Economic Review

New Zealand

26 June 2009

Gross Domestic Product – March 2009 quarter

Key points

> **The economy contracted for the fifth consecutive quarter – the longest recession since the mid-1970s – and we expect further contractions to come.**
>
> **Manufacturing was particularly weak as the impact of the global recession bites.**
>
> **Today's data paints a picture of an economy in a deeper trough than initially thought, and recent signs of stabilisation should be viewed in this light.**
>
> **The pace of contraction likely slowed in Q2, but any recovery is going to be slow and drawn out.**
>
> **We do not expect the GDP data to bring the RBNZ back into play. The hurdle to further cuts is high. But it does reinforce the low for longer message for interest rates.**

Assessment

The economy contracted by 1.0 percent in the March quarter. This was in-line with our expectations, though was worse than market expectations of a 0.7 percent decline. It is the fifth consecutive fall in GDP and follows a downwardly revised 1.0 percent fall in the December quarter. Compared to the March quarter last year, the level of GDP is down 2.7 percent. On an annual basis, the contraction was the largest since the June 1992 quarter.

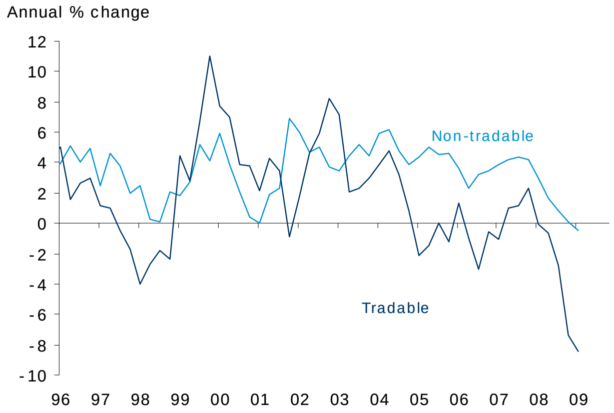
Goods producing industries drove much of the weakness. In fact, the contraction in goods producing industries (at -4.9 percent) was the largest quarterly decline since this data began in 1987. Activity within the manufacturing sector was particularly weak, contracting 7.2 percent in the quarter – again the largest quarterly fall on record and knocked 0.9 percentage points off growth. Statistics NZ report that with the exception of non-metallic mineral manufacturing, which remained flat, all manufacturing industries decreased in the March quarter. Activity from primary industries was flat in the quarter, with increased mining activity (up 2.3 percent courtesy of the new Maari oil field coming on line) offsetting weakness from forestry and fishing. Services industries were also largely flat in the quarter, with a large fall in transport and communication (down 4.5 percent) being offset by a 2.3 percent increase in activity from the finance and business service sector (the latter is again somewhat of a surprise to us).

On an expenditure basis, activity contracted by 0.7 percent. Domestic demand fell sharply in the quarter (down 3.2 percent), with private consumption (-1.3 percent), a considerable inventory adjustment (-1.3 percentage points) and other investment (down 7.3 percent) the big contributors. This was partly offset by a large positive net export contribution, driven by a 8.6 percent fall in imports. While the expenditure measure of GDP was slightly stronger than its production counterpart in the quarter, it has in fact been the reverse for much of this recession. We view the discrepancy in the March quarter as the production measure "catching up". The cumulative loss in GDP shown by both measures has now come in line.

	GDP (qtr % chg)	GDP (ann % chg)	GDP (ann ave % chg)
Mar-07	1.2	2.4	1.8
Jun-07	0.9	3.3	2.3
Sep-07	0.6	3.4	2.8
Dec-07	0.9	3.7	3.2
Mar-08	-0.3	2.1	3.1
Jun-08	-0.2	1.0	2.5
Sep-08	-0.5	-0.2	1.6
Dec-08	-1.0	-2.0	0.2
Mar-09	**-1.0**	**-2.7**	**-1.0**
ANZ	***-1.0***	***-2.6***	***-0.9***
RBNZ	*-1.0*	*-2.6*	*-0.9*
Market	*-0.7*	*-2.3*	*-0.8*

Today's data clearly shows this is no longer a domestic driven recession. Last year's recession was mainly due to domestic factors, caused by drought conditions, a housing market starting to correct, and high petrol and food prices eroding disposable incomes. The full brunt of the global recession has now been felt, with the manufacturing and the rest of the tradable sector being hit hard. Given that the NZ economy still has considerable external imbalances, ongoing de-leveraging and a current account adjustment process will continue to weigh on domestic demand. And a weak global backdrop alongside a currency that is doing the export sector no favours mean any sustained recovery still looks to be some way off.

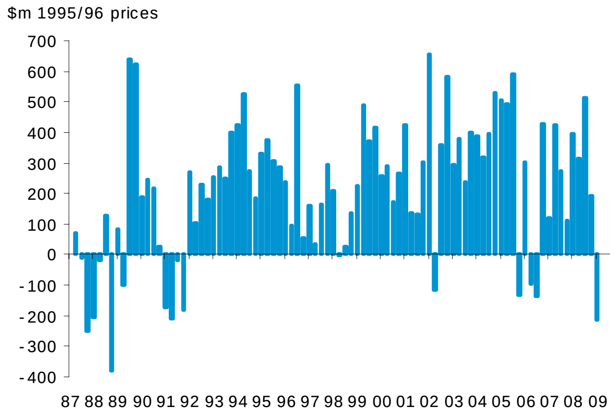
Tradable vs non-tradable growth



Sources: ANZ National, Statistics NZ

Recent signs of stabilisation should be view in accordance with the economy being in a deeper trough in the first place. The improvement in some recent leading gauges such as business and consumer confidence, and tentative evidence that consumer spending is finding a base, are encouraging. However, part of the reason for the improvement is just a natural bounce from the economy being in a deeper hole. While the rate of change might look to be improving (or contracting by a smaller amount), this is generally because it is starting from a much lower level.

Change in inventories



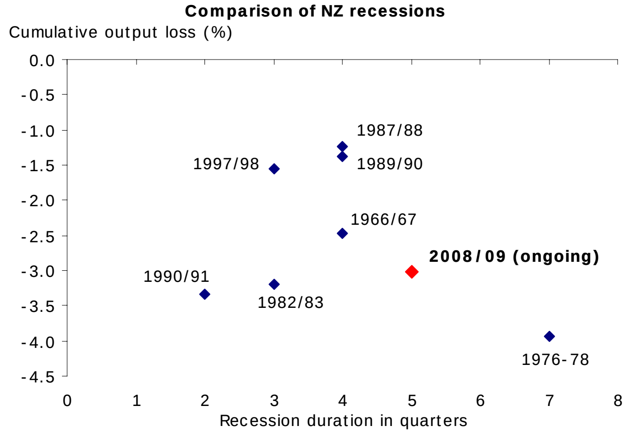
Sources: ANZ National, Statistics NZ

We expect the pace of contraction to slow. The June quarter likely contracted at a slower rate, and we expect the economy to come out of recession later this year. However, there will be timing issues that will complicate the picture, particularly with volatility associated with the inventory adjustment cycle. There has been a build-up in inventories and the March quarter was the first time that we have seen a substantial rundown. Despite this, the level of inventories is likely still too high given the weak demand environment, and further rundowns can be expected as companies continue to manage their stock levels.

But we continue to expect a relatively drawn out recovery process. The economic outlook continues to be driven by the need for the economy to de-leverage and reduce its large external imbalances. This is something that will take some time, particularly with the weak global backdrop hampering the ability of the growth baton to be passed to the export sector. Effectively, we see the economy moving across the bottom of the bath tub and a strong and sustained recovery looks some way away yet.

The recession to date is the longest since the 1970s, and the cumulative output loss to date is 3 percent. However, compared to our major trading partners, NZ has fared somewhat better.

Comparison of NZ recessions



Sources: ANZ National, Statistics NZ, RBNZ

Q1 GDP	QoQ	YoY
Malaysia	-4.3	-6.1
Hong Kong	-4.3	-7.8
Singapore	-3.9	-10.4
Japan	-3.8	-8.4
Euro	-2.5	-4.8
UK	-1.9	-4.2
US	-1.4	-2.5
Canada	-1.4	-2.1
Taiwan	-1.1	-10.2
NZ	**-1.0**	**-2.7**
South Korea	0.1	-4.3
Australia	0.4	0.4
China	..	6.1

Implications

We do not expect today's GDP data to bring the RBNZ back into play. The outturn was in line with their June *MPS* forecast, and the RBNZ has already aggressively front-loaded policy partly in anticipation of negative news such as today's. There are also encouraging signs of stabilisation overseas, and migration inflows are accelerating, providing some support to the housing market and consumption. But the NZ economy still faces headwinds with lower rural incomes and a weak global backdrop hampering the tradable sector. The currency is providing absolutely no favours to the latter.

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