

NEW ZEALAND ECONOMICS DATA REVIEW

Gross Domestic Product – September 2011 quarter

22 December 2011

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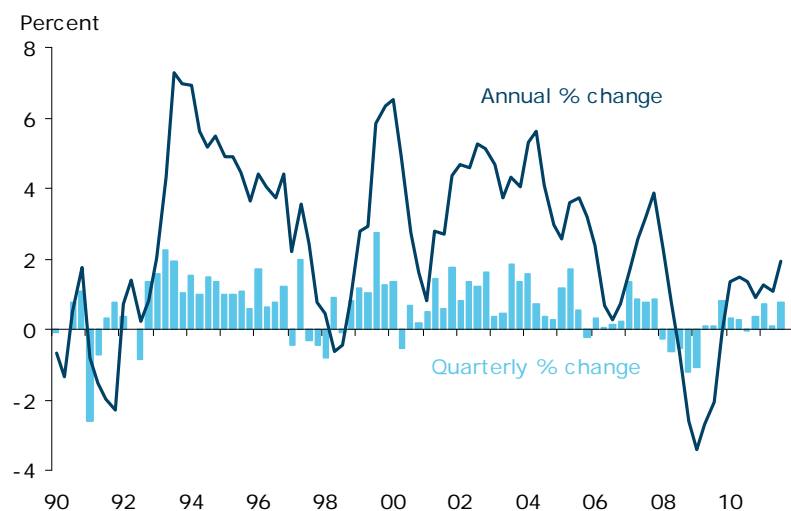
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PARTY IN Q3 BUT HANGOVER LOOMING

KEY POINTS

- Q3 GDP growth beat market expectations and the RBNZ pick, coming in at 0.8 percent. There were significant downward revisions to historical GDP data, with the level of activity in Q2 2011 revised down by 0.8 percent.
- Appropriately, given the mixed messages, plus the fact that the quarter was so heavily influenced by a one-off event, market reaction was muted.
- The production-based GDP measure showed wide sector divergences. Strength was (unsurprisingly) evident in retail, while in the goods sector higher manufacturing (+2.3 percent) was offset by weaker construction sector output (down 2.2 percent). Activity in the primary sector was flat, with higher mining activity offsetting falls in agriculture production.
- The expenditure measure of GDP increased 1.0 percent, underpinned by a build-up in inventories, which does not bode well for growth in subsequent quarters. The big retail spend-up was evident in consumption (+1.5 percent), whereas business investment fell. Net exports made another large negative contribution.
- Our take is that the underlying momentum in the economy is running around 2 percent per annum, our new sustainable normal in a deleveraging environment.
- We expect a post Rugby World Cup lull early next year. Given that, plus the global situation, the RBNZ will be in no hurry to lift the OCR. We look for a December 2012 start to the tightening cycle, but this is crucially dependent on the global economy holding together.

New Zealand economic growth



Sources: ANZ, National Bank, Statistics NZ

DATA REVIEW

DATA WRAP

Today's GDP data for Q3 was stronger than both market expectations and the RBNZ's pick, coming in at +0.8 percent. There were some downward revisions to the historical levels of GDP, with the level of activity still below its December 2007 peak. Looking through the volatility, GDP is growing around 2 percent a year, which is about the best that can be expected in a deleveraging world.

GDP	QoQ	YoY	Ann Ave %
Mar-10	0.3	1.3	-0.9
Jun-10	0.3	1.5	0.2
Sep-10	-0.1	1.4	1.0
Dec-10	0.3	0.9	1.3
Mar-11	0.7	1.3	1.2
Jun-11	0.1	1.1	1.1
Sep-11	0.8	1.9	1.3
ANZ	0.9	2.5	1.7
RBNZ	0.6	2.2	1.7
Market	0.6	2.2	1.7

The result feels historical, given that it was heavily influenced by a one-off event, namely the Rugby World Cup. It gave mixed messages, with quarterly growth beating expectations but downward revisions to history lowering the level of GDP, which goes straight into the RBNZ's estimate of momentum and spare capacity in the economy. In sum, today's data is no threat to the Reserve Bank's plan to keep the OCR on hold for the foreseeable future.

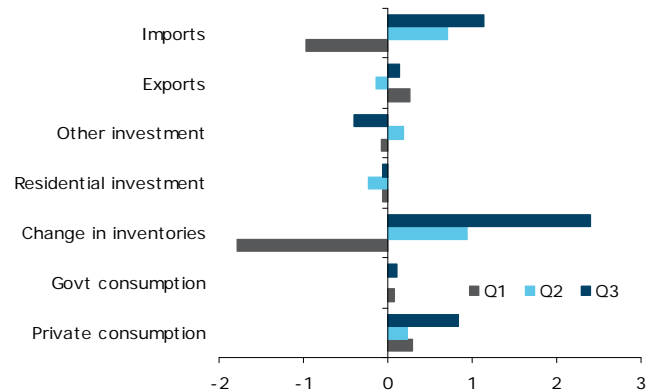
As has been typical in recent times, the production-based measure of GDP showed wide sector divergences. Activity in the goods sector (+1.0 percent q/q) showed offsetting movements, with higher manufacturing (+2.3 percent) activity offset by weaker construction sector output (down 2.2 percent q/q), but the latter will be a key contributor to growth in 2012.

Activity in the primary sector lifted 0.5 percent, with higher fishing/forestry/mining activity (+3.7 percent) offsetting a fall in agriculture production (-1.1 percent).

Activity in the services sector posted a respectable 0.5 percent quarterly increase, with offsetting movements amongst the components. Strength was evident in retail, accommodation and restaurant activity (up 2.5 percent), which was the largest quarterly increase since 2007Q1. Activity in finance, insurance and business services rose 0.6 percent, with little evidence of a displacement impact

taking place, although this would have been difficult to capture in the published statistics. Wholesale trade activity fell 0.7 percent, whereas personal and community services were fairly flat.

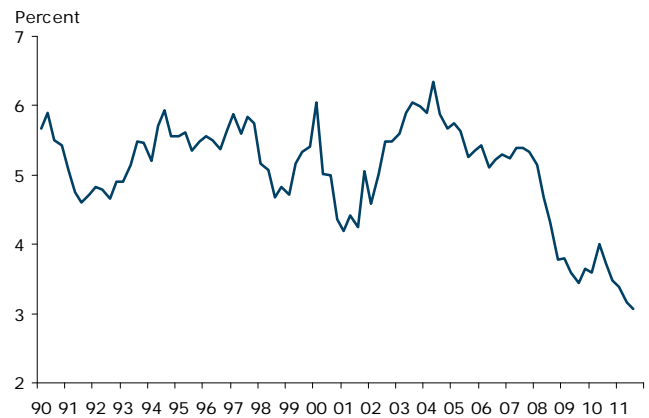
Percentage point contributions to quarterly growth



Sources: ANZ, National Bank, Statistics NZ

Expenditure GDP rose 1.0 percent, with the components again a mixed bag. Growth was underpinned by a build-up in inventories, with the 2.4 percentage point contribution from inventory rebuilding, the largest since 1987. There was also a sizeable increase in private consumption (up 1.5 percent q/q), driven by non-durable activity (+3.3 percent). Services and durable activity both displayed solid increases. Residential investment activity fell 1.8 percent in Q3 but appears to be at its trough and looks set to make a strong positive contribution to growth over 2012. The pick-up in construction will not just be an earthquake rebuilding story, but will be heavily dependent on construction sector capacity being available.

Residential investment, as a percent of GDP



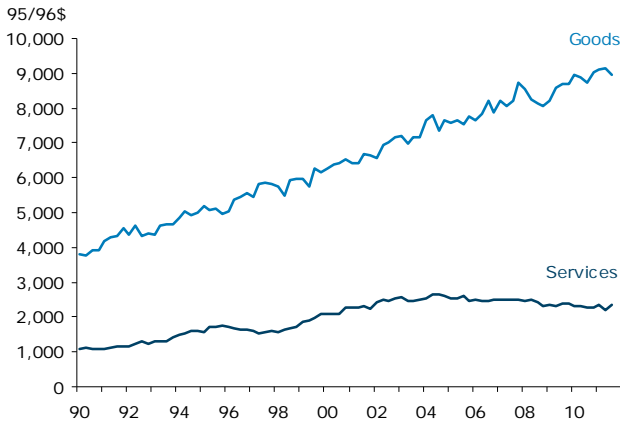
Sources: ANZ, National Bank, Statistics NZ

Business investment fell, with a lift in plant and machinery equipment (+6.0 percent) more than offset by a fall in non-residential building (-7.1 percent) and transport equipment (-9.8 percent).

DATA REVIEW

Other construction also fell (-6.5 percent). Despite the Rugby World Cup boosting exports of services, a 3.1 percent increase in import volumes contributed to **another large negative net export contribution.**

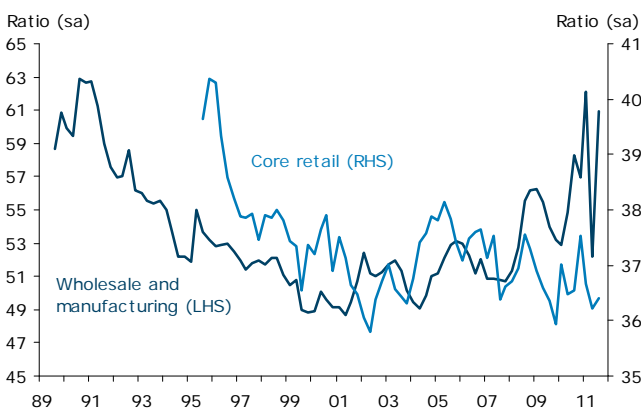
Export volumes



Sources: ANZ, National Bank, Statistics NZ

Export volumes rose 0.4 percent in the September quarter. Goods export volumes fell 1.8 percent, with forestry, meat, dairy, other food and beverages, textiles and metals and other non-metallic products all down. The only goods sector to show a decent lift was coal and crude, up 2.2 percent. **Exports of services rose strongly (+7.2 percent), courtesy of a rush of visitors for the Rugby World Cup.** Beyond the Rugby World Cup, the still-high NZD and weak global outlook suggests a difficult period ahead for the export sector.

Stock to sales ratio

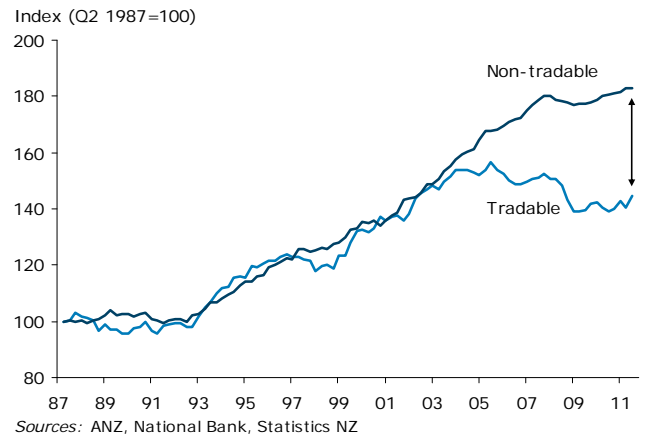


Sources: ANZ, National Bank, Statistics NZ

The build-up in inventories was primarily in manufacturing and distribution inventories as retailers and wholesalers built up stocks in anticipation of strengthening demand. A key question is whether some of the Q2 and Q3 build-up in inventories was unintentional, which would suggest unexpected weakness in demand and a drop in output to come. Given the anecdotes about a

“disappointing” Rugby World Cup, we suspect there may be an element of this. Time will tell, but the unwinding of the build-up in inventories and the Rugby World Cup boost are likely to weigh on activity over the next few quarters.

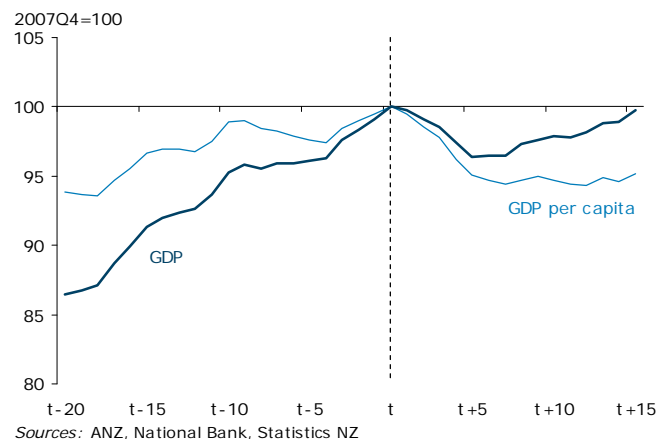
NZ tradable vs non-tradable sector output



Sources: ANZ, National Bank, Statistics NZ

In production terms, despite more than 95 percent of the quarterly growth in Q3 GDP being generated from the income generating part of the economy, activity in the tradable sector continues to lag the non-tradable sector. **Without another Rugby World Cup boost on the horizon, and with manufacturing stocks already high, this welcome turnaround seems unlikely to persist.** The still high NZD and weaker global outlook continue to make life difficult for much of the export sector. This is not to say that the “average” exporter has not done well, courtesy of high commodity prices. But agricultural output is slow to respond to price signals, and those exporters selling to US and European markets are struggling with the high NZD. Given the resource implications of Canterbury rebuild and the mix of monetary conditions, we expect this divergence to widen over 2012.

GDP levels



Sources: ANZ, National Bank, Statistics NZ

DATA REVIEW

Revisions to historical data were noticeable, with the level of GDP revised down 0.8 percent by 2011Q2. Revisions were concentrated in 2010 and 2011Q1. This matters, as the level of GDP is what goes into the Reserve Bank's assessment of the output gap, or the level of spare capacity in the economy that provides the "demand-pull" element of inflation (as opposed to cost-push, from oil prices, for example). The upshot of this is that there is no threat to the Reserve Bank's plan to leave the OCR on hold for the foreseeable future. On a per-capita basis the economy has failed to make up any of the output lost in the last recession, with per-capita activity still 4.8 percent below its 2007 peak.

ASSESSMENT

Looking through the quarterly volatility, the economy is growing at about 2 percent per year, which is about the best that can be expected in a world of debt payback. Tellingly, the level of output is still marginally below its late 2007 peak, and well below on a per-capita basis. We've seen a pretty modest bounce-back from this recession compared to history. But this is not just a New Zealand story – developed nations around the world have found the same thing in recent years, as they struggle under high levels of debt. Loose monetary policy and still-high commodity prices are much-needed tailwinds, but there are plenty of forces in the opposite direction: ongoing debt reduction, the still-high NZD and now sharply slowing global growth spring to mind. The latter is the major risk for growth in 2012.

We see a strong risk of a soft patch in the first half of next year before the Christchurch rebuild starts to kick in. A strong unwinding in inventories could see this weakness brought forward to 2011Q4. The New Zealand economy continues to "muddle along". In the glass half full version, relatively sound fundamentals look set to see New Zealand outperform many of its global peers.

The feel-good sector of consumption is set to continue to do it fairly tough, but **pockets of the economy are doing quite well.** Dairy prices are hanging in remarkably well in the face of global turmoil and high supply from competitors. Interest rates are extremely low, and parts of the housing market are starting to respond.

We have pencilled in the first Reserve Bank rate hike for December 2012, but the timing is dependent on how the current global turmoil feeds into commodity prices and bank funding costs. The process of policy normalisation will be stop-start, reflecting our view

that the global situation will not be resolved quickly, and that inflation looks to be in retreat for now.

IMMEDIATE MARKET REACTION

The NZD ignored the data, as it is well understood that Q3 was always going to be heavily influenced by a one-off event. Swap rates rose 2-3bp. A muted reaction was appropriate. The Reserve Bank made it clear in their recent *Monetary Policy Statement* that the hurdle for either a rate cut, or a rate hike, is very high.

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