Westpac

Institutional Bank

10 September 2014

Foot off the accelerator

Preview of June 2014 quarter GDP (18 Sep, 10:45am) and current account (17 Sep, 10:45am)

- We estimate that GDP rose 0.7% in the June quarter, a moderate slowdown after three straight quarters of above-trend growth.
- Export-oriented sectors were weaker, but growth in the domestic economy remains robust.
- The current account deficit is expected to narrow slightly to 2.5% of GDP, with export conditions this year still more favourable than during last year's drought.

	Mar-14 actual	Jun 14 Westpac f/c
Balance of Payments (17 Sep)		
Current account balance $m	1,406	-1,000
Annual balance $m	-6,323	-5,750
Annual balance % of GDP	-2.8	-2.5
GDP (18 Sep)		
Quarterly % chg	1.0	0.7
Annual % chg	3.8	3.9
Annual average % chg	3.3	3.6

After a blazing start to the year, there's no question that the New Zealand economy has lost some of its momentum in recent months. However, we expect next Thursday's GDP figures for the June quarter to show that the change in fortunes hasn't been dramatic – more like a slowing from above-trend growth to something closer to trend.

The Reserve Bank is likely to have come to a similar conclusion in tomorrow's *Monetary Policy Statement,* which on its own would only warrant a marginal downgrade to the RBNZ's interest rate projections. Interest rates and the New Zealand dollar will no doubt react to the GDP release on the day, but the general election two days later is the bigger risk event for financial markets.

Meanwhile, the current account deficit for the year to June, published next Wednesday, is expected to show a further modest improvement. However, that largely reflects a 'soft' comparison with last year, when a short but severe drought hammered agricultural exports. Revisions to the last couple of years' data will also help to flatter the story a little. However, the deficit will widen from here as it captures the full impact of the plunge in dairy prices.

Q2 GDP, 18 September

We estimate that GDP growth slowed to 0.7% in the June quarter, after three straight quarters of growth of 1% or more. High-level indicators of economic activity, such as business confidence surveys, were still running hot in absolute terms over the quarter – it's just that in some cases they were coming off two-decade highs that were reached earlier in the year.

Our estimates of the breakdown of GDP growth show an unusually neat split between weakness in the trade-oriented sectors and strength in the domestically-focused ones. On the weak side, falling world prices for dairy products led to an estimated 5% drop in milk production in seasonally adjusted terms, weighing on the agriculture and food manufacturing sectors. Falling log prices also reduced output in the forestry sector (though we think the greater hit will come in the September quarter). The expected fall in mining output reflects the fact that the previous two quarters were temporarily boosted by exploration activity.

On the positive side, we expect to see solid growth in business services – a diverse group that accounts for about 20% of GDP. The Quarterly Employment Survey, an important indicator for both business and personal services, pointed to strong growth in employment and hours worked in these sectors.

The wholesale and retail trade surveys both showed a strong rebound from relatively subdued outturns in the March quarter. Manufacturing activity was down overall, but with non-food manufacturing managing some small gains. Construction has been one of the biggest contributors to GDP over the last few years as a whole, but the relationship has been tenuous on a quarterly basis – our estimate of a 0.5% rise in June follows a whopping 12.4% increase in March, and is in no way a reflection of how much the wider economy has slowed in that time.

Q2 current account, 17 September

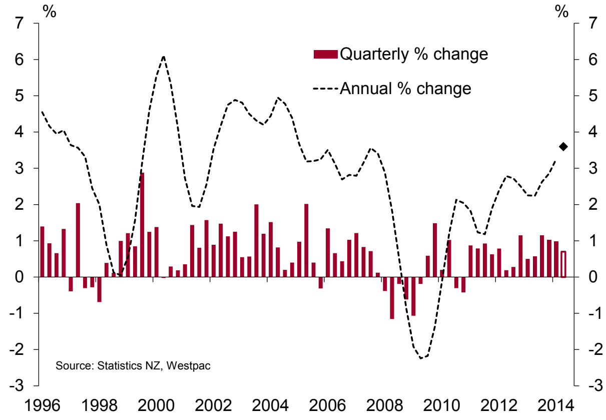
We expect the current account deficit to shrink further to 2.5% of GDP for the year to June, which would be the lowest since late 2010. The improvement in the annual balance reflects the fact that, while conditions were getting tough for exporters over the June quarter this year, they were still better than the same time last year – dairy export prices were high, but volumes were devastated by drought.

The improved trade balance for goods (and services to a lesser degree, as tourist spending has picked up this year) is likely to be partly offset by an increase in the investment income deficit. A consequence of the strengthening economy is that profits accruing to foreign owners of New Zealand-based firms are trending higher.

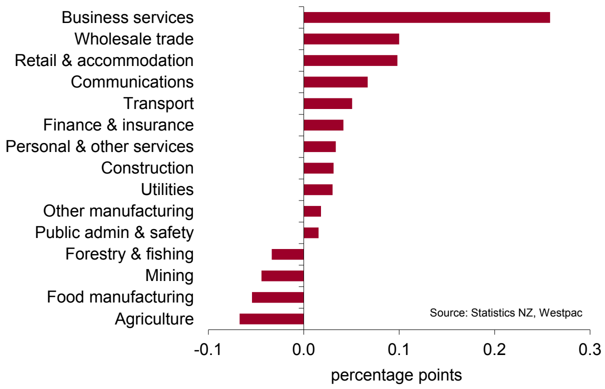
For the June quarter release, Statistics NZ will be shifting to the latest international standards for measuring the balance of payments (GDP will be making a similar move next quarter), along with a host of data improvements. The impact of the new standards doesn't appear to be economically significant: some items will be reclassified, but the current account balance won't be affected. However, the other changes will include the annual update of investment income earned overseas by New Zealanders, based on IRD data. Statistics NZ has indicated that this will have the effect of reducing the current account deficit a little over the past two years – for instance, we estimate that the previously published current account deficit will be revised from 2.8% to 2.6% of GDP. Our forecast of the June year balance (and the history shown in the chart to the right) incorporates these revisions.

Michael Gordon
Senior Economist

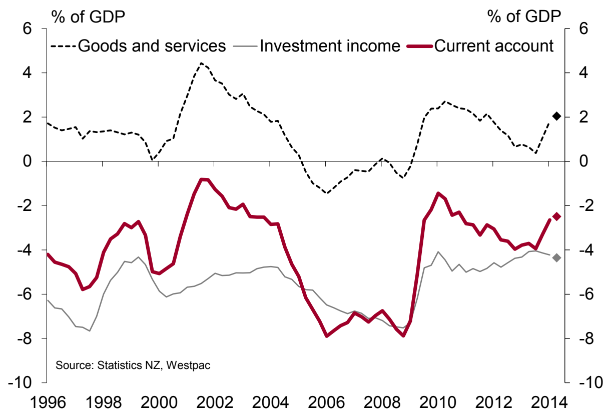
Production-based GDP



Contributions to Q2 GDP growth



Annual current account balance



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