STRONG STARTING POINT

BOTTOM LINE

- The economy expanded 1.0% q/q in Q2, boosted by temporary factors. The underlying details were generally strong, although it is uncertain whether it will be sustained, with doubts about the strength of economic momentum into the second half the year casting a shadow.

- We expect that the RBNZ will “look through” the temporary strength, but will be reassured by the underlying resilience in today’s data, providing some breathing room to continue to “watch, worry and wait”. The RBNZ will be focused on how economic activity evolves from here – standing at the ready to cut the OCR should they judge the economy needs it.

KEY POINTS

- The economy expanded by 1.0% q/q in Q2, above consensus expectations of 0.8% (and our own expectations of 0.7%). This is a strong pace of quarterly growth. It saw annual growth stabilise tick up to 2.8% y/y from 2.6%, following recent deceleration from the recent peak of 4.4% y/y in June 2016.

- Today’s print was boosted by temporary factors, but nonetheless, the underlying picture is strong. Production was boosted by a number of temporary factors in the June quarter, including weather-related recovery in agriculture, livestock slaughtering due to M. Bovis, above-average hydro lake levels, and population growth. In per capita terms, GDP growth posted a decent 0.5% q/q recovery from last quarter’s flat print, but is up only 0.7% y/y. Expenditure GDP was boosted by government consumption, and net exports provided a boost rather than a drag, but business investment fell 0.2% q/q.

- The underlying strength in today’s print will give the RBNZ some breathing room to continue to "watch, worry and wait”. Today’s data were undeniably stronger than we had anticipated and the resilience in the data will give the RBNZ space to remain in data-watching mode, seeking further clarity about the strength of economic momentum into the second half of the year, with concerns about domestic demand already casting a shadow over today’s strong print.

- While today’s data provides some reassurance, the RBNZ will not be complacent about downside risks. The economy is grappling with headwinds, recent drivers of growth are waning, and there is a risk that downbeat business expectations become self-fulfilling – with employment and investment having turned negative. At the OCR review next week we expect that the RBNZ will reiterate their willingness to do what it takes to support the economy, restating that the next move in the OCR could be “up or down”.

- Expenditure GDP rose 1.2% q/q, much stronger than expected. However, this was boosted by very strong growth in government consumption, which contributed 0.4%pts. Net exports posted a positive contribution on the back of weaker-than-expected imports, compared with a small drag expected. Exports increased 2.4%, while imports were up 1.5%.

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Data summary

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- **Consumption increased in line with expectations.** Private consumption increased 0.6% in the quarter (3.0% y/y). Consumption was flat in the March quarter, so a solid rebound was expected. Consumption continues to be supported by strong population growth, but underlying consumption is fairly subdued, having moderated over the past two years.

- **Investment spending dipped.** Residential investment increased 0.5% (a little below our expectations of a 0.7% rise), while other fixed asset capital investment fell 0.2% q/q – the only genuine weak spot in the whole release. It remains to be seen whether investment will be affected by downbeat business intentions into the second half of the year.

- Nominal GDP rose 1.5% q/q to be up 5.0% annually. Real gross national disposable income rose 0.8% q/q (3.1% y/y).

- **In terms of the underlying details, 15 of the 16 production industries recorded stronger levels of activity.** As expected, the services sector made the strongest contribution to growth, rising 1% with broad-based gains across all services industries. Primary industries were up 0.2%, boosted by a weather-related recovery in milk production offset by a significant fall in mining. Goods production was up 0.9%, with construction and electricity generation both rebounding.
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