Westpac

Institutional Bank

18 September 2014

Cruising speed

GDP rose 0.7% in Q2

- GDP grew by 0.7% in the June quarter, as we expected. This was a modest slowdown from the 1% or more gains over the previous three quarters.
- There was a clear split this quarter between weakness in the export-oriented sectors versus strong and increasingly broad-based growth in domestic activity.
- Our view remains that while the economy has passed its peak rate of growth on a quarterly basis, it will continue to run ahead of potential over the next year or so.

Key results

	Actual		Q2 expectations	
	Q1	**Q2**	**Westpac**	**Market**
GDP q/q	1.0	0.7	0.7	0.6
GDP ann % chg	3.8	3.9	3.9	3.8
GDP ann avg % chg	3.2	3.5	3.6	3.6

The latest GDP figures showed the New Zealand economy pulling back to a more sustainable growth pace over the June quarter, compared to the headlong rush seen in late 2013 and early 2014. The 0.7% increase in production GDP was right in line with our expectations, and brings the annual average growth rate up to 3.5%, the fastest since September 2007.

The result was above the median market forecast of 0.6% and below the Reserve Bank's forecast of 0.8% in its September Monetary Policy Statement, though not sufficiently far away to trouble either side. Consequently, there was no significant market reaction to the release, with the New Zealand dollar rising about a tenth of a cent.

While growth slowed in the June quarter, it was no lower than where we would peg the economy's non-inflationary potential growth rate right now. In contrast, the gains of 1% or more over the previous three quarters were unsustainably fast – continued growth at that pace would eventually pose a substantial inflation threat. Moreover, the June quarter figures gave a clear sense of how embedded the economic upturn has become. While the export-oriented sectors took a hit in the quarter, every other sector recorded a lift in activity.

The main points of weakness were in dairy production and forestry. Dairy production fell by 5% in seasonally adjusted terms, taking it back to more normal levels after very strong growing conditions earlier in the season. (There's some uncertainty around seasonally adjusting these figures in any case, given that actual milk production falls to minimal levels over the June quarter.) There was also a commensurate 1.1% fall in food and beverage manufacturing. Forestry production fell by 3.5% as lower log prices reduced the incentive to harvest today.

In contrast, the domestically-focused service industries that make up around 70% of GDP had a particularly strong run, growing by a combined 1.4% – the biggest quarterly increase since December 2006. Business services made the strongest contribution, but there were also sizeable gains in wholesaling, retail trade, transport and personal and social services.

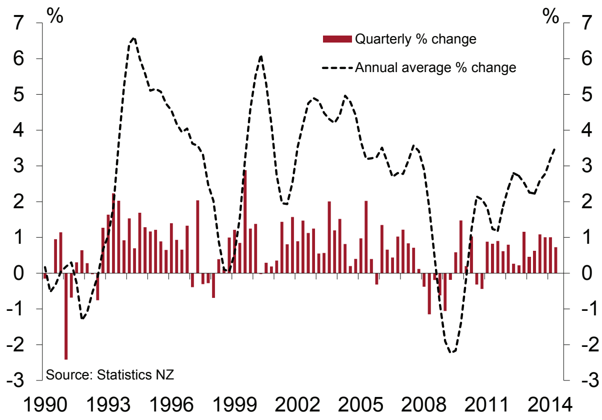
The construction sector grew by 2.2%, after 12.5% growth last quarter. This was even stronger than the 1% increase in the building work survey earlier this month. The difference appears to have been in infrastructure work, which is quite lumpy from quarter to quarter. Construction activity has now risen by 52% from its low point in the March 2011 quarter, just after the February 2011 Christchurch earthquake.

Perhaps a more telling measure of the economy's recent fortunes is gross national disposable income, a series that accounts for changes in the terms of trade. This fell by 0.5% in the June quarter. However, over the year to June, it's still up by 7.8%, the biggest annual increase since records began in 1987. The fall in export commodity prices this year has been severe – and is only just starting to show up in the national accounts – but even so, export incomes are coming off very high levels.

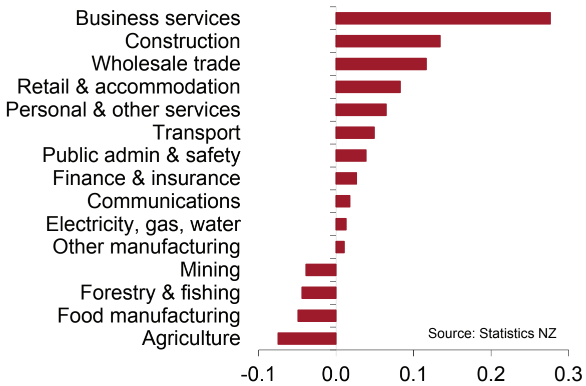
Overall, today's release backs our long-held view that the economy has probably already passed its peak rate of growth. However, we still expect relatively strong GDP growth over the year or so ahead, though the divergence that was apparent in today's data between the very strong domestic economy and the weaker export sector may continue or even intensify.

Michael Gordon
Senior Economist

Production-based GDP



Percentage point contribution to Q2 GDP growth



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