20 December 2012

Westpac Institutional Bank

Low note

Q3 GDP rose 0.2%

- **Production GDP grew by 0.2% in the September quarter, with a strong lift in construction the only real highlight.**
- **Annual average growth rose slightly to 2.5%, the highest since the year to March 2008.**
- **Improvements to the series have lifted the level of GDP by around 3%, though they also appear to have made it more variable.**
- **A range of indicators suggest that Q3 was the low point for growth this year. We expect growth to pick up into 2013, led again by construction activity.**

Key results

	Actuals		Q3 expectations		
	Q2	**Q3**	**WBC**	**Mkt**	**RBNZ**
GDP q/q	0.3	0.2	0.0	0.4	0.2
GDP ann % chg	2.5	2.0	2.1	2.5	2.3
GDP ann avg % chg	2.4	2.5	2.2	2.3	2.3

Summary

We've been bracing for a soft September quarter GDP outturn for some time, and it was finally confirmed today. In the event it wasn't quite as bad as we'd expected, although downward revisions to growth in the first half of the year took off any gloss that we might otherwise have placed on this result. More recent data gives us some comfort that the September quarter marked the low point for this year, but the prospects for growth in 2013 remain selective, as the Christchurch rebuild accounts for an increasing share of activity.

Details

Production GDP rose by 0.2% in the September quarter, splitting the difference between the median market forecast of 0.4% and our pick for a flat outturn. In addition, March quarter growth was revised down from 1.0% to 0.9%, and the June quarter from 0.6% to 0.3%, giving the release a weak flavour overall (more on the revisions later).

The mix of growth was a little more balanced than we expected, though still heavily weighted towards one area: construction. Residential (+7.4%) and non-residential (+12.4%) building work both rose sharply as expected, but were partly offset by a fall in infrastructure. Rebuilding and repairs in Canterbury were the major contributor to this, but there were also gains in many other parts of the country.

Electricity generation was another major positive (+4.4%), although that only partly reversed the downwardly-revised

Figure 1: Production based GDP

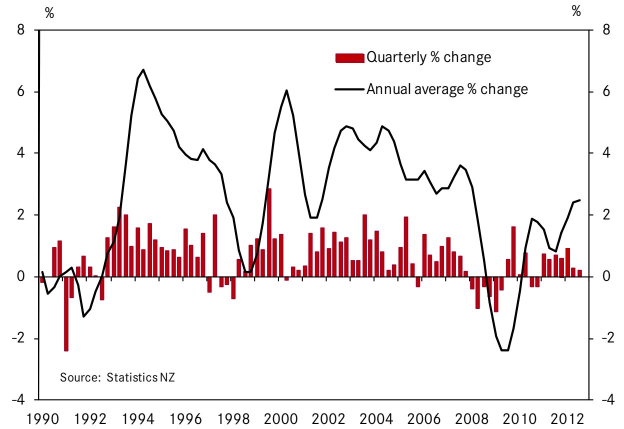
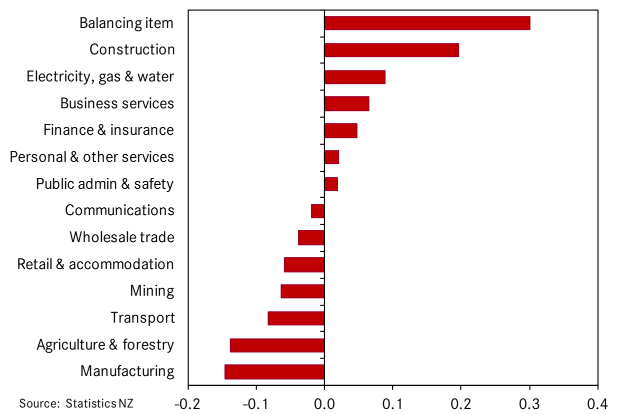


Figure 2: Percentage point contributions to Q3 GDP growth



5.8% drop in the previous quarter. Hydro generation –which is cheaper than non-renewable sources and therefore higher value-added – rebounded in the September quarter after dropping to abnormally low levels in the first half of the year.

The main positive surprise for us was that services held up better than expected, though they were still flat on the whole, after six straight quarters of solid growth. The labour market surveys for Q3 had suggested that there was a rather abrupt downturn in professional services; we're pleased to see that wasn't the case. Wholesale (-0.7%) and retail trade (-0.8%) contracted, as already flagged by their respective surveys, and transport fell 1.6%, unwinding an unusually large 1.9% rise in the June quarter.

The weak spots for the quarter were agriculture and manufacturing. In the case of agriculture, it was weak only in comparison to the stellar conditions in the first half of the year – output was still up 9% on the same time last year. The moderation in agricultural output also weighed on food manufacturing, down 2.0%. Other manufacturing was down 0.6%, highlighting that conditions remain tough for the industry, but are hardly at crisis levels.

The expenditure measure of GDP also rose by 0.2%. The mix of activity was largely as expected: household spending flat, construction expenditure up sharply, exports strong but drawing from a run-down of inventories to some degree. Investment in plant and equipment was very weak (-17.6%) even after allowing for payback from a strong June quarter, demonstrating perhaps better than anything the abruptness of the slowdown in Q3. Imports of capital equipment are tracking slightly higher again for Q4.

Statistics NZ has made some major revisions to the history of the GDP series, as a result of annual benchmarking, methodological improvements, and new indicators for some sectors. There's a lot to digest here in terms of the composition of the economy – more than we can handle this close to the Christmas break – but we can make two general observations. One is that the changes – which bring us somewhere closer to how Australia measures its GDP – have lifted the current level of production GDP by about 3%. It's far from closing the gap with Australia, but it does make the task a little less daunting.

The second is that GDP appears more volatile than before, with a more pronounced cycle in the rate of growth over recent years. The 2008 recession is now deeper, the rebound in 2009 stronger, and the economy now more clearly slipped into a technical recession (two quarters of negative growth) after the first Canterbury earthquake in September 2010. The pickup in 2011 is now stronger, and the mid-2012 slowdown is more pronounced. We actually take some comfort from this: if quarterly growth is more variable than we thought, and if +0.2% is the lowest it's going to get, then it bodes well for some strong reported growth in coming quarters as the Christchurch rebuild gathers pace.

Market implications

The below-consensus outturn dampened a little of the recent bullishness in financial markets, taking the NZ dollar down 30 points to 0.8340 and the two-year swap rate down 3 basis points to 2.71%. The result for the quarter was much in line with the RBNZ's forecast, although the historical revisions could make a modest difference to their understanding of the economy's potential output and how much non-inflationary slack remains. We still expect the first OCR increase in September 2013.

The monthly data suggest that July-August in particular was the low point for the economy, and that momentum has been building again over the last few months. We continue to expect 0.7% growth in the December quarter, picking up further through 2013. That said, the outlook is for a two-speed economy over the next year or so, with construction, and any other sectors positioned to benefit from the Christchurch rebuild, likely to dominate.

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