Westpac

Institutional Bank

12 December 2014

A tale of two countries

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

- We estimate that GDP rose by 0.8% in the September quarter, with agriculture, manufacturing and construction making the strongest contributions.
- The current account deficit is expected to widen to 2.9% of GDP as the impact of lower dairy prices starts to flow through.

	Jun 14 actual	Sep 14 Westpac f/c
Balance of Payments (17 Dec)		
Current account balance $m, s.a.	-1,983	-3,270
Annual balance $m	-5,798	-6,635
Annual balance % of GDP	-2.5	-2.9
GDP (18 Dec)		
Quarterly % chg	0.5	0.8
Annual % chg	3.5	3.2
Annual average % chg	3.1	3.1

The September quarter national accounts, published next week, will illustrate the two contrasting stories of the New Zealand economy that are playing out at the moment. There's the 'real' story, where the level of activity is forging ahead at an above-trend pace. Then there's the 'nominal' story, where income growth in dollar terms is set to slow sharply as dairy export revenue plunges.

We estimate that GDP growth (Thursday) accelerated to 0.8% in the September quarter, largely due to stronger growth in milk production. We suspect that our forecast will be around the middle of the range of market forecasts; the Reserve Bank aimed slightly higher with a 0.9% forecast in yesterday's *Monetary Policy Statement.*

The current account deficit, on Wednesday, is likely to have widened for the first time in a year. Last year's record dairy exports have now given way to steeply lower world prices, and the impact on the overseas accounts will take several quarters to flow through. Rising imports of capital equipment and higher profits for overseas-owned firms will also have contributed to a wider deficit.

Q3 GDP, 18 December

We expect a 0.8% increase in GDP for the September quarter, an improvement from the 0.5% increase in June but not quite back at the 1% average pace seen in the previous three quarters. The main factor behind the acceleration in growth is a strong lift in agricultural output, which was one of the few weak spots in June quarter GDP. Milk production was up 10% in seasonally adjusted terms, more than reversing a previous 5% fall (though we suspect that much of this volatility comes from the difficulty of seasonally adjusting milk production, which falls to minimal levels in winter).

The industry surveys published in recent weeks have demonstrated strong growth in retail sales (up 1.5%), construction (also up 1.5%), and non-food manufacturing (sales up 0.9%, and a large inventory build-up suggests that production rose more than 2%). In contrast, wholesale trade was close to flat, and the labour market surveys indicated a downturn in business services. The latter fits with some of the anecdotes we heard about business decisions being held off until after the September election.

The forestry sector is likely to be the biggest underperformer by a wide margin, with production falling by about 4% for the second quarter in a row. Like with dairying, world prices for logs have fallen this year as Chinese demand has slowed. Unlike with dairying, supply has responded rapidly; harvesting is down and prices appear to have stabilised again.

We note that next week's GDP release will include revisions to history, as Statistics NZ incorporates new information from annual surveys. These revisions can make a meaningful difference to the reported pace of growth over the last few years in particular, though we can't really anticipate which direction the changes will go.

Q3 current account, 17 December

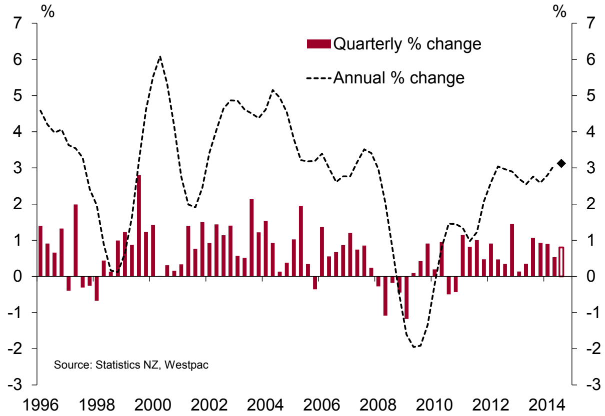
We expect the annual current account deficit to widen from 2.5% to 2.9% of GDP. While the quarterly balance had already started to deteriorate in the June quarter, the legacy of last year's high dairy prices meant that the annual balance had continued to improve up until June. That effect has now come to an end, and the annual deficit is set to widen substantially over the next few quarters.

In seasonally adjusted terms, the goods balance flipped from surplus to deficit in the September quarter. Export earnings fell, primarily due to lower dairy prices, although wood exports were also weaker. At the same time there was a strong lift in goods imports, although much of the increase reflects large aircraft imports as Air New Zealand upgrades its fleet.

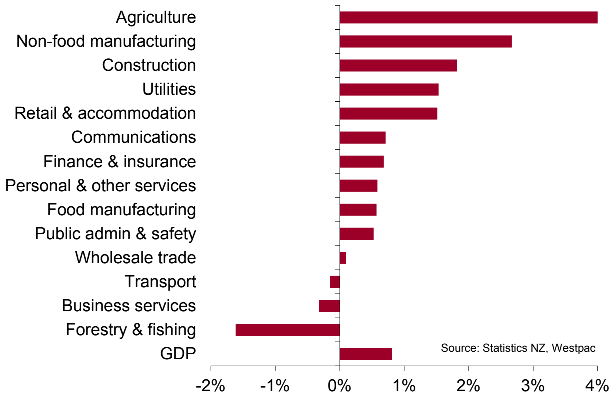
We also expect a narrower surplus for services trade, with flat exports (although tourist spending has been rising) and a rise in imports as New Zealanders spent more while overseas. The investment income deficit is likely to have widened further in the September quarter, with growing profits for overseas-owned firms in New Zealand as the domestic economy has strengthened.

Michael Gordon
Senior Economist

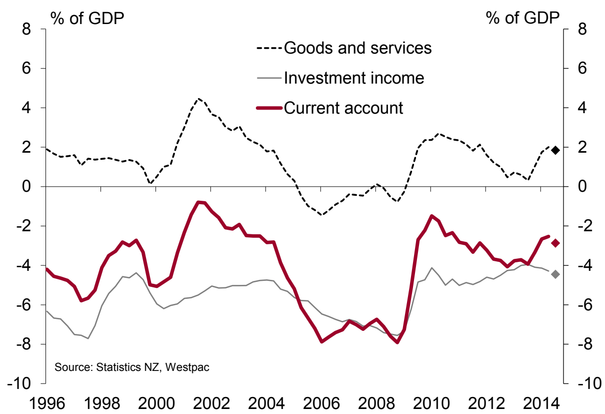
Production-based GDP



Q3 GDP growth by sector



Annual current account balance



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