WINDS OF CHANGE

- GDP growth is expected to register a relatively soft print of 0.4% q/q in Q1. Annual growth is expected to moderate from 2.9% to 2.6%.
- The economy is facing headwinds and growth momentum has slowed. From here, we expect continued growth around trend, but not above, and perhaps a few more downside risks are becoming evident.
- We expect the seasonally adjusted current account deficit will widen, but in annual terms will remain stable at 2.7% of GDP.

KEY POINTS

- March quarter Balance of Payments and GDP figures are released at 10:45am next Wednesday and Thursday respectively.
- We expect GDP will expand 0.4% q/q – a softer print than recent performance. Annual growth is expected to moderate from 2.9% to 2.6% y/y (below where we see trend), as growth momentum continues to slow from the 4½% annual pace experienced in mid-2016. Now there is perhaps some modest upside risk to our quarterly pick, but only at the margin. And reinforcing the underlying softness, if GDP is in line with our expectations, it would imply a fall in per capita GDP of 0.2% q/q, to be up just 0.6% y/y.
- Services industries are expected to make the largest contribution to growth in the quarter (increasing 0.6% q/q). Services strength is expected to be broad based, with an easing in wholesale trade (-0.4%) the only exception. Solid growth is expected from public administration and safety (+1.5%), professional, scientific, administration and support (+1.0%), financial and insurance (+0.8%), health care and social assistance (+0.8%), and rental, hiring and real estate services (+0.7).
- We expect primary industries to only partially recover (+0.6% q/q), after falling 2.4% in Q4. Milk production has seen little growth this quarter, and livestock slaughtering was seasonally weak (falling 10%). Adding to this, sawn timber and log exports were down 4.9% q/q. On the other hand, solid performance from horticulture should provide a boost.
- Goods production is expected to increase modestly (+0.4% q/q), with small increases across construction and manufacturing. Partial data for the latter points to a 0.4% q/q lift in food manufacturing, alongside a more modest (0.1%) increase in ‘core’ manufacturing volumes. Electricity production is expected to provide a boost, following recent falls in wholesale electricity prices.
- Net exports are expected to drag on the expenditure-based measure of GDP, and we wouldn’t be surprised to see it undershoot its production-based equivalent. Exports are expected to decline 1.6%, while imports are expected to increase 1.7%. Offsetting this, private and government consumption are expected to increase 0.7% and 0.8% respectively. Residential investment is expected to increase a modest 0.3% q/q and gross fixed capital investment is expected to increase 2.5%. Inventories are expected to make a small, positive contribution.
The economy is clearly facing headwinds. Quarterly GDP growth has averaged 0.9% since 2014, but we expect it will be difficult to achieve such strong rates of growth from here. In fact, the underlying pace of growth is already slowing. Construction and net immigration – key drivers of recent growth – are expected to have topped out, and we believe consumption growth will cool in the face of a softer housing market. Businesses are facing credit and capacity constraints, along with margin pressure and policy uncertainty – and these headwinds are flowing through to activity, with the recent data flow looking fairly lacklustre.

That said, we don’t expect the cycle to completely roll-over just yet. Despite headwinds, the economy appears resilient and doesn’t have the degree of imbalances (especially external imbalances) that have often been the catalyst to tip the cycle over in the past. Supported by strong income growth (in large part a result of elevated export prices) and fiscal expansion, our base case is that the economy will grow around trend (or thereabouts) over the next couple of years. But it is fair to say that downside risks to the outlook have increased a little of late. That is of course relevant for the RBNZ; growth of at least at trend is needed to push core inflation pressures higher.

With regards to the Balance of Payments, we expect the seasonally adjusted current account deficit will widen. We have a $3.0bn seasonally adjusted deficit pencilled in, which is around $1.0bn larger than in Q4. However, the annual deficit isn’t expected to widen nearly as much due to base effects. With nominal GDP expected to lift, the annual deficit is expected to remain stable at 2.7% of GDP.

Our expectation for a widening seasonally adjusted current account deficit reflects a widening of the goods deficit. The 1.9% fall in the goods terms of trade in Q1 suggests prices will drag, alongside a negative contribution from net exports volumes. Imports have also been buoyed by reasonable underlying domestic demand, while exports have been navigating some weather-induced headwinds. The services surplus is expected to widen slightly ($1.3bn), reflecting a busy tourism sector, while the income deficit is expected to narrow a touch ($2.5bn). But ultimately, these moves are all within recent quarterly volatility and do not point to any shifts in underlying trends or themes.

### ANZ Q1 GDP industry-level forecast

<table>
<thead>
<tr>
<th>Industry</th>
<th>q/q%</th>
<th>%pt cont.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture, forestry, and fishing</td>
<td>-0.6</td>
<td></td>
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<tr>
<td>Mining</td>
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<td></td>
</tr>
<tr>
<td>Manufacturing</td>
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<td></td>
</tr>
<tr>
<td>Electricity, gas, water, and waste services</td>
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<td></td>
</tr>
<tr>
<td>Construction</td>
<td>0.5</td>
<td></td>
</tr>
<tr>
<td>Wholesale trade</td>
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<td></td>
</tr>
<tr>
<td>Retail trade and accommodation</td>
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<td></td>
</tr>
<tr>
<td>Transport, postal, and warehousing</td>
<td>0.4</td>
<td></td>
</tr>
<tr>
<td>Information media and telecommunications</td>
<td>0.5</td>
<td></td>
</tr>
<tr>
<td>Financial and insurance services</td>
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</tr>
<tr>
<td>Rental, hiring, and real estate services</td>
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<td></td>
</tr>
<tr>
<td>Prof, scientific, technical, admin, and support</td>
<td>1.0</td>
<td></td>
</tr>
<tr>
<td>Public administration and safety</td>
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<tr>
<td>Education and training</td>
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<td></td>
</tr>
<tr>
<td>Health care and social assistance</td>
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<td></td>
</tr>
<tr>
<td>Arts, recreation, and other services</td>
<td>0.0</td>
<td></td>
</tr>
<tr>
<td>Unallocated</td>
<td>0.4</td>
<td></td>
</tr>
</tbody>
</table>

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