22 March 2012

Westpac Institutional Bank

# The measure of things

## Q4 GDP rose 0.3%, below expectations

- **GDP growth was slightly less perky than we anticipated in the December quarter of 2011, rising by 0.3%.**
- **Domestic demand appears to be lifting, reconstruction in Canterbury is in its early stages, and growing conditions remained positive for the agricultural sector. The Rugby World Cup also gave a modest lift to spending.**
- **Impending revisions to the measurement of GDP may help to resolve the widening gap between the production and expenditure measures of GDP.**

**Key results**

| | Actuals | | Q4 expectations | | |
|---|---|---|---|---|---|
| | **Q3** | **Q4** | **WBC** | **Mkt** | **RBNZ** |
| GDP q/q | 0.7 | 0.3 | 0.6 | 0.6 | 0.6 |
| GDP ann % chg | 1.8 | 1.8 | 2.2 | 2.2 | 2.2 |
| GDP ann avg % chg | 1.2 | 1.4 | 1.6 | 1.6 | 1.6 |

### Summary

The production measure of GDP grew by 0.3% in the December quarter, less than we or the market expected. However, the main contributions by sector were much as anticipated, and on the face of it offer no compelling reason to alter our forecasts for 2012.

It's clear that the New Zealand economy was growing only slowly in the second half of last year. However, we'd caution against putting too much emphasis on the latest quarterly outturn at this stage, for two reasons. The first is that the expenditure measure of GDP, while normally considered to be less reliable on a quarterly basis, was much closer to expectations with a 0.5% rise, and in our view tells a more coherent story of where the momentum in the economy lies.

The second is that these two measures have been diverging for several years now, telling two starkly different stories of the economy's progress since the recession. Next month Statistics NZ will republish the GDP figures based on newer international standards of measurement, which will hopefully close at least some of the gap – although we can only guess in which direction.

### Details

Production GDP grew by 0.3%, against our forecast of 0.6%. There were the expected positive contributions from finance, business services, agriculture and retailing, partly offset by sharp declines

**Figure 1: Production based GDP**

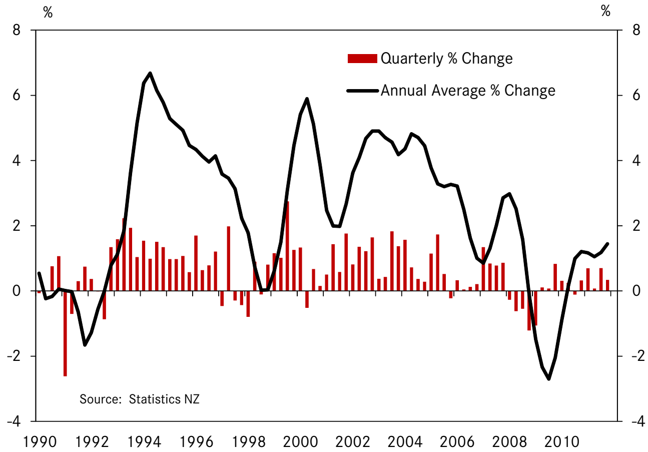



**Figure 2: GDP Production Components**

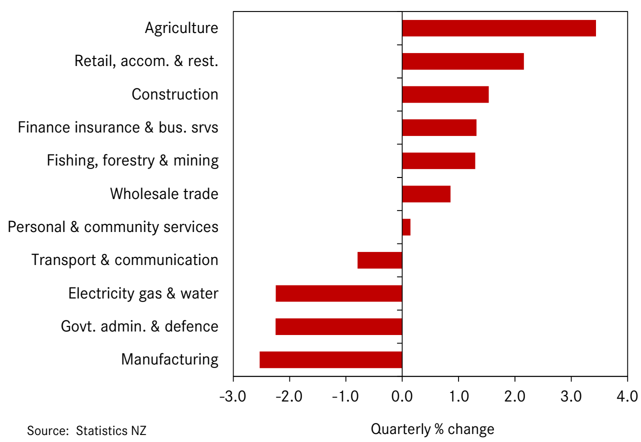
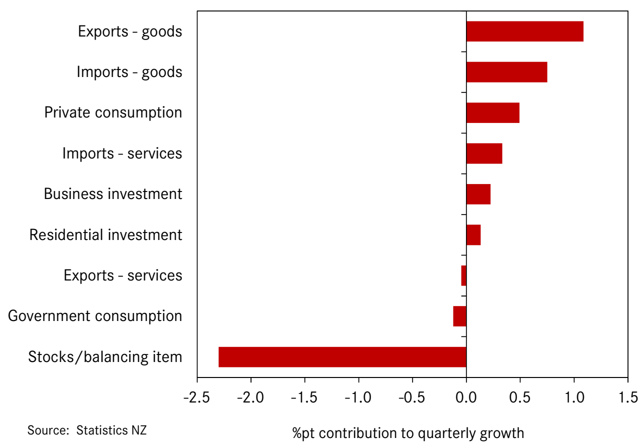



**Figure 3: GDP Expenditure Components**



in manufacturing, government and communications. Yet more revisions to the recent history of GDP knocked about 0.1% off the growth pace of the past two years.

The strongest growth was in agriculture (up 3.8%). Excellent grass growing conditions drove an estimated 7% increase in milk production, partly offset by a drop in recorded sheep and beef production, as livestock were held on farms for longer to fatten up. That aspect may be revised up once the stock are sent to slaughter and the actual rate of animal growth is revealed.

The lower number of animals sent for slaughter was a sizeable negative for the manufacturing sector, with overall food manufacturing was down 5.6% (albeit following a 6.4% rise in the September quarter). Other manufacturing fell by 0.8%, possibly affected by the temporary disruption to the Maui gas supply line in late October.

Retail and wholesale trade were boosted by a rise in turnover during the Rugby World Cup (RWC) finals in October. The 0.9% rise in wholesale trade was less than we expected, given a 2.5% rise in the Wholesale Trade Survey earlier this month. However, the GDP measure has tended to be revised over time to be more in line with the survey.

There was a strong contribution from real estate and business services (up 1.6%), a diverse group that is likely to have benefited from higher property sales and insurance assessments. There was also a surprisingly strong 1.9% rise in financial services, although this was largely offset by a drop in the 'unallocated' category, reflecting the fact that financial services are largely treated as a 'cost' to other sectors of the economy (one of the many ways that GDP measurement in New Zealand differs from other countries such as Australia).

Construction output rose 1.5%, the first increase in four quarters. At a first glance that would suggest a very weak pace of reconstruction activity in Canterbury; however, the expenditure measure of GDP provides more colour and suggests that activity in Canterbury is indeed getting under way (though we can't be precise about this, as there's no regional breakdown for GDP). Residential investment rose 4.2%, while non-residential building investment rose 7.6%, with surveys indicating that Canterbury was an outperformer in both series. These were offset by a 4.6% drop in 'other construction', which includes infrastructure and building site preparation. We'd assumed a Canterbury boost here as well; if there was one, it may have been swamped by softer activity in the rest of the country.

Government activity was a sizeable drag on GDP growth. Local government fell by 3.1%, unwinding a temporary boost from quake-related spending and the amalgamation of the Auckland city councils. The surprise for us was a larger than expected 1.9% drop for central government. Stats NZ suggested that the change in the timing of school holidays last year may have affected the seasonality of this series, so the quarterly drop may be overstated. But that shouldn't detract from the point that government's contribution to GDP is now in decline, as re-prioritisation gives way to outright belt-tightening.

The other surprise for us was a larger than expected 1.5% drop in communications. We've registered our concerns about mismeasurement many times now; we can only hope that this sector benefits from the impending shift to newer international standards for GDP measurement – a lot has changed in this industry since the previous standards were developed in 1993.

The expenditure measure of GDP highlighted how important domestic developments have been, and will continue to be, for the pace of growth. Firstly, while the RWC saw a 5.8% rise in spending by overseas visitors, a far greater share of the 0.8% rise in private consumption was driven by locals (particularly on durable goods). Secondly, post-quake reconstruction activity in the Canterbury region was clearly getting under way by the end of 2011, as shown by the strong gains in residential and non-residential building. Investment in transport equipment (up 46%) also appears to have been stronger than we expected, after allowing for the fact that another Boeing 777 was imported during the quarter. Finally, good growing conditions last year contributed to the 4.3% rise in goods exports, led by dairy products.

Inventories rose slightly in Q4 after a sharp run-up in Q3; that change in momentum translated to a sharp negative contribution to GDP growth. As usual, though, large swings in stocks tell us little about overall growth, as they tend to be offset elsewhere; in this case, through the export of dairy products that had built up in the previous quarter, and through less need to import consumption and intermediate goods.

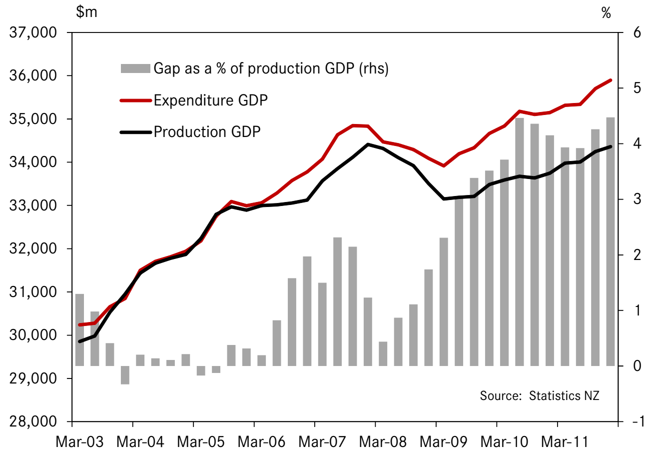
The overall message from expenditure GDP is that private demand is gathering momentum (although public demand is falling substantially), that post-quake reconstruction is in its early stages, and that our export performance depends on growing conditions as much as on global demand.

### Made to measure

Last quarter, we noted the substantial divergence between the expenditure and production measures of GDP in the last few years (something that has also attracted the RBNZ's attention recently). That gap widened further in the December quarter; the level of expenditure GDP is now a record 4.5% higher than production. These measures should roughly reconcile over time, so the fact that the gap is not only persistent but widening is cause for concern.

At least some of this may be due to the fact that Stats NZ is gradually phasing in newer international standards for the measurement of GDP (in contrast to the all-in approach that Australia took in 2009). Some aspects have been updated, while others haven't; the result is that things have been drifting in terms of consistency across the two measures.

**Figure 4: Two measures of GDP**




The first step towards correcting this could come as early as 27 April, when Stats will publish a revised history of GDP based on newer industry classifications. We have no way of knowing how far this might narrow the gap, or in which direction it may narrow. But it's worth waiting another month to see what happens before jumping to any conclusions about the state of the New Zealand economy.

**Michael Gordon**
Senior Economist

Westpac Economics Team Contact Details

| | | |
|---|---|---|
| **Dominick Stephens,** Chief Economist | Ph: (64-9) 336 5671 | dominick_stephens@westpac.co.nz |
| **Michael Gordon,** Senior Economist | Ph: (64-9) 336 5670 | michael_gordon@westpac.co.nz |
| **Felix Delbrück,** Senior Economist | Ph: (64-9) 336 5668 | felix_delbruck@westpac.co.nz |
| **Anne Boniface,** Senior Economist | Ph: (64-9) 336 5669 | anne_boniface@westpac.co.nz |