Westpac

Institutional Bank

11 March 2015

Keeping pace

Preview of December 2014 quarter GDP (19 Mar, 10:45am) and current account (18 Mar, 10:45am)

- We estimate that GDP rose by 0.7% in the December quarter, led by continued strength in consumer spending.
- The current account deficit is expected to widen to 3.2% of GDP as the impact of last year's fall in dairy export prices flows through.
- A quarter of around-trend GDP growth, and a restatement of last year's dairy price decline, would not change the RBNZ's assessment of inflation pressures.

	Sep 14 actual	Dec 14 Westpac f/c
Balance of Payments (18 Mar)		
Current account balance $m, s.a.	-2,532	-2,400
Annual balance $m	-6,090	-7,680
Annual balance % of GDP	-2.6	-3.2
GDP (19 Mar)		
Quarterly % chg	1.0	0.7
Annual % chg	3.2	3.2
Annual average % chg	2.9	3.2

The December quarter national accounts, published next week, are likely to show some deterioration compared to the surprisingly strong reports for the September quarter. That said, our GDP forecast implies that the economy was still growing at around trend over the quarter – and above-trend for 2014 as a whole. Barring a massive undershoot of our December quarter forecast, full-year GDP growth will exceed 3% for the first time since the financial crisis. (It was previously reported as being above this mark, but historical revisions in the September quarter release took a significant chunk out of growth for the last year or so.)

Meanwhile, the widening of the current account deficit largely reflects the lagged impact of the fall in dairy export prices last year. Indeed, with dairy prices now rising again, and imported oil becoming significantly cheaper, it's likely that New Zealand's trade position is close to bottoming out if it hasn't already. The current account is commonly reported as an annual balance, and there's no question that this will widen further, reaching about 5% of GDP by the end of this year. However, we expect it to narrow again over 2016.

Q4 GDP, 19 March

We forecast a 0.7% increase in GDP for the December quarter, with the risks more to the downside. High-level indicators such as business confidence and the flow of monthly data had pointed to another very robust quarter, suggesting something similar to the 1% growth pace recorded in the September quarter. However, the sectoral surveys published in the last week, which feed directly into GDP, all failed to fire.

The expected slowdown in the pace of growth compared to September is not as substantial as it might seem, as there were some elements of the previous quarter that looked overdone or were unlikely to be repeated. In particular, the reported 9.5% surge in dairy production probably had more to do with the difficulty of seasonally adjusting this series around the winter shutdown. Another example is the 8% jump in mining sector output, which was attributed to a burst of exploration activity. This is lumpy by nature, and we've assumed that it came to an end by the December quarter.

The retail sector reported the strongest growth over the December quarter. As reported last month, total retail spending rose by 1.7%, with especially strong growth in the hospitality sub-sector which gets upweighted for GDP purposes. We also expect a strong pickup in the forestry sector, recovering about half of the 8% decline seen over the previous year. Weaker demand from China saw log prices fall sharply in early 2014, which discouraged harvesting. Since then, a weaker NZ dollar and falling transport costs have seen prices improve in domestic terms.

Other notable positives for the quarter include a strong rebound in house sales, which will have boosted financial and real estate services; a rise in road and air transport; and a partial rebound in professional and administrative services after a weak September quarter.

Consented building activity rose by just 0.3%, still struggling to expand further after a 14% surge in the March quarter last year. Wholesale sales also rose by 0.3%, but were flat after accounting for price increases. And while non-food manufacturing sales rose a healthy 0.9%, a rundown of inventories suggests that production was down slightly. However, that follows a 3.3% rise in the September quarter, which was the biggest quarterly increase in five years.

Q4 current account, 18 March

We expect the annual current account deficit to widen from 2.6% to 3.2% of GDP, driven entirely by a deterioration in the goods trade balance. That widening has as much to do with what's dropping out of the annual balance as with what's going in: in the December 2013 quarter, a steep rise in dairy export prices led to a record trade surplus. That quarter now drops out of the calculation, with the December 2014 quarter recording a sharp fall in dairy prices instead.

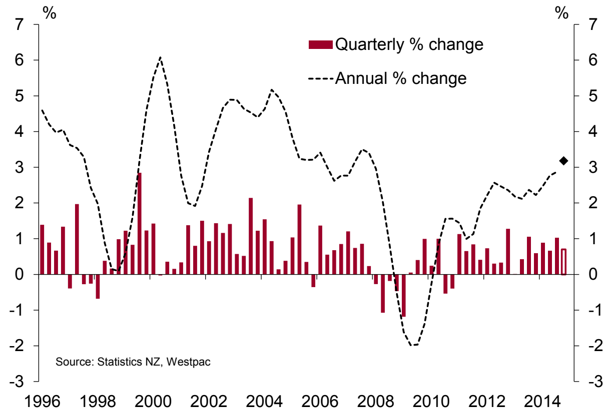
Dairy prices tend to be set around three months in advance of shipment, so we can reasonably expect last year's fall in prices to carry through into the March quarter trade figures as well. However, that will be substantially offset by the steep drop in the price of oil imports in recent months.

Elsewhere, we expect a modest improvement in the services balance, with continued strong growth in tourist spending. We also expect a small narrowing in the investment income deficit, with overseas-owned banks reporting lower profits compared to the September quarter.

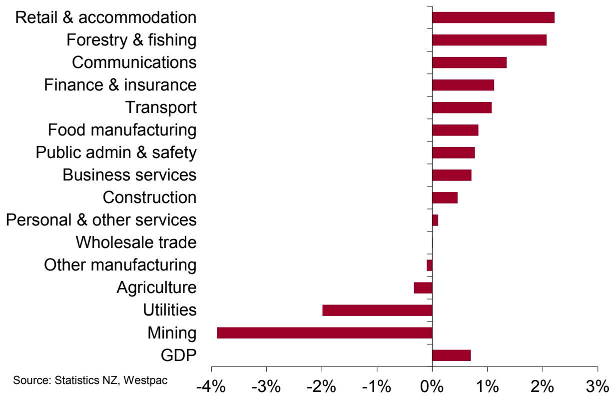
One detail from the release that's worth watching – though we don't attempt to forecast it – is New Zealand's overseas liabilities position. While still large by the standards of developed economies, it has been improving consistently over the last several years. Even after adjusting for the offshore 'asset' of earthquake reinsurance claims yet to be settled, net liabilities had narrowed to around 66% of GDP by the September quarter, the lowest ratio since 2003.

Michael Gordon
Senior Economist

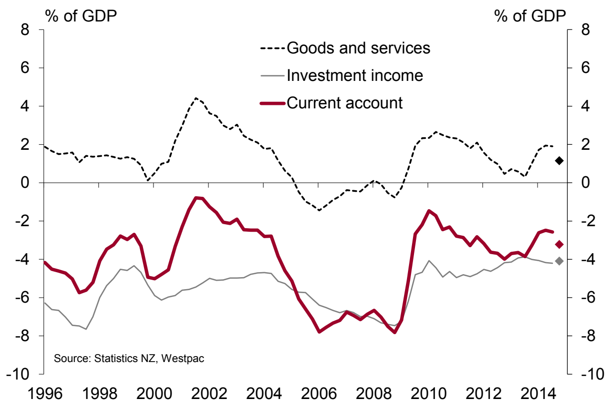
Production-based GDP



Q3 GDP growth by sector



Annual current account balance



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