19 September 2011

Westpac Institutional Bank

Steady progress
Q2 GDP preview

- **We estimate that June quarter GDP grew by 0.7%, continuing the momentum that has been building since late last year.**
- **Excellent dairying conditions and a post-quake rebound in many service sectors were the major drivers. Construction, outside of recovery activity in Christchurch, remains a drag on the economy.**
- **The GDP figures are historic and should have limited impact on the RBNZ, given the more timely concerns around overseas funding costs.**

GDP expectations

	GDP q/q	GDP y/y	GDP ann avge
Q1 actual	0.8%	1.4%	1.5%
Q2 Westpac forecasts	0.7%	1.9%	1.5%
Q2 market forecasts	0.5%	1.7%	1.5%

The New Zealand economy has been gathering momentum since late last year, as activity has responded to low interest rates, a stabilisation in asset values and strong commodity export prices. We estimate that GDP rose by 0.7% in the June quarter, following the surprisingly strong 0.8% rise in the March quarter. This would mark a minor milestone, taking GDP above its pre-recession peak (though on a per-capita basis we think there's at least another year to go).

The strong growth in the March quarter came in spite of the devastating Christchurch earthquake in February. While it's clear that there were serious disruptions to many parts of the regional economy, there was also a great deal of relocation of activity, and some outright positive contributions such as insurance assessments and housing repairs. These effects continued to work their way through in Q2, with some sectors experiencing a post-quake rebound and others seeing activity scaled back.

Details

We estimate that growth was concentrated in the service industries, with the star performer being real estate and business services, based on a strong pickup in property sales and a sharp rise in hours worked in the sector. We also expect solid growth in retail and wholesale trade, based on their respective surveys. While each of these sectors already recorded strong growth in the March quarter, they would have been stronger still were it not for quake-related disruptions, which will be partly unwound in the June quarter.

The other significant contributor was the agricultural sector, and particularly dairying. Excellent grass-growing conditions meant that milk production was much higher than a year ago (though it is the low point of the season). We estimate that production was up 6% for the quarter in seasonally adjusted terms. Milk processing should also have lifted manufacturing output overall (non-food manufacturing was about flat).

Figure 1: Production based GDP

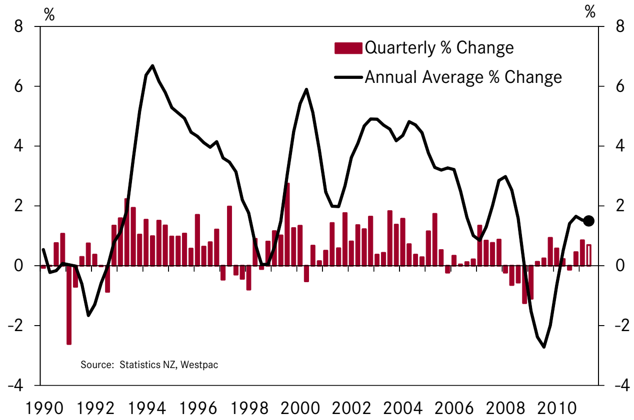
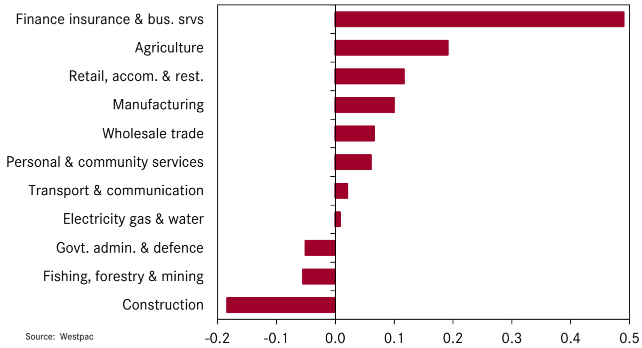


Figure 2: Percentage point contribution to Q2 GDP growth



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Some notable weak spots remained in Q2, only some of which can be pinned on quake effects. Consented building activity plunged 6.6% in the June quarter, reflecting the weakness in housing consents over the last year. The impact on construction sector GDP should be smaller as it includes repairs and non-building work such as infrastructure and site clearing, which has been the focus of much of the activity in Christchurch to date.

We expect a drop in central and local government activity, which rose 2.1% in the March quarter due to spending on civil defence and emergency management, and the inclusion of EQC on a quarterly basis for the first time. The former will have been scaled back in Q2, but EQC assessors will still have been out in full force.

On an expenditure basis, we expect a modest 0.5% rise in household consumption, a 10% drop in residential construction, and a build-up of inventories, partly due to restocking of goods that were damaged in the quake. Net exports will make a sizeable negative contribution, with goods exports flat, tourism weak and goods imports higher. The latter partly reflects aircraft imports, which will be balanced out by a rise in business investment.

Market implications

Our pick for 0.7% growth is at the top end of the range of forecasts, though we're not alone up there. The median market forecast is 0.5%; the RBNZ estimated a 0.6% rise in last week's *Monetary Policy Statement,* though this was finalised before some of the recent indicators such as the manufacturing survey.

A surprise result either way should have limited market implications, given the historic nature of the data and the more pressing concerns lately around the state of the European economy and financial system. The RBNZ is currently concerned about the rising premium required for overseas funding; a stronger than expected GDP outturn is unlikely to accelerate its tightening plans unless the funding situation eases. A weaker than expected result could see the market push out the expected timing of rate hikes further, but it would have little bearing on the outlook for growth over the next year or two, which will be heavily influenced by the reconstruction job in Christchurch.

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