

Gross Domestic Product – September 2008 quarter

Key points

- > **Economic activity contracted for the third consecutive quarter.**
- > **Weak demand has led to involuntary inventory accumulation, which needs to unwind over coming quarters. This will act as a drag on future GDP outturns.**
- > **The economy heads into the global downturn with negative momentum, which will accentuate NZ's vulnerability.**
- > **Monetary and fiscal policy have more work to do to lend support to the economy.**

Assessment

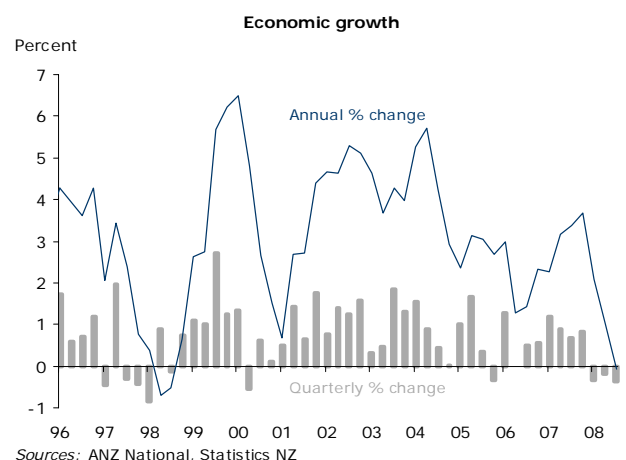
Production GDP fell for the third consecutive quarter, though it was broadly in line with expectations. Following contractions of 0.3 percent and 0.2 percent in the March and June quarters respectively, GDP fell by 0.4 percent in the September quarter. This is the first time since 1997/98 that the economy has experienced three consecutive negative quarters of growth. The goods and services sectors both contracted (by 1.4 percent and 0.2 percent respectively), with the latter experiencing its first consecutive quarterly fall since 1991. The manufacturing sector acted as the biggest drag on activity across the economy as a whole, resulting in a -0.3 percentage point contribution to growth. Offsetting some of this weakness was a solid recovery from the agricultural sector (up 6.0 percent) following two drought-induced quarterly contractions in March and June.

Once again, expenditure GDP undershot its production counterpart, highlighting the weakness in domestic demand. Expenditure GDP fell by 0.7 percent in the September quarter and is the fifth consecutive quarter where it has come in weaker than the production measure. This highlights that the downturn in the economy has been led by a turn in domestic demand. We expect the production numbers to "catch-up" to the expenditure measure over the coming year, and this points to some weak quarterly production GDP prints ahead.

The sharp contraction in demand has led to a large involuntary build-up in inventories. The contribution from inventories to growth in the quarter was 0.7ppts. Most of the build-up was in manufacturing (up \$308 million), which is potentially related to the solid agricultural production in the quarter. Such an inventory accumulation will need to unwind over the coming quarters, and will act as a huge drag on GDP

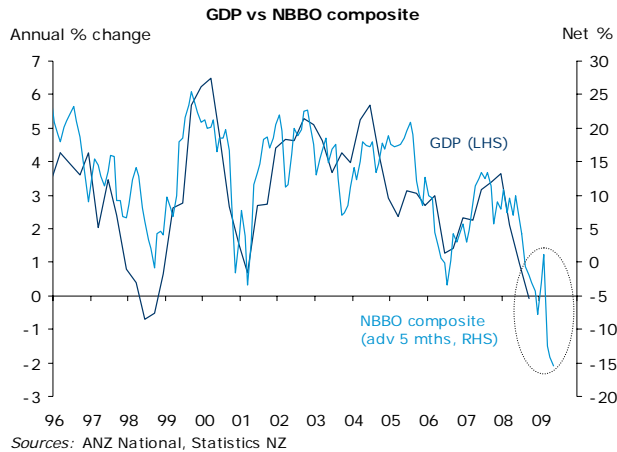
growth going forward. This reinforces our view that production GDP will start to print weaker than its expenditure counterpart over the year ahead. The flip-side to this is that demand for imports will fall sharply as firms work off their inventory excesses, which should help the trade balance to improve.

	GDP (qtr % chg)	GDP (ann % chg)	GDP (ann ave % chg)
Sep-06	0.5	1.4	2.1
Dec-06	0.6	2.3	2.0
Mar-07	1.2	2.3	1.8
Jun-07	0.9	3.2	2.3
Sep-07	0.7	3.4	2.8
Dec-07	0.8	3.7	3.1
Mar-08	-0.3	2.1	3.1
Jun-08	-0.2	1.0	2.5
Sep-08	-0.4	-0.1	1.7
ANZ	-0.5	-0.1	1.7
RBNZ	-0.5	-0.1	1.7
Market	-0.3	0.1	1.8



This will not be the last contraction for this cycle. Forward indicators point to further weakness ahead, and suggest that the recession is not over yet. The latest National Bank *Business*

Outlook survey reinforces that the economy is yet to find a base, and points to a further contraction in activity in the December quarter. With the economy yet to feel the full brunt of the global downturn and facing the prospect of a current account adjustment process, this leaves us with the view that 2009 will be weaker than 2008.



While the Q3 GDP print is largely historical, there are four important aspects to today's results:

- > The economy has negative momentum heading into the global recession, which will accentuate NZ's vulnerability. Often, an economy can ride through shocks if momentum is strong in the initial phases (such as Australia during the Asian crisis). This is not the case with NZ at present.
- > The composition of the GDP numbers (very weak domestic demand, an export sector that is struggling, and a large build-up in inventories) portends of further weakness ahead.
- > The length of the recession (three quarters already and more to come) means firms have less flexibility to simply "ride" through it. Attention is increasingly turning to costs, and in particular labour inputs, which is the next leg of

the economic cycle for 2009. This means another leg for the household sector (including the housing market), despite the benefit of lower petrol prices, tax cuts and falling interest rates.

- > The economy is quickly purging excess demand. Growth is now well below trend for three successive quarters, and the economy will start to show considerable slack. This should eventually lead to easing domestic inflation pressure, although the exact timing is still uncertain at this stage. There are some encouraging signs, with the GNE implicit price deflator (not a perfect pricing gauge by any means) rising by only 0.2 percent in the past two quarters.

Monetary and fiscal policy still have work to do. The bottom line from today's numbers is that the economy remains very weak and is yet to stabilise. There is further scope for monetary and fiscal policy to lend support to the economy as it faces the full force of the global downturn next year. With the latter potentially being limited in terms of how much more it can deliver due to an already large projected fiscal deficit (and Treasury will be revising down their forecasts further at next year's *Budget*), it looks like monetary policy will have to carry more of the burden, and possibly sooner.

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- Adjudicated bankrupt;
- Prohibited by an Act or by a court from taking part in the management of a company or a business;
- Subject of an adverse finding by a court in any proceeding that has been taken against them in their professional capacity;

- Expelled from or has been prohibited from being a member of a professional body; or
- Placed in statutory management or receivership.

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- Share in a limited partnership;
- Superannuation schemes and bonds;
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- Life insurance products;
- Derivative products including interest rate and currency forward rate contracts and options; and
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