Westpac

Institutional Bank

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Squaring the circle

GDP rose 1% in Q3 but past growth revised lower

- September quarter GDP grew by more than expected, though for reasons that could prove temporary.
- The underlying message is one of continued steady rather than spectacular growth.
- This message was underscored by some sizeable downward revisions to the pace of growth in recent years.
- That helps to explain why inflation has been mysteriously low in recent years: the economy has not been approaching full capacity as quickly as previously thought.
- Today's release reinforces our view that further OCR hikes will be delayed until 2016.

Key results

	Actual		Q3 expectations	
	Q3	Q2	Westpac	Market
GDP q/q	1.0	0.7	0.8	0.7
GDP ann % chg	3.2	3.2	3.2	3.3
GDP ann avg % chg	2.9	2.8	3.1	-

The September quarter GDP report carried an important message, and not the one that the headline figure might suggest. While growth over the quarter was higher than we expected, all of the surprise came from the volatile primary sectors, which are more than likely to reverse next time. More importantly, the modest positives in the latest quarter were swamped by some major downward revisions to the pace of reported growth over the last few years, as new data and methodologies were incorporated.

The picture is now one of an economy that has been trotting rather than galloping along since it emerged from recession in 2009, and as a result is probably less capacity-constrained than the previous figures suggested. For some time now we, the Reserve Bank, and other forecasters have been puzzling over the New Zealand economy's ability to grow without inflation. By taking an axe to the first part of that story, the new GDP figures help to explain the second part: inflation is low because the economy has not been growing all that rapidly.

The implications of these new figures will take some time to digest, an exercise that we'll pick up again in the new year. But the obvious interpretation is that any further interest rate hikes can be held off for some time. We're quite comfortable with our view that the OCR won't be increased again before 2016.

Data details

Production GDP rose 1% in the September quarter, following a 0.7% increase in the June quarter. This was higher than all forecasts, ranging from the market median of 0.7%, our forecast of 0.8% and the Reserve Bank's forecast of 0.9%. The more volatile expenditure measure of GDP rose by 1.3%, though this followed a 0.2% increase last quarter.

The largest gains – and the main source of surprise versus our forecasts – came in the primary sectors, with agriculture up 4.7% as milk production rebounded from a dip last quarter, and an 8% jump in mining due to oil exploration. Both of these sectors can be quite variable on a quarterly basis – especially mining, as exploration tends to be intermittent, so there's a good chance that this bounce could be reversed next quarter.

There are also signs that milk production is slowing now, due to lower farmgate prices which discourage farmers from intensifying productions, and dry conditions in some parts of the country.

There were also strong contributions from manufacturing and retailing, as previously shown in their respective surveys. Manufacturing output rose by 2%, with food and beverages down slightly but strong gains in wood products, metals, minerals and machinery. Retail trade rose by 1.7% – driven all by New Zealanders, as spending by overseas visitors was reported to be down 2.6%.

The service industries as a whole saw modest growth of just 0.3%. However, that followed a 1.3% jump in June, the biggest quarterly increase since 2006; we suspected that there was some noise in that number and that there could be some payback this time. Professional services (down 2.0%) and transport (down 2.6%) were the main drags.

The new reality

The revisions to the history of GDP were the result of the shift to the new international standards for GDP reporting (known as SNA08), updated source data from annual surveys, and a host of methodology tweaks across several sectors. Statistics NZ had already indicated that the shift to SNA08 would lower the reported pace of growth over 2013 – though these figures were released in late November, too late to be factored into either the December Monetary Policy Statement or the Treasury's half-year fiscal update. The other changes have further reduced the pace of GDP growth over the last several years.

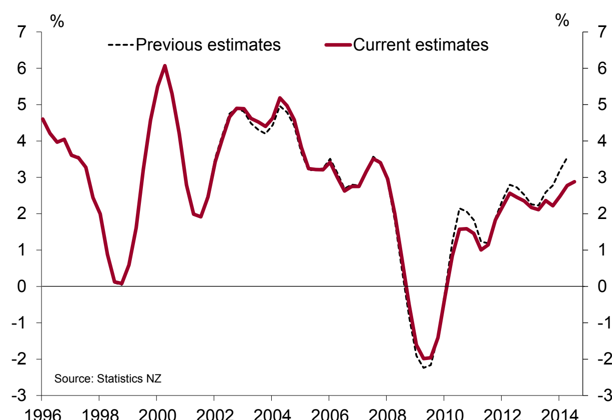
Consequently, the new figures tell a substantially different story about the pace of the economy's upturn. Previously, annual average GDP growth was reported to have reached 3.5% in June, the fastest since 2008. The new data shows annual average growth currently running at just 2.9%, and it hasn't been above 3% at any point since 2007. Over the four quarters of 2013 alone, growth was a whopping 1.2% lower than previously reported.

While news of slower growth is hardly welcome, it does go a long way towards explaining the mystery of why New Zealand has been experiencing such low inflation in recent years. It seems plausible to argue that population growth, capital deepening and efficiency gains have boosted the economy's potential growth rate in recent years. But the new GDP figures point to an additional, simpler explanation: the economy hasn't been moving towards full capacity was quickly as thought.

Lest we sound too down in the mouth about today's data, we'd point out that it still points to an economy that's in reasonable shape. After a few post-recession stumbles, GDP growth has consistently been at or above trend for the last five quarters.

Michael Gordon
Senior Economist

GDP growth, annual average



Percentage point contribution to Q3 GDP growth

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