27 November 2013

The beauty of hindsight

Revisions will boost the levels of NZ GDP and current account balance

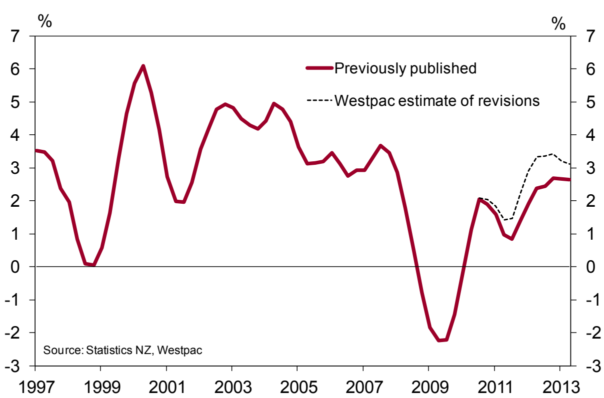
- Statistics NZ has signalled a range of improvements to the measurement of GDP and the balance of payments.
- The net effect will be to portray the state of the New Zealand economy in a slightly more flattering light, with a higher level of GDP, a smaller current account deficit, and a better savings track record.
- The implications for the current economic cycle are less straightforward. While measured growth in recent years may have been stronger, the economy is probably no closer to its full capacity than we thought a week ago. Hence, the case for OCR hikes is unaffected.

Statistics NZ has recently flagged some sizeable revisions to the history of New Zealand's national accounts, as part of its ongoing programme of quality improvements.[1] While the full details won't be published until next month, the indicative figures are significant enough to warrant bringing them to the market's attention now.

The upshot will be a slightly more flattering picture of the state of the New Zealand economy compared to the previous record – a little wealthier, a more sustainable trade position, and a slightly better savings record. In particular, the revisions will change our understanding of how quickly the economy has powered out of recession in the last few years, with the post-earthquake rebuild a significant driver.

Although the revisions will present a stronger starting point for the economy, they shouldn't have much bearing on forecasts of growth from here on. Nor do they present an argument for earlier OCR hikes, which is the interpretation that financial markets seem to be heading towards. While the economy may have grown faster over the last few years than previously thought, we've already observed how much inflation pressure was generated over that time – which is to say, not a lot. Instead, the implication seems to be that the economy's non-inflationary potential has been similarly understated.

NZ annual GDP growth



Details

The releases of the September quarter balance of payments (18 Dec) and GDP (19 Dec) will incorporate four major revisions to history. The first two will lead to an outright increase in the current level of GDP. The next two deal with changes in the composition of GDP, specifically the allocation between domestic and international spending. While these will have little or no impact on total GDP, they will lead to a net improvement in the balance of overseas trade.

We have to emphasise that the following figures are only indicative. Statistics NZ has given some guidance on the size of the four major revisions, but the final details will be included in the data releases next month, along with a

1 The most recent update is available at www.stats.govt.nz/browse_for_stats/economic_indicators/NationalAccounts/improvements-gdp-dec2013.aspx

host of minor revisions and the annual updates of sectoral benchmarks for GDP (which will have an indeterminate impact on recent history).

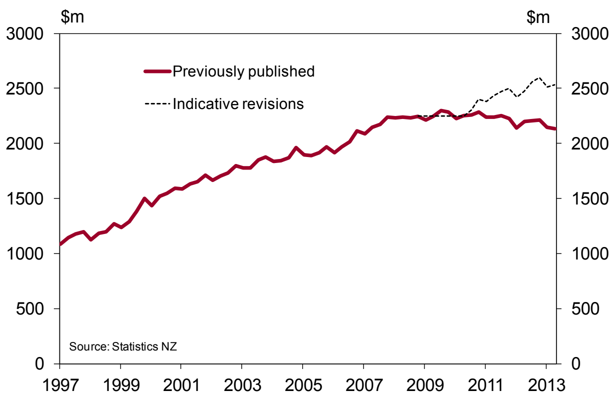
Construction: The main indicator for construction GDP is a survey of building work completed, which is drawn from a sample of building consents. However, to date much of the quake-related building work in Canterbury has been repairs, which don't require a new consent. As a result, quake-related activity appears to have been significantly undercounted.

Using industry data for the year to March 2012[2] –the year following the February 2011 earthquake – Statistics NZ estimate that nationwide construction activity was 12% greater than previously reported. That equates to a 0.6 percentage point boost to total GDP growth over that period. Depending on the quarterly profile of when that boost occurred, it may end up lifting the growth rate over 2013 as well.

Communications: This is the most rapidly developing sector of the economy, clocking up average annual growth of almost 7% between 1991 and 2008. However, the current measurement approach has struggled to keep up with recent developments – indeed, until now the sector was reported as having been shrinking since 2010.

The new measurements take better account of the massive growth in broadband/mobile data use over the last few years, driven in part by a sharp drop in per-unit prices (which was already incorporated in the CPI). This restores the sector's upward trend, with around 3% average annual growth since 2010, adding around 0.4ppts to annual GDP growth.

Communications contribution to GDP



Overseas visitor spending: There are two measurement changes involved here. First, a new online survey of spending by overseas visitors has revealed a substantial undercount from the old survey method, which used face-to-face interviews. Second, a recent study has provided a new benchmark for international students' living expenses.

The revisions mean that within total GDP, some spending that was attributed to New Zealanders (household consumption) will now be attributed to overseas visitors (exports of services), with no change in the total. However, the boost to services exports will narrow the current account deficit going back to 1988. We estimate that the improvement for the last year will be around $2.3bn ($1.6bn from tourists and $700m from students).

Low-value imports: Imports of goods valued at less than $1000, such as purchases from overseas online retailers, are a known source of under-coverage as they are not well monitored (for instance, items under $400 are not subject to GST). Statistics NZ will include an estimate of the value of these imports, dating back to 2000 (when they were seen as negligible) and reaching as high as $900m in the year to March 2013.

The net effect on GDP will be close to zero, as the increase in imports will be balanced out by an upward revision to household consumption. On its own this revision will worsen the current account balance, but as it's smaller than the previous revision, the net change is still positive.

Implications

The net effect of the revisions will be to portray the state of the New Zealand economy in a slightly more flattering light. Compared to the previous record, the current level of GDP will be higher (by as much as 2%), the current account deficit will be smaller (though still large by the standards of advanced economies), and the reallocation of spending away from households and towards overseas visitors means that households' saving record will improve.

It's worth noting that these kinds of revisions are not out of the ordinary – Statistics NZ has made several improvements to the measurement of the national accounts over the last few years, largely in the same direction as these ones. Together, these have helped to address some of the data puzzles that we have long been highlighting, such as the implausibly low household savings rate through the 2000s (initially reported to be as low as -15%, later revised to more like -10%). However, we suspect there is still more to be done.

The implications for the current economic cycle are not so straightforward. It's clear that the New Zealand economy has been growing faster than thought since the recession ended, and especially since the post-quake rebuild got under way. The previous figures showed that annual GDP growth had risen to a five-year high of 2.7% by June 2013; depending on how the final revisions pan out, it's plausible that annual growth is actually running above 3% today, and that it has been for over a year.

However, from the RBNZ's point of view, what matters is where the economy current stands relative to its non-inflationary potential, and it's not at all obvious that these revisions change that story. We've already observed what inflation did in that time – falling below the 1-3% target band between mid-2012 and mid-2013, which strongly suggests

2 This would have been incorporated next year anyway as part of the annual benchmarking process. But given its significance, Statistics NZ has included it a year earlier than usual.

that the economy was running below its potential, whatever that may be.

The implications for financial markets are limited. We don't think this alters the case for OCR hikes, so there should be no impact on swap rates. However, a smaller historic current deficit and lower debt to GDP ratios (thanks to a larger denominator) could warrant a small drop in government bond yields and a slightly higher exchange rate.

Finally, we note that these revisions do not affect our forecasts of the September quarter current account and GDP. Our current account forecast is more or less complete – we expect the deficit to widen by 0.3ppts, driven by a spike in imports. Based on our estimate of the revised starting point, this would see the deficit widen from 3.6% to 3.9% of GDP. Last week we revised up our GDP growth forecast from 1.2% to 1.4%, partly due to an improved estimate of the agricultural sector's post-drought rebound. This forecast is preliminary; we'll finalise it after the manufacturing and construction surveys in early December, but we suspect the risks are more to the upside.

Michael Gordon
Senior Economist

Westpac economics team contact details

Dominick Stephens, Chief Economist
+64 9 336 5671

Michael Gordon, Senior Economist
+64 9 336 5670

Felix Delbrück, Senior Economist
+64 9 336 5668

Anne Boniface, Senior Economist
+64 9 336 5669

Any questions email:
economics@westpac.co.nz

For email address changes contact:
WNZResearch@westpac.co.nz

Disclaimer

Things you should know: Each time someone visits our site, data is captured so that we can accurately evaluate the quality of our content and make improvements for you. We may at times use technology to capture data about you to help us to better understand you and your needs, including potentially for the purposes of assessing your individual reading habits and interests to allow us to provide suggestions regarding other reading material which may be suitable for you.

If you are located in Australia, this material and access to this website is provided to you solely for your own use and in your own capacity as a wholesale client of Westpac Institutional Bank being a division of Westpac Banking Corporation ABN 33 007 457 141 AFSL 233714 ('Westpac'). If you are located outside of Australia, this material and access to this website is provided to you as outlined below.

This material and this website contain general commentary only and does not constitute investment advice. Certain types of transactions, including those involving futures, options and high yield securities give rise to substantial risk and are not suitable for all investors. We recommend that you seek your own independent legal or financial advice before proceeding with any investment decision. This information has been prepared without taking account of your objectives, financial situation or needs. This material and this website may contain material provided by third parties. While such material is published with the necessary permission none of Westpac or its related entities accepts any responsibility for the accuracy or completeness of any such material. Although we have made every effort to ensure the information is free from error, none of Westpac or its related entities warrants the accuracy, adequacy or completeness of the information, or otherwise endorses it in any way. Except where contrary to law, Westpac and its related entities intend by this notice to exclude liability for the information. The information is subject to change without notice and none of Westpac or its related entities is under any obligation to update the information or correct any inaccuracy which may become apparent at a later date. The information contained in this material and this website does not constitute an offer, a solicitation of an offer, or an inducement to subscribe for, purchase or sell any financial instrument or to enter a legally binding contract. Past performance is not a reliable indicator of future performance. The forecasts given in this material and this website are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The ultimate outcomes may differ substantially from these forecasts.

Transactions involving carbon give rise to substantial risk (including regulatory risk) and are not suitable for all investors. We recommend that you seek your own independent legal or financial advice before proceeding with any investment decision. This information has been prepared without taking account of your objectives, financial situation or needs. Statements setting out a concise description of the characteristics of carbon units, Australian carbon credit units and eligible international emissions units (respectively) are available at www.cleanenergyregulator.gov.au as mentioned in section 202 of the Clean Energy Act 2011, section 162 of the Carbon Credits (Carbon Farming Initiative) Act 2011 and section 61 of the Australian National Registry of Emissions Units Act 2011. You should consider each such statement in deciding whether to acquire, or to continue to hold, any carbon unit, Australian carbon credit unit or eligible international emissions unit.

Additional information if you are located outside of Australia

New Zealand: The current disclosure statement for the New Zealand division of Westpac Banking Corporation ABN 33 007 457 141 or Westpac New Zealand Limited can be obtained at the internet address www.westpac.co.nz. Westpac Institutional Bank products and services are provided by either Westpac Banking Corporation ABN 33 007 457 141 incorporated in Australia (New Zealand division) or Westpac New Zealand Limited. For further information please refer to the Product Disclosure Statement (available from your Relationship Manager) for any product for which a Product Disclosure Statement is required, or applicable customer agreement. Download the Westpac NZ QFE Group Financial Advisers Act 2008 Disclosure Statement at www.westpac.co.nz.

China, Hong Kong, Singapore and India: Westpac Singapore Branch holds a wholesale banking licence and is subject to supervision by the Monetary Authority of Singapore. Westpac Hong Kong Branch holds a banking license and is subject to supervision by the Hong Kong Monetary Authority. Westpac Hong Kong branch also holds a license issued by the Hong Kong Securities and Futures Commission (SFC) for Type 1 and Type 4 regulated activity.

Disclaimer continued overleaf.

Disclaimer continued

Westpac Shanghai and Beijing Branches hold banking licenses and are subject to supervision by the China Banking Regulatory Commission (CBRC). Westpac Mumbai Branch holds a banking license from Reserve Bank of India (RBI) and subject to regulation and supervision by the RBI.

U.K.: Westpac Banking Corporation is registered in England as a branch (branch number BR000106), and is authorised and regulated by the Australian Prudential Regulatory Authority in Australia. WBC is authorised in the United Kingdom by the Prudential Regulation Authority. WBC is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority in the United Kingdom. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request. Westpac Europe Limited is a company registered in England (number 05660023) and is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. This material and this website and any information contained therein is directed at a) persons who have professional experience in matters relating to investments falling within Article 19(1) of the Financial Services Act 2000 (Financial Promotion) Order 2005 or (b) high net worth entities, and other persons to whom it may otherwise be lawfully communicated, falling within Article 49(1) of the Order (all such persons together being referred to as “relevant persons”). The investments to which this material and this website relates are only available to and any invitation, offer or agreement to subscribe, purchase or otherwise acquire such investments will be engaged in only with, relevant persons. Any person who is not a relevant person should not act or rely upon this material and this website or any of its contents. In the same way, the information contained in this material and this website is intended for “eligible counterparties” and “professional clients” as defined by the rules of the Financial Services Authority and is not intended for “retail clients”. With this in mind, Westpac expressly prohibits you from passing on the information in this material and this website to any third party. In particular this material and this website, website content and, in each case, any copies thereof may not be taken, transmitted or distributed, directly or indirectly into any restricted jurisdiction.

U.S.: Westpac operates in the United States of America as a federally licensed branch, regulated by the Office of the Comptroller of the Currency. Westpac is also registered with the US Commodity Futures Trading Commission (“CFTC”) as a Swap Dealer, but is neither registered as, or affiliated with, a Futures Commission Merchant registered with the US CFTC. Westpac Capital Markets, LLC (‘WCM’), a wholly-owned subsidiary of Westpac, is a broker-dealer registered under the U.S. Securities Exchange Act of 1934 (‘the Exchange Act’) and member of the Financial Industry Regulatory Authority (‘FINRA’). This communication is provided for distribution to U.S. institutional investors in reliance on the exemption from registration provided by Rule 15a-6 under the Exchange Act and is not subject to all of the independence and disclosure standards applicable to debt research reports prepared for retail investors in the United States. WCM is the U.S. distributor of this communication and accepts responsibility for the contents of this communication. All disclaimers set out with respect to Westpac apply equally to WCM. If you would like to speak to someone regarding any security mentioned herein, please contact WCM on +1 212 389 1269. All disclaimers set out with respect to Westpac apply equally to WCM.

Investing in any non-U.S. securities or related financial instruments mentioned in this communication may present certain risks. The securities of non-U.S. issuers may not be registered with, or be subject to the regulations of, the SEC in the United States. Information on such non-U.S. securities or related financial instruments may be limited. Non-U.S. companies may not subject to audit and reporting standards and regulatory requirements comparable to those in effect in the United States. The value of any investment or income from any securities or related derivative instruments denominated in a currency other than U.S. dollars is subject to exchange rate fluctuations that may have a positive or adverse effect on the value of or income from such securities or related derivative instruments.

The author of this communication is employed by Westpac and is not registered or qualified as a research analyst, representative, or associated person under the rules of FINRA, any other U.S. self-regulatory organisation, or the laws, rules or regulations of any State. Unless otherwise specifically stated, the views expressed herein are solely those of the author and may differ from the information, views or analysis expressed by Westpac and/or its affiliates.

For the purposes of Regulation AC only: Each analyst whose name appears in this report certifies that (1) the views expressed in this report accurately reflect the personal views of the analyst about any and all of the subject companies and their securities and (2) no part of the compensation of the analyst was, is, or will be, directly or indirectly related to the specific views or recommendations in this report.