Westpac

Institutional Bank

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Face value

GDP rose 0.8% in Q4

- GDP grew by 0.8% in the December 2014, in line with market expectations and slightly ahead of our forecast.
- The services sectors, particularly retail, were the main drivers of growth, while the primary sectors were unable to repeat their September quarter surge.
- With no unusual details for the quarter, we feel we can take today's result at face value: the economy has continued to outstrip its long-run potential growth pace.

Key results

	Actual		Q4 expectations	
	Q4	**Q3**	**Westpac**	**Market**
GDP q/q	0.8	0.9	0.7	0.8
GDP ann % chg	3.5	3.2	3.2	3.3
GDP ann avg % chg	3.3	2.9	3.2	-

As expected, the New Zealand economy ended 2014 on as strong a note as it began. GDP rose by 0.8% in the December quarter, which was a touch higher than our forecast, but was accompanied by a slight downward revision to the September quarter. The annual average growth rate topped the 3% mark for the first time since December 2007, just before the Global Financial Crisis reached full force.

We'd take today's figures as a fair representation of how the economy has been tracking: growth of 0.8% a quarter, or more than 3% annually, would be above anyone's estimate of the economy's long-run potential growth rate. A continuation of this pace of growth would eventually put a strain on the nation's resources and, one could reasonably expect, lead to higher wage and price inflation.

Of course the picture won't be quite so straightforward in the near term. The effects of dry weather will weigh on GDP growth over the first half of the year (though we've recently softened our estimate of the impact), while providing a boost to growth later in the year as farm output recovers. That dip in the pace of growth will probably have little bearing on the degree of inflation pressure in the economy. But a temporary run of soft data would encourage those in the market who are speculating on the Reserve Bank cutting the OCR.

Turning to the details, the production measure of GDP rose 0.8% for the December quarter, while the more volatile expenditure measure rose by 1.1%. As we expected, the surge in primary sector activity in the September quarter proved to be temporary, while the services sector took over again as the main engine of growth.

Agricultural production was about flat for the December quarter, after a downwardly revised 3.5% rise in the September quarter. Milk production was down about 2%, and is set for a much sharper fall over the first two quarters of this year due to the dry weather over much of the country. Meanwhile, mining output was down 1.5%, partly unwinding an exploration-led 5.9% jump in the September quarter (which was also revised down from 8% previously). Forestry saw a 4.2% rise, recovering some of the drop in harvesting earlier in the year when log prices fell sharply.

Manufacturing rose by 1.0%, following a 1.9% rise in the September quarter. This was stronger than we expected, although the surprise was due to a 5% jump in petroleum and chemical manufacturing (the one segment where we don't have a good indicator).

Retailing made one of the biggest contributions to growth, with a 2.3% rise for the quarter including a 3.4% rise in the hospitality sectors. That coincides with a reported 15% rise in overseas visitor spending in the quarter, which also showed up in yesterday's current account figures.

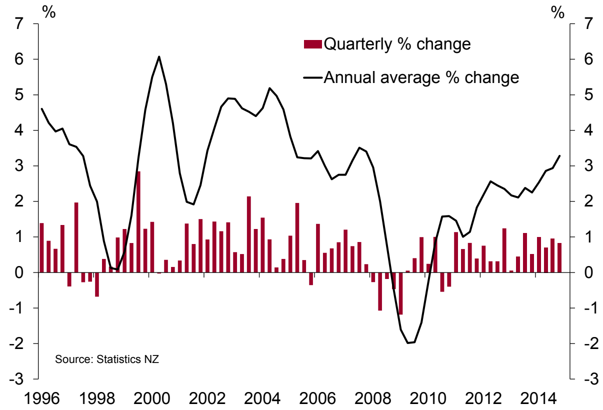
As anticipated, we saw strong gains in finance and real estate services, up more than 1% each as house sales rebounded after the September election; a strong lift in communications (probably due to improved broadband data offerings); and a rebound in professional services after an unexpected dip in the previous quarter.

One area that has continued to surprise us is the public sector, on both the production measure (up 1.5% for the quarter and 4.3% on a year ago) and on the final expenditure measure (0.6%qtr, 3.2%yr). We tend to defer to the Treasury's forecasts of how the fiscal accounts will translate through to the national accounts, but a persistent gap has opened up in recent times: the government's direct contribution to GDP growth has been much greater than the aura of 'austerity' and spending restraint would suggest.

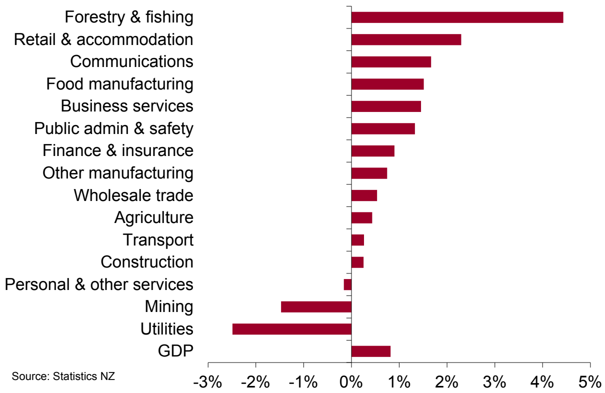
One important aspect of today's GDP report provides reason for caution: real gross national disposable income (RGNDI), a measure that takes account of changes in New Zealanders' purchasing power, fell by 0.5% in the December quarter, the first quarterly decline since June 2012. That's largely a by-product of the terms of trade, with export prices falling 1.7% over the quarter. This measure of economic performance was a standout over 2014, reaching a record high of 6.5% annual growth in June and still running at 5% annual growth by the end of the year. But the growth of this measure is set to slow significantly this year, which will have some knock-on effects for real economic activity.

Michael Gordon
Senior Economist

GDP growth, annual average



Percentage point contribution to Q4 GDP growth



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