Westpac Institutional Bank

Ticking up

Preview of Q1 GDP (21 Jun, 10:45am) and current account (20 Jun, 10:45am)

- **We expect a 0.7% rise in March quarter GDP, which would be the biggest quarterly rise since the Canterbury earthquakes. Reconstruction is likely to boost the pace of growth over this year, but doesn't appear to have been a major factor in the March quarter.**
- **The current account deficit is expected to widen to 4.5% of GDP, as tougher external conditions weighed on exports and the temporary boost to tourism generated by the Rugby World Cup faded.**

Summary

We expect next week's accounts to show a 0.7% increase in GDP and a widening of the current account deficit to 4.5% of GDP in the March quarter, as the economy shows more signs of life than in the past two years. Our picks are a little more optimistic than the median market forecasts (0.6% GDP growth and a 4.6% deficit), though the differences are well within margins of error.

Q1 GDP, 21 June

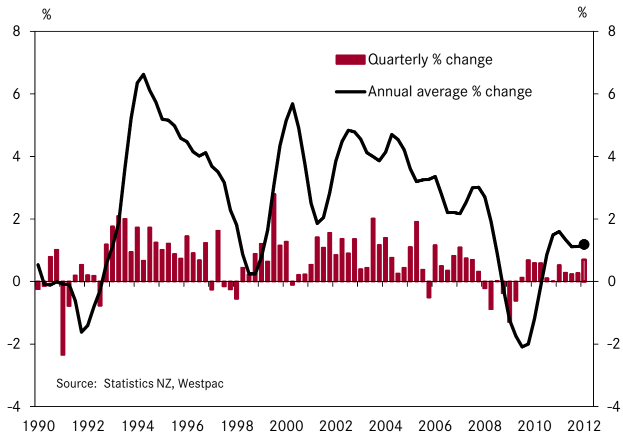
Our forecast of 0.7% GDP growth implies a faster pace than we have seen in the last two years, and in particular since the Canterbury earthquakes. We've long been expecting post-quake reconstruction activity to boost the pace of growth over the next couple of years. However, the details of our forecast don't suggest that this was a major factor in the March quarter, at least not directly.

Rather, the sectors that we see making the biggest growth contributions all have an element of bouncing back from recent weak outturns. Manufacturing is coming off a 2.3% decline in the December quarter, which at least in part could be traced to the gas supply disruptions in October. Wholesale trade is still recovering from a 3.1% drop in September. Meat production picked up after a steep drop in December as farmers held onto stock for longer than usual. And while government will be a drag on growth over coming years, we think that the previous 3.6% fall overstates the case.

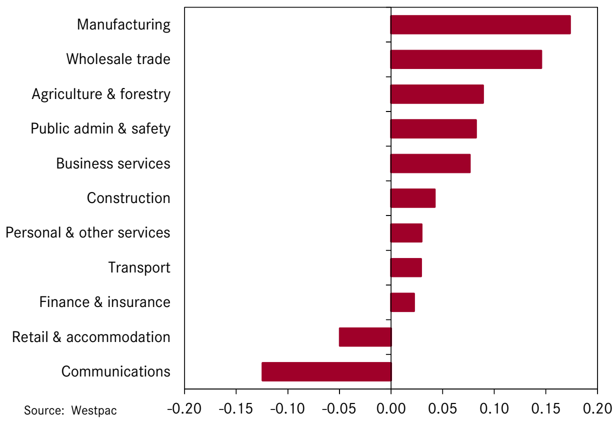
Construction is expected to make only a small positive contribution to growth. While the building work survey showed that housing construction was down slightly nationwide, we think that non-consented work in Canterbury (infrastructure and earthquake repairs) should tip the balance.

The main negatives are a post-Rugby World Cup pullback in retail spending (although not as severe as first thought, according to the revised retail figures published this week), less value-

Production based GDP



Percentage point contribution to Q1 GDP growth



added in electricity (low lake levels meant greater reliance on more expensive forms of generation), and another sharp drop in communications. The weakness of the latter category in recent years has been puzzling, but we have no reason to suspect that the trend has turned.

Statistics NZ recently overhauled the GDP figures (producing a significantly different pattern to the recent pace of growth); this is our first attempt at forecasting the revised series. The changes have improved the accuracy of some indicators, while opening up fresh questions in other areas, particularly in services. On balance, our degree of confidence in the forecast is similar to usual (we are usually within 0.2 percentage points).

Michael Gordon
Senior Economist

Q1 current account, 20 June

Trade figures show that the goods balance remained in surplus territory during the March quarter, although the size of the surplus is shrinking. Deteriorating external conditions are starting to weigh on export prices, including fruit (particularly apples), meat (especially lamb), wool, dairy and forestry products. We expect further slippage over the rest of this year, eventually returning to deficit for the first time since September 2008.

The services deficit is expected to widen, as the temporary effect of the flood of Rugby World Cup tourists drops out. New Zealand's tourism sector remains under pressure due to still-weak domestic economies in traditional tourist markets such as the UK and Europe and a cautious Australian consumer. In conjunction with the high NZ dollar, this has kept the services balance in negative territory since mid-2010.

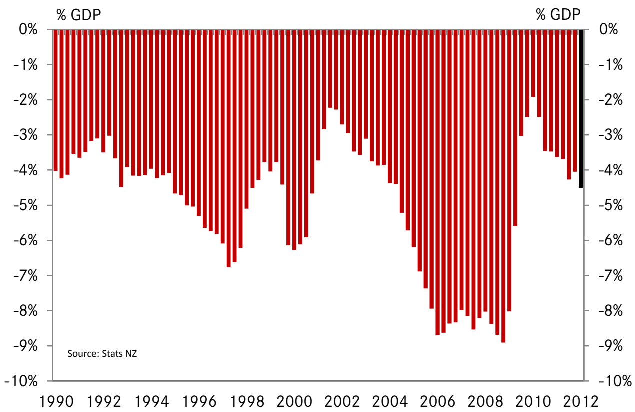
We expect a temporary contraction in the investment income deficit, as indicators suggest foreign owned firms' profitability moderated following a couple of strong quarters. However, over a longer horizon, and as momentum in the New Zealand economy improves, we expect profits of foreign-owned (and domestic) firms will pick up as well, leading to a widening in the investment income deficit.

Anne Boniface
Senior Economist

Current Account components ($million)

	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12 (forecast)
Goods Balance (s.a.)	908	997	543	1,066	500
Services Balance (s.a.)	-163	-404	-283	-199	-380
Investment Income Balance	-2,134	-2,420	-2,956	-2,801	-2,480
Transfers balance	-78	-145	-78	-63	-80
Current Account Bal (s.a.)	-1,495	-1,997	-2,794	-2,033	-2,470
CAB Ann Total	-7,194	-7,395	-8,828	-8,270	-9,220
Ann CAB, % of GDP	-3.6	-3.7	-4.3	-4.0	-4.5

NZ Current Account Balance



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