ANZ Research

GDP – 2019Q2

19 September 2019

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Data summary

	Latest	Prev
Quarterly % change	0.5%	0.6%
Annual % change	2.1%	2.5%
Annual average % change	2.4%	2.7%

Glass 0.5 empty

Bottom line

- The New Zealand economy expanded 0.5% q/q in Q2, a touch stronger than both our and market expectations of 0.4%.
- As expected, a rebound in growth among services industries led quarterly growth – up 0.7% q/q from Q1's weak read of just 0.3%.
- The broader narrative that economic momentum is slowly running out of puff was confirmed in today's GDP figures.
- Annual growth slowed 0.4%pts from Q1 to just 2.1%, and we think this slowdown will persist into early 2020.

Key points

The New Zealand economy grew 0.5% q/q in three months to June 2019, a touch stronger than the 0.4% we had pencilled in. The small positive surprise means annual growth has been running a touch stronger than we thought (2.1% in Q2 compared to 2.0% expected), but the broader story of slowing momentum remains fully intact (figure 1).

Today's print was in line with the RBNZ's May MPS forecast for growth of 0.5% q/q, but was a little stronger in annual growth terms (they also expected 2.0% y/y). However, Q2 GDP was never going to be the litmus test for the OCR outlook. The forward-looking indicators matter more for the RBNZ, and they suggest momentum will continue to soften over the second half of the year and into 2020 – rather than turn a corner and begin lifting from now, as per the RBNZ's August MPS forecasts. Another downgrade to the RBNZ's growth outlook is on the cards at the November MPS.

The details of today's release were broadly as expected. A rebound in services industries (+0.7% q/q) drove quarterly growth, as expected, following Q1's very weak (but upwardly revised) 0.3% q/q lift. That said, looking through the quarterly volatility, the easing trend in annual services growth remains firmly in place, with it slipping from over 4% in 2016 to just 2.4% in Q2. There were a few overs and unders in terms of the underlying components, but nothing to challenge the overall narrative. Retail trade was a touch stronger than expected, but wholesale trade was weaker.

Resilience in the household sector – supported by a tight labour market, ongoing moderate wage growth, still-high (but easing) net migration inflows, and buoyed consumer confidence – is expected to eventually put a floor under the slowdown in services industries. But it's fair to say risks are skewed firmly to the downside – a significant deterioration in household sentiment would be particularly concerning. We'll get our next ANZ-Roy Morgan Consumer Confidence read on 27 September.

Growth across the goods-producing industries of -0.2% q/q, while negative, was stronger than we expected. Construction was a little weaker (-0.8% q/q vs -0.4% expected), while the decline in manufacturing (-0.8%) was a little smaller and electricity production expanded by more (up 3.1%). Looking forward, we think both construction and manufacturing will struggle to up the ante any time soon. Forward-looking manufacturing indicators are in contractionary territory (both activity and employment) and so too are some construction sector indicators.

Conversely, primary industries GDP lifted by less than we had pencilled in (up 0.7% q/q vs 0.9% expected). Agriculture, forestry and fishing all lifted in the quarter, but a 4.4% dip in mining provided some offset. The near-term outlook for forestry and logging is capped as China continues to work through still-elevated inventories.

Overall, 10 of the 16 production industries recorded higher levels of activity compared to Q1.

As expected, expenditure GDP outperformed its production-based equivalent, rising 0.7% q/q. This too was a little stronger than our forecast (0.5%) as government spending and investment came in a touch stronger. In terms of the detail:

- Private consumption growth was weaker than expected at just 0.5% q/q (0.8% expected), up only slightly from Q1's soft 0.4% print. This suggests momentum in the household sector might not be as buoyant as assumed. That said, spending on durables, up 0.8% q/q, remains healthy.
- Residential investment remains at a high level, but ticked down slightly (0.2% q/q). Business investment fell 0.9%, driven by a 3.7% fall in non-residential construction. Given the numerous headwinds we're seeing in the construction sector, we don't foresee a lot of upside from here.
- General government consumption rose 0.6% q/q, a quarterly pace we see continuing for a while yet.
- Net exports made a weaker-than-expected contribution to growth, with the decline in exports (-1.8% q/q) outpacing that of imports (-0.3%).

The nominal economy grew a solid 1.9% q/q – faster than we had expected and well above its real counterpart. At face value, this points to higher pricing pressures across the broader economy, including the recent lift in the terms of trade. However, there isn't a strong correlation between the GDP deflator and CPI inflation.

As expected, per capita growth was soft at 0.2% q/q, with annual growth in this measure moderating 0.4%pt from Q1 to just 0.5%. While per capita measures are being influenced by the noisy migration data, per capita growth certainly confirms that labour productivity remains soft. That said, we think the migration cycle has probably eased a touch more than the recent data shows, and that could see per capita measures revised slightly higher over time. Next week's census release could move per capita measures around a bit too.

All up, despite the slightly stronger print than expected, today's data continue to reflect an economy that has continued to slowly lose steam over the first half of 2019. And with forward-looking indicators continuing to slip, this process looks set to continue for a while yet. But it's not just the domestic economy that looks set to disappoint the RBNZ's August MPS forecasts. Trading partner growth has also been softening – and as a small open economy that's a growth anchor to be particularly concerned about.

While we're not expecting growth to roll over (our forecasts are for annual growth to bottom out at a little below 2% in Q1 2020), we do think inflation pressures will wane in this environment. We expect the RBNZ will use the tools it has available to lean against that (and keep inflation expectations from deteriorating significantly). We have pencilled in 25bp cuts in for November, February and May, taking the OCR to just 0.25%.

Figure 1. Production-based GDP

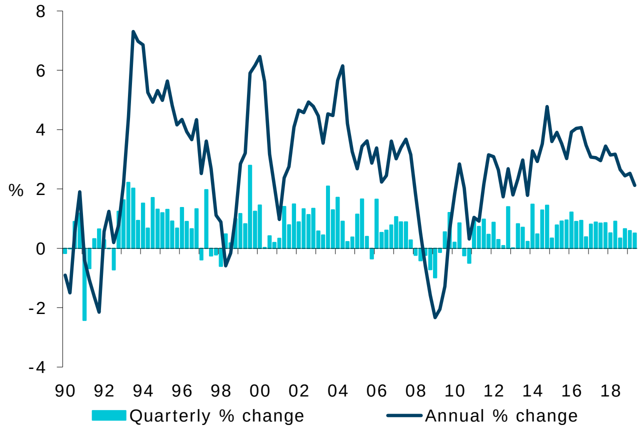


Figure 3. GDP per capita

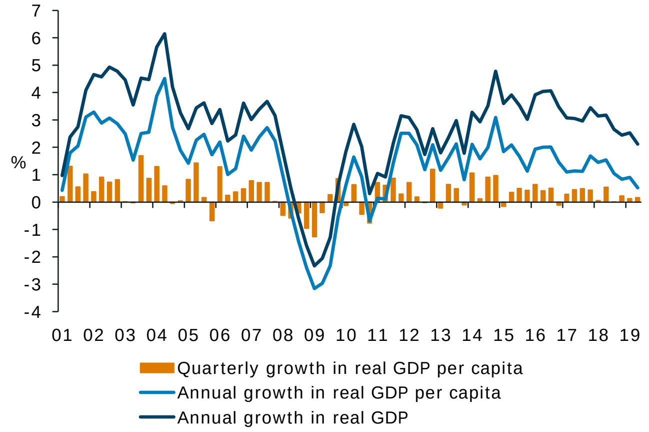


Figure 2. Production-based GDP components

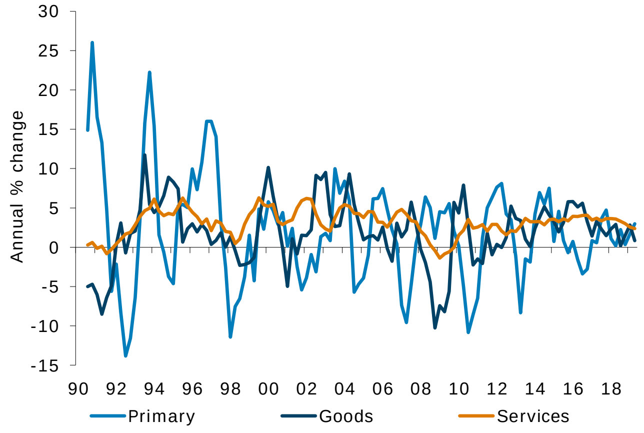
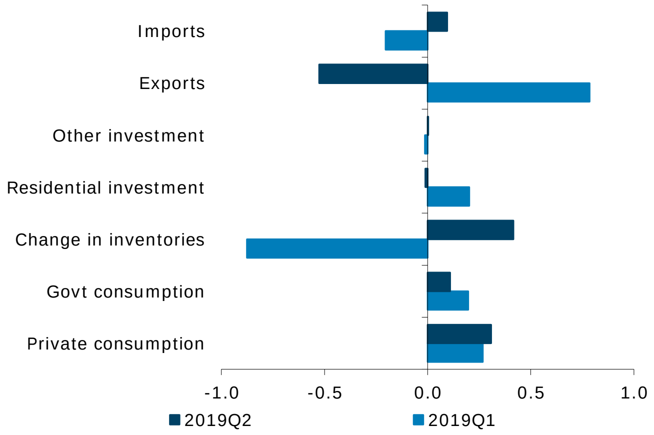


Figure 4. Contributions to quarterly growth in expenditure-based GDP



Source: Statistics NZ

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