21 June 2012

Westpac Institutional Bank

From grumpy growth to jumpy growth

Q1 GDP rose 1.1%, well above expectations

- **GDP grew by much more than expected in the March 2012 quarter, rising 1.1% by production and 0.8% by expenditure.**
- **While we're not entirely convinced that this represents how the economy was tracking in the early part of this year, the bottom line is that the pace of growth is picking up in 2012, as we have long expected.**

Key results

	Actuals		Q1 expectations		
	Q4	**Q1**	**WBC**	**Mkt**	**RBNZ**
GDP q/q	0.4	1.1	0.7	0.4	0.4
GDP ann % chg	1.9	2.4	1.5	1.3	1.2
GDP ann avg % chg	1.3	1.7	1.2	1.1	1.1

Summary

The production measure of GDP rose 1.1% in the March quarter, compared to the median forecast of 0.4% and our top-of-the-market forecast of 0.7%. On top of this, the rate of growth was revised up slightly for each of the previous four quarters, lifting the annual average growth rate to 1.7%. The expenditure measure of GDP – usually considered a less reliable measure on a quarterly basis – rose by 0.8% for the quarter.

After a string of weak GDP outturns in the last year (and a parade of downward revisions to history), some people will no doubt be left asking whether today's result is genuine. Having dug into the numbers in some detail, our conclusion is: sort of. There are some possible statistical quirks with the production measure; our feeling is that the 0.8% rise in expenditure is more representative of what the economy was doing in the early part of this year.

Either way, though, the story is that the pace of growth is picking up right on cue, after a prolonged recession and the disruption of several earthquakes. The composition of growth is likely to change in coming quarters, as exports slow and reconstruction activity picks up, but we are on track for an acceleration in overall activity this year.

Details

Production GDP rose 1.1% in the March quarter, which along with small upward revisions to each of the four previous quarters lifted year-on-year growth to 2.4%. Interestingly, with the revisions the second half of 2010 now registers as a technical recession, with very small declines in both quarters following the first Canterbury earthquake.

Figure 1: Production based GDP

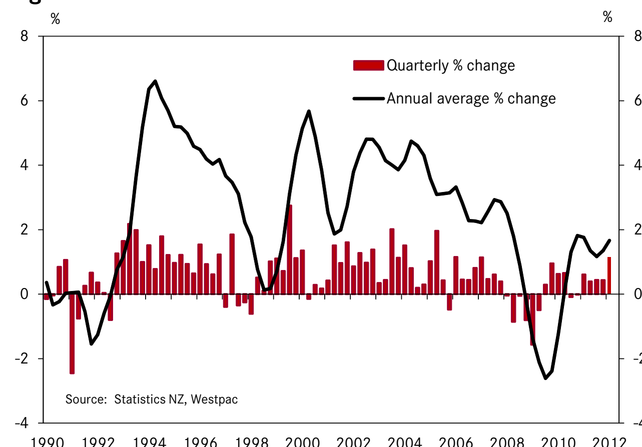
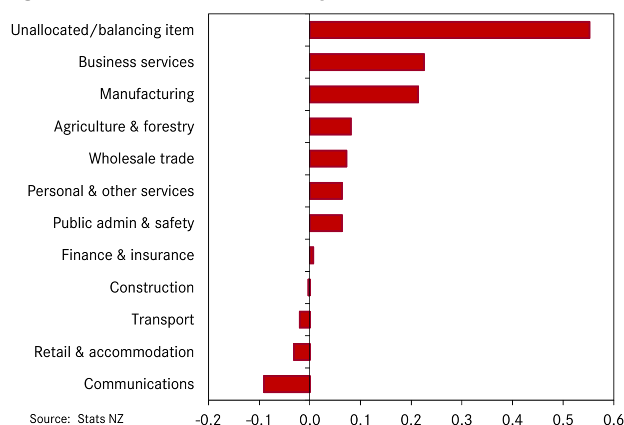


Figure 2: GDP Production Components



What makes us wary of the rise in the production measure is that the parts don't add up to the whole. This is partly because, under the recent revamp of the GDP series, some industries are no longer seasonally adjusted – in particular telecommunications, even though it looks distinctly seasonal to us (Figure 2 above is based on our own seasonal adjustment). But even after allowing for this, totting up the components only explains 0.7 percentage points of the growth. That leaves us with two problems: it makes it harder to tell a story about 'where the growth came from', and it suggests that this measure could be more vulnerable to downward revisions in future releases.

But the bottom line, no matter which measure you use, is that Q1 growth was stronger than the market expected. And what's encouraging about the production measure is that growth was seen across a broader range of industries than we have seen in recent times.

The largest growth contributions – and the biggest surprises relative to our forecast – came from business services, manufacturing and agriculture. Agriculture rose 2.3% as milk production was boosted further by excellent growing conditions, a factor that also contributed to a 3.2% rise in food and beverage manufacturing. The pace of growth in these two sectors probably won't be maintained over the rest of the year; there are already signs that dairy production is starting to ease back.

Professional and administrative services rose 2.0%, and in fact have maintained a similar pace of growth for seven of the last eight quarters. This industry serves as an interesting bellwether for the wider economy – it links into almost every other sector in some way, and it isn't buffeted by factors like the weather.

Public administration rose by 1.4% for the quarter. While we expected a bounce in this category, what we didn't expect was that the sharp 3.6% drop in the previous quarter would be almost completely revised away. For all of the talk of austerity, real government activity was still expanding up to March this year.

Construction fell 0.1%, against our expectation of a 1% rise. While the Q1 building work survey showed a small drop in consented building activity, we'd thought that non-consented work in Canterbury (infrastructure and earthquake repairs) might tip the balance. Statistics NZ believes that this didn't have a significant impact on GDP, although it's possible that this could be revised as more information about completed work becomes available.

The other declines were in retail trade – as expected after the Rugby World Cup – transport, and telecommunications. The latter industry has been in steep decline for several years – at least according to the GDP figures – and the 3% drop in the March quarter was even larger than we'd braced for.

On the expenditure measure of GDP, household consumption proved to be more resilient than we expected after the Rugby World Cup, rising 0.1%. However, this was largely due to a 16% jump in spending overseas, as New Zealanders took advantage of the strong exchange rate. (This doesn't add to total GDP, as it counts towards imports of services). Residential investment fell by 0.6%, but other fixed asset investment rose by 2.1%, led by non-residential construction (up 2.0%) and plant and machinery (up 5.2%). Plant and machinery investment has recovered strongly in the last two years, but remains about 6% below its pre-recession peak.

Market implications

The surprisingly strong outturn sent the New Zealand dollar around half a cent higher, and pushed the two-year swap rate up by 12 basis points. Interest rate markets are now pricing a one-third chance of an OCR cut this year. We broadly agree with this pricing, although we don't think today's figures really shifted the odds much – the Reserve Bank made it clear in its June *Monetary Policy Statement* that the case for cutting rates depends on a nasty turn of events in Europe.

On the other hand, while it represents a major upside surprise to the RBNZ's forecast of 0.4% growth, we don't think that today's result will prompt the RBNZ into raising interest rates any sooner than it was already intending. The RBNZ has long been forecasting growth to pick up, but expects inflation to remain comfortably near the middle of the 1-3% target range, giving it more room to absorb upside surprises than other private sector forecasters. And the ongoing pickup in business investment could be read as a positive for the New Zealand economy's non-inflationary 'speed limit' in coming years.

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