16 March 2012

Westpac Institutional Bank

Neither hot nor cold

Q4 GDP preview: 22 March, 10:45am

- **We expect a 0.6% rise in December quarter GDP, roughly a trend pace of growth.**
- **Along with the temporary boost from the Rugby World Cup, growing conditions remain strong and there are signs of improving domestic demand. Construction is turning the corner as the Canterbury rebuild starts to gear up.**
- **Evidence of moderate growth at this stage of the cycle would not sway the RBNZ.**

	GDP q/q	GDP y/y	GDP ann avg
Q3 actual	0.8%	1.9%	1.3%
Q4 Westpac forecasts	0.6%	2.2%	1.6%
Q4 market forecasts	0.6%	2.2%	1.6%

Summary

The New Zealand economy appears to have largely sidestepped the concerns about global growth and financial stability that were mounting during the second half of 2011. We estimate that GDP clocked up 0.6% growth in the December quarter, a pace that would be the envy of many developed countries at the moment, though not particularly remarkable in its own right. In fact, this is probably a fair reflection of the economy's trend pace of growth.

Details

Our GDP estimates suggest a more domestic flavour to the recovery during the December quarter. Some of the growth no doubt reflects an even stronger contribution from the Rugby World Cup (RWC) than in the September quarter, with the number of overseas visitors peaking during the finals in October. But there are signs of an improvement in local conditions as well.

We expect the largest positive contribution to come from finance, property and business services (a wide-ranging category that accounts for nearly 30% of GDP). Employment rose strongly in these areas, house and farm sales picked up after a subdued September quarter, and credit growth ticked higher. Note that this group will capture some quake-related work such as insurance assessments.

The RWC was clearly a boost for retailing and hospitality, with an estimated 2.3% gain on top of the 2.5% rise in the September quarter. That said, about half of the Q4 lift in retailing was in durable goods, which is more likely to reflect spending by New Zealanders than by visitors. The RWC may have also contributed to a lift in wholesale trade, although that follows an unexpected drop in Q3.

Figure 1: Production based GDP

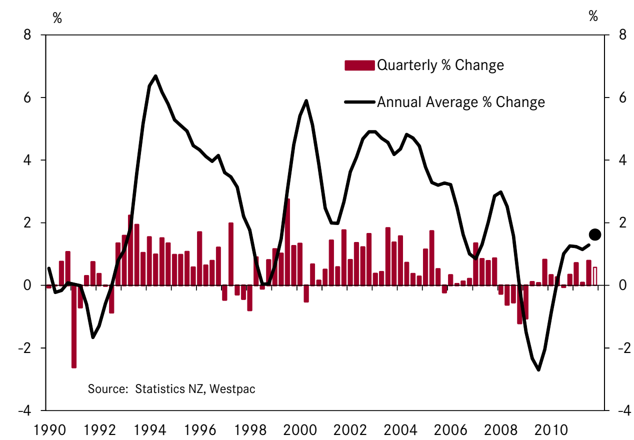
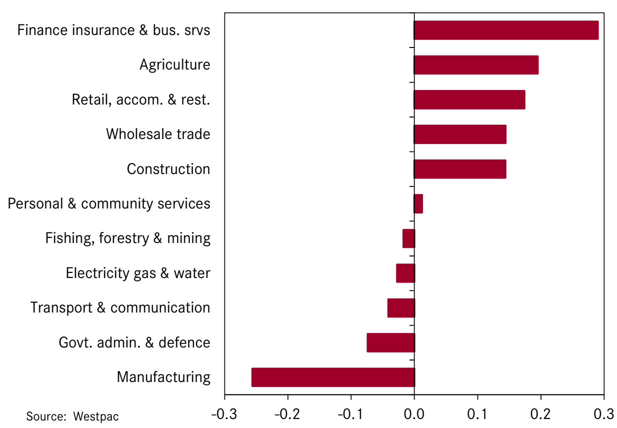


Figure 2: Percentage point contribution to Q4 GDP growth



Construction is set to make a positive contribution after a combined 10% drop in the previous three quarters. The Q4 building work survey showed a 2.9% increase, and although quake-related activity wasn't identified it was clear that the Canterbury region was a major contributor. Unlike this survey, the GDP measure includes unconsented work such as repairs, infrastructure and demolitions, which have made up a large part of the recovery activity to date and probably accelerated in the December quarter.

The agricultural sector continued to benefit from excellent growing conditions. Milk production rose an estimated 7% for the December quarter alone, and farmers are likely to have used the good grass growth as an opportunity to fatten animals up (although stock numbers remain down on last year).

On the negative side, we expect a sizeable drop in manufacturing output, and in particular a 4% drop in food and beverages. While sales were stronger for the quarter, a large part of this will have come from a rundown of stocks (especially dairy products) that built up in the previous quarter. Slaughter numbers suggest a sharp drop in meat production, as livestock were kept on the farm for longer. At the margin, a temporary disruption to gas supplies in the upper North Island in October could have had a meaningful impact on overall production levels for the quarter.

We expect a decline in government administration, with the initial focus on reprioritisation having given way to outright spending cuts. We also expect small drops in electricity generation and mining, and we've assumed another sizeable drop in communications although we still suspect that this sector is chronically under-recorded.

Market implications

Our 0.6% growth forecast is at the median of market forecasts, with a fairly typical range of 0.3% to 0.8%. The Reserve Bank also projected 0.6% growth in its latest Monetary Policy Statement.

In terms of the outlook for the economy in the next couple of years, there's a notable divergence at the moment between market sentiment (with a low growth, low inflation scenario priced into markets), private sector forecasts (higher growth and inflation), and the Reserve Bank (higher growth but low inflation). Next week's GDP data is unlikely to break this three-way deadlock; at its heart, the dispute is about the economic impact of the impending rebuild in Canterbury, which is more of a question for 2013 and beyond.

Nevertheless, this suggests that the risks around the GDP outturn are slightly lopsided. A downside surprise would see the market price in a lower interest rate path, and probably rightly so. However, an upside surprise might rattle markets, at least initially, but not so much the RBNZ, which has long anticipated stronger growth.

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