

Back to earth

Q1 GDP rose 0.3%, less than expected

- GDP rose by 0.3% in the March 2013 quarter, slightly short of forecasts and following a sharp rise in the December 2012 quarter.
- Construction and related services were the main source of growth; other sectors were mixed, and drought was likely a drag on overall activity.
- Our forecast for June quarter GDP growth remains at 0.3%. Recent data suggest a pickup in underlying momentum, but the impact of the drought on production is likely to fall most heavily in this quarter.

Key results

	Actuals		Q1 expectations		
	Q4	Q1	WBC	Mkt	RBNZ
GDP q/q	1.5	0.3	0.5	0.5	0.5
GDP ann % chg	3.2	2.4	2.4	2.5	2.4
GDP ann avg % chg	2.7	2.5	2.4	2.4	2.4

After blowing everyone away with a 1.5% surge in activity in the December 2012 quarter, the New Zealand economy put in a more modest effort in the March quarter of this year, with both the production and expenditure measures of GDP rising by 0.3%. Construction and related services were the standout for the quarter, reflecting not just the post-quake rebuild in Canterbury but the demand-driven pickup in the Auckland market.

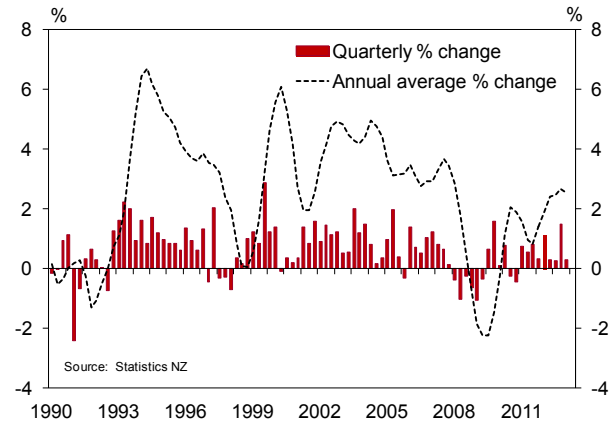
Relative to our forecasts, the downside surprises were small and widely dispersed, which doesn't suggest that we'll get a positive 'payback' in the June quarter. Combine this with the fact that the impact of the drought – which was masked to some degree in Q1 – is likely to have its greatest impact on Q2 production, and our forecast for Q2 growth remains at 0.3%. We expect growth to accelerate from later in the year, as the impact of the drought passes and the Canterbury rebuild gathers pace.

Details

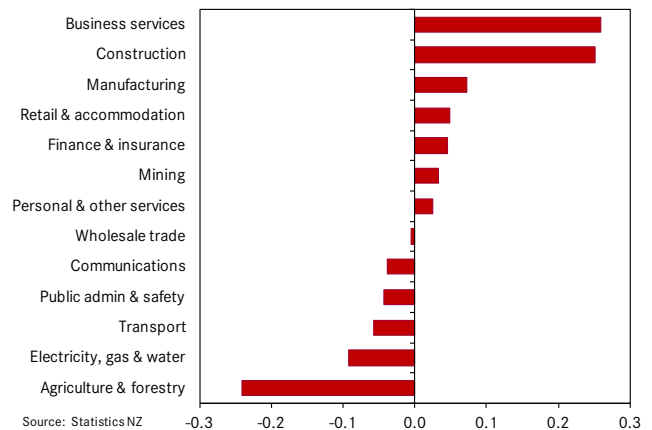
The 0.3% rise in March quarter GDP fell short of the 0.5% gain that we, the market and the RBNZ expected. Full-year growth of 2.5% was actually slightly higher than expected, due to some small upward revisions to the rate of growth in the first three quarters of last year.

Growth in the March quarter was heavily concentrated in construction-related activity, in contrast to the December 2012 quarter where all but one sector reported growth (and construction itself was positive but not a standout). On top of a 5.5% gain in the construction sector, there was a 3.9% rise in professional services, which Statistics NZ partly attributed to

Production-based GDP growth



Percentage point contributions to Q1 GDP growth



demand for architectural and engineering services – notably, not just in Christchurch but in Auckland as well. Housing construction is picking up in Auckland in response to the obvious signs of a shortage of supply, although it remains well below the levels seen in the last housing cycle.

The short but severe drought early this year had a notable impact on March quarter activity, though with some opposing effects. Agricultural output was down 4.7% for the quarter, with a 6% fall in milk production and a 4% decline for sheep farming. The fall in milk production also weighed on dairy processing, although this was more than offset by a rise in meat production as sheep and cattle were sent to slaughter earlier than usual – food and beverage manufacturing overall was up by 3%. The impact of the drought will be much harsher in the June quarter, where both dairy and meat production will be below normal.

There was a range of modest negatives that also weighed on March quarter growth. Ex-food manufacturing was surprisingly weak

(down 0.8%) given the very strong readings for the monthly PMI survey over that period. We expected a rebound in petrochemical production to provide a saving grace in Q1, but even that didn't quite pan out – instead, the sharp drop in the previous quarter was revised away. Transport fell 1.1% (lower milk collections might have been a factor here), communications recorded its now seemingly standard decline, and electricity generation fell in response to lower aluminium production at Tiwai.

On the expenditure measure of GDP, the sharp rise in building activity and a modest 0.4% rise in household consumption were offset by weaker business investment and a 0.2% drop in government consumption. One notable bright spot was a 7% rise in services exports, as overseas visitor spending more than bounced back from a weak Q4 (which itself was revised up). Overseas travel by New Zealanders was also up, with services imports rising by 2.2%.

Market implications

New Zealand's economic data tends to be choppy, and the deceleration from December to March almost certainly overstates the case. Averaging over the last two quarters suggests an economy in a steady upturn, with modest growth in most sectors and construction as a standout. This is a story that we're comfortable telling, and have been forecasting for some time.

That said, it's fair to say that the economy's momentum has cooled a little so far this year. The drought is likely to have played a part in this, although it's been surprisingly difficult to find direct evidence of this in the high-frequency data. We continue to expect a self-sustaining pickup in growth over the next couple of years, although this may not be apparent in the GDP figures until later in the year, with the drought likely to be a substantial drag on Q2 – we expect another quarter of just 0.3% growth.

From the RBNZ's perspective, softer than expected GDP growth will temper some of the risk to its inflation outlook stemming from the NZ dollar's unexpected decline in recent weeks. However, the surprise was relatively small and doesn't alter the fundamental picture of the economy: accelerating growth and the Canterbury rebuild will lead to higher inflation in the future, necessitating higher interest rates at some point. The market reaction to today's release was in line with this interpretation, with the New Zealand dollar initially falling half a cent but soon recovering this lost ground.

Michael Gordon
Senior Economist

Westpac Economics Team Contact Details

Dominick Stephens , Chief Economist	Ph: (64-9) 336 5671	dominick_stephens@westpac.co.nz
Michael Gordon , Senior Economist	Ph: (64-9) 336 5670	michael_gordon@westpac.co.nz
Felix Delbrück , Senior Economist	Ph: (64-9) 336 5668	felix_delbruck@westpac.co.nz
Nathan Penny , Economist	Ph: (64-9) 336 5669	nathan_penny@westpac.co.nz

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. 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 be 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.