Economic Update
Q2 GDP Review
18 September 2014

Growth pulse remains strong

- 0.7% lift in Q2 GDP a touch higher than our forecast.
- Driven by a broad-based lift in services sector activity.
- Underlying momentum intact in NZ economy, indicating a solid growth outlook over the rest of the year.

Q2 GDP increased 0.7%, broadly in line with both our forecast of a 0.6% increase and the RBNZ’s forecast of a 0.8% increase. The key driver behind this growth was strong services sector activity, with the 1.4% increase contributing wholly to the 0.7% increase in GDP in Q2. This result is in line with the improvement in hiring and investment intentions we have seen over the past year as businesses feel more confident.

Over the past year, strong construction activity and a rebound in agriculture production from the previous summer’s drought had been the key drivers behind NZ economic growth. We have seen the surge in construction activity flow through to stronger demand in other industries such as professional and business services and ex-primary manufacturing production. The Q2 GDP result shows strong demand for services beyond those related to the construction sector, with StatsNZ highlighting the strong lift in services activity across all the sub-industries including advertising, employment services and software.

The broad-based nature of Q2 GDP growth confirms our view that the NZ economy remains on a solid footing this year. Recent activity indicators point to a pick-up in growth over the second half of 2014, as higher business and consumer confidence flow through to a continued improvement in business investment, hiring and household spending. The Q2 GDP result is consistent with the RBNZ’s outlook, and the RBNZ has signalled it is on hold into 2015. We continue to expect the RBNZ to remain on hold until March 2015, before recommencing gradual OCR increases to a peak of 4.5% in March 2016.

Key figures

+0.7% qoq (ASB f/c +0.6%, RBNZ +0.8%)
+3.9% yoy, +3.5% aapc

The 0.7% increase in Q2 GDP was a touch higher than our forecast of a 0.6% increase, and confirms our view that the underlying momentum remains intact in the NZ economy. The 1.4% increase in total services sector activity contributed wholly to the 0.7% increase in GDP in Q2. Declining primary industry activity offset an increase in goods-producing industry activity.

Exceptionally strong demand for services

In particular, there was a strong 4.2% lift in professional and business services activity across all the sub-industries, a key source of forecast surprise to us. The increase in this industry is the largest quarterly increase since Q4 2001. StatsNZ highlighted strong increases in advertising, employment services and software over the quarter. This result is in line with the improvement in employment demand we have seen over the past year, as businesses feel more confident about hiring and committing to other spending.

Higher demand for discretionary household spending.

Higher consumer confidence also boosted services activity through increased discretionary spending such as accommodation services.
Manufacturing activity not quite as weak as we expected. Meanwhile, manufacturing activity was not as soft as we expected, reflecting the smaller than expected 1.1% decline in primary manufacturing in Q2. Excluding the primary industries, core manufacturing production increased slightly, as we expected.

Strong infrastructure spending drives construction growth in Q2. The 2.2% increase in total construction activity in Q2 was in line with our expectations, driven by stronger infrastructure construction over the quarter. Both residential and non-residential investment held up at high levels, as the earlier release of Q2 Building Work Put in Place had indicated. This result follows a surge in both residential and non-residential activity in the previous quarter.

Solid increase in real estate and hiring services activity despite moderation in house sales. Meanwhile, real estate, rental and hiring services activity in Q2 was stronger than what house sales would suggest. The 0.7% increase in activity is at odds with the continued moderation we have seen in housing activity over the first half of 2014. By our estimates, housing turnover dipped 6% between Q1 and Q2, based on our seasonal adjustment of REINZ data.

We expect a further lift in business investment over the coming year. On the expenditure side, business investment was not as strong as we expected, as some of the capital imports went into inventories this quarter. We expect a further lift in business investment over the coming quarters (of which some will be sourced out of the build-up in inventories).

Growth expected to remain solid over second half of the year. Solid growth outlook Recent activity indicators point to a pick-up in growth over the second half of 2014, as higher business and consumer confidence flow through to a continued improvement in business investment, hiring and household spending. The rebound in manufacturing sector surveys such as the PMI in more recent months points to a pick-up in ex-primary manufacturing activity over the second half of 2014.

What is particularly encouraging is the broad-based nature of this growth beyond construction activity and agriculture production.

Driven by stronger activity across a broad range of industries. We expect annual average growth will peak at 3.8% by the end of this year, before moderating to just under 3% by 2016.

Underlying momentum clearly intact in NZ economy. Implications We don’t see any implications for the growth outlook and OCR outlook from the release, given how similar the outcome was to both market and RBNZ expectations. The underlying momentum in the growth figures was very respectable, particularly given the weaker contributions from sectors that had been driving growth strongly
Uncertainty about the extent to which this solid growth flows through to inflation pressures.

Slight lift in interest rates and NZD in the wake of GDP release.

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in recent quarters (construction, agriculture). The details show that growth was broad-based over the quarter and that the recovery is about more than just a strong lift in construction and favourable pastoral conditions.

Both we and the RBNZ expect growth in the second half of the year to be at least as strong as the trend pace in the first half of the year (0.8% on average per quarter). The RBNZ is taking the view that the economy will sustain that growth this year without inflation pressures becoming problematic, but will look to business surveys and inflation outcomes to test that assumption. We continue to expect the RBNZ to remain on hold until March 2015, before recommencing gradual OCR increases to a peak of 4.5% in March 2016. The next key event on the radar is the General Election on September 20.

Initial market reaction

NZ swap rates have lifted only modestly this morning, with 1-5 year swap rates up 1 basis point. The NZD has been heavy in the wake of the FOMC announcement earlier this morning, and has drifted slightly higher since the GDP data release. NZD/USD is trading near 81 cents at the time of writing, above 80. 90 cents at 10am this morning.

Background to the data

Gross Domestic Product (GDP) is a measure of the output produced in an economy during a period. Total output is collated in value-added terms to avoid double counting of production. GDP is measured on a quarterly basis and released towards the end of the next quarter. It provides a reasonably comprehensive measure of activity within the economy but the long delay in compilation and release does tend to negate the importance of the actual data release. Three measures of GDP are possible: via income data, via expenditure data and via production data. The latter two are reported on a quarterly basis in New Zealand with the production series preferred as the more accurate measure of short-term change.

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