the data on this. While we judge generation increased, overall, value-add looks to have been compromised by a switch to non-hydro generation (which tends to be more expensive). This, by the way, will likely reverse out in Q4, given the surfeit of water in hydro dams at present.

Another negative for Q3 GDP is likely to come from the forestry sector. This, in the main, reflects a correction in local log harvesting and processing (and prices), as the key China market encountered excess supply (principally from parts of Europe). We expect this to be a once-off adjustment rather than the start of a downturn.

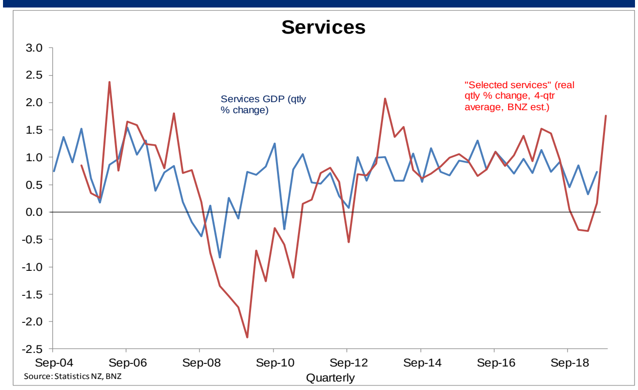
The large majority of production GDP components will probably post expansion, however, of varying degrees. As part of this, the service sectors appear to have replicated the momentum they reclaimed in Q2, after a very slow gain in Q1, of 0.3%. At least as a grouping, that is, with component results not without their usual ups and downs.

We certainly get a strong signal from the selected-services data for Q3, as published by Statistics NZ. These cover many of the professional services, including science, architecture, engineering, legal and accounting.

Basing



Better



They do not have a tight relationship with their services-GDP counterparts, but, as a grouping, they have certainly rebounded a lot over recent quarters.

In terms of expenditure-based GDP we (also) anticipate a real increase of 0.5% in Q3 2019. At the heart of this is a 0.8% expansion in private consumption. Investment spending will probably be a bit mixed in detail, but up moderately overall. Also, there is a potentially sharp lift in inventory to watch for, particular in manufactured goods (including meat and dairy). This counterbalances what will likely be a further clear correction in goods export volumes in Q3 (after outsized strength back in Q1), while imports register a steady gain.

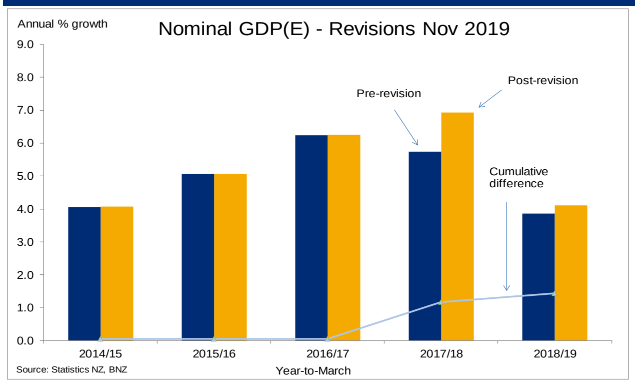
If we are right with our 0.5% call on Q3 GDP growth, it will be stronger than the 0.3% increase the RBNZ had in its November Monetary Policy Statement (MPS). For the record, the Bank forecast a 0.6% increase for Q4.

However, also note the likelihood of substantial upward revisions to quarterly GDP's recent historical trajectory, come next Thursday. Statistics NZ has certainly confirmed some major upgrades to New Zealand's annual nominal GDP profile over the last few years. This has made for a level of nominal expenditure-based GDP for the year to March 2019 1.4% higher than previously estimated.

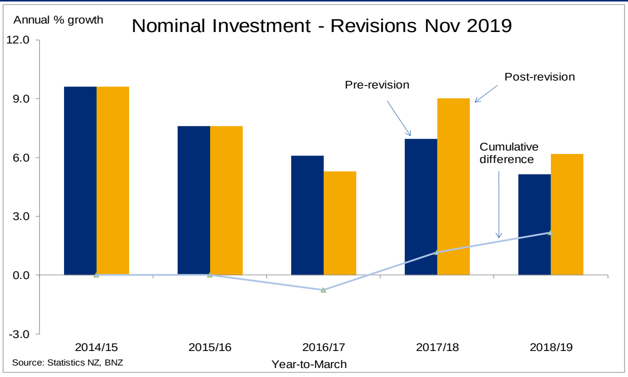
For this same year, we don't have a reference point on the income-based GDP figures, as these are updated only annually (whereas the expenditure GDP accounts are effectively updated every quarter). What we can say is that the level of nominal income-based GDP for the year to March 2019 is now estimated at $303.44b, compared to the $300.99b level nominal expenditure-based GDP has been revised up to. That's a difference of 0.8%. And it's the income-based measure that influences the real production-based measure of GDP – the latter being the one the market focuses on.

While these levels changes are significant, the most obvious revision to GDP growth looks likely to be for the year to March 2018. That's presuming most of the nominal revision turns out to be volume, rather than price – as is typically the case from these annual revisions.

Stronger



More Encouraging



If so, we could easily see a real production-GDP growth number for 2017/18 well above 4.0%, versus the 3.2% presently estimated.

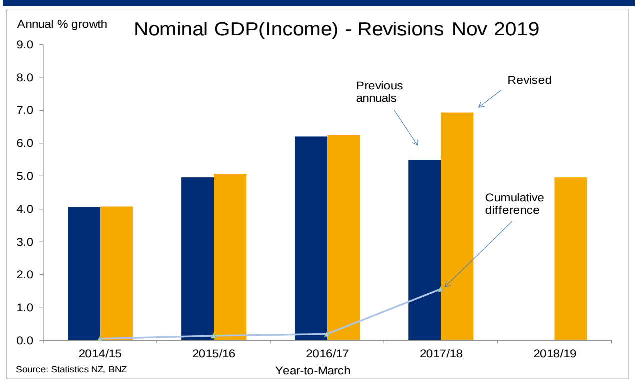
And while this would not deny a slowdown in the subsequent year to March 2019, it might be to a rate of growth a bit better than the 2.7% currently judged.

All considered then, we can reasonably expect, in next week's national accounts, a much-stronger view on New Zealand's GDP growth over recent years, culminating in a significantly higher level. This, in turn, will upgrade macro productivity measures and thus inferences of potential growth.

The composition of the revisions will probably reinforce this. When looking at why nominal expenditure GDP has been revised up so much, a lot of this has been via investment spending. This is corroborated on the income side, with business profits experiencing significantly more upgrade than employee compensation. It paints a picture of a much stronger corporate sector over recent years than previously thought.

How might the Reserve Bank view the GDP revisions? Well, if it simply runs a filter through it, it might well get the impression of relatively greater excess demand. However, the revisions will also be cause for the Bank to reassess its judgements of supply potential, with labour productivity growth measures integral to this. It might all come out in the wash, in terms of inflation messages. But the Reserve Bank's conclusions on this matter will be important to listen out for.

Even Stronger



Luckily, there has been a decent precedent, in the bigger upgrades to GDP that were instituted two years ago. The February 2018 MPS devoted a box to this event, noting that “The revision to GDP does not significantly change the Bank’s estimate of the output gap. The Bank uses a suite of indicators to infer the level of capacity pressure in the economy.”

It’s a reminder to look out the window to the many obvious indicators of capacity pressure, rather than working backwards from a number of macro data series which are subject to heavy revision over time.

The latest sense is that the economy has been doing better than generally appreciated/feared. This will certainly be integral to the historical revisions due for the GDP accounts next week and probably corroborated in a resilient result for Q3 2019 to boot – just when questions were starting to be asked.

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