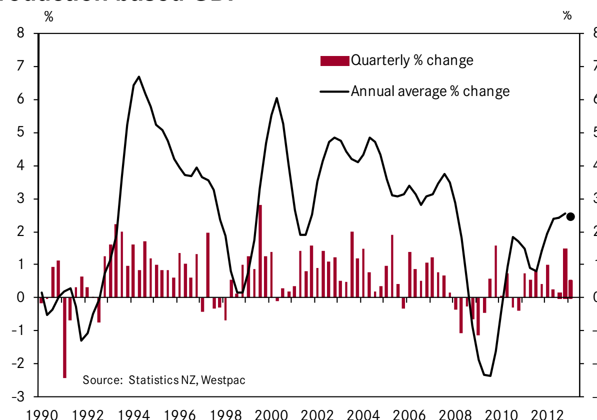
Westpac Institutional Bank

A dry spell

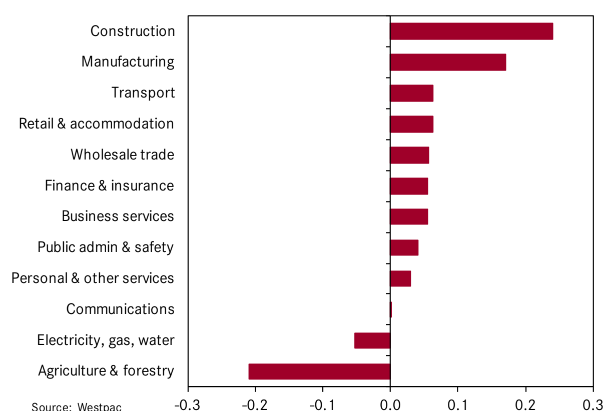
Preview of March 2013 GDP (20 Jun, 10:45am) and current account (19 Jun, 10:45am)

- **We estimate that GDP rose 0.5% in the March quarter, following a 1.5% bounce in the December 2012 quarter.**
- **Surging construction activity will be partly offset by the impact of a short but severe drought.**
- **The current account deficit is expected to narrow slightly to 4.8% of GDP, with improved export prices boosting the goods trade surplus.**
- **Our picks are in the middle of the range of market forecasts. The impact of the drought creates some uncertainty around our forecasts, but markets are aware that its effects will be temporary.**

Production based GDP



Percentage point contribution to Q1 GDP growth



The national accounts for the December 2012 quarter featured blockbusting growth in domestic demand, though with signs of a corresponding increase in economic imbalances. The March 2013 quarter figures published next week are likely to be less dramatic – we expect a small but temporary narrowing of the current account deficit (Wednesday) and a modest 0.5% increase in GDP (Thursday). Both figures will have been influenced by the short but severe drought early this year, though we suspect that the full effects won't become apparent until the June quarter.

Q1 GDP, 20 June

Our pick for a modest 0.5% rise in March quarter GDP follows a storming 1.5% gain in the December 2012 quarter. Quite aside from the fact that it would have been tough to repeat that effort, the March quarter figures will reflect a shift from excellent agricultural conditions in late 2012 to a short but sharp drought in early 2013. We've revised our GDP forecast down from an initial estimate of 0.8%, after a disappointing read on manufacturing activity and a closer look at the timing of the drought impact (we have correspondingly shaded up our June quarter forecast to 0.3%).

We estimate that agricultural output fell 5% for the quarter, led by a 7% drop in milk production. The drought will also have affected food manufacturing, although the impact will be less visible here: lower milk processing was probably offset by higher meat production as stock was sent to slaughter early. On top of this, low hydro lake levels were a drag on electricity generation.

The star performer for the March quarter was construction, where we estimate that output rose 5%. Post-earthquake repairs and rebuilding in the Canterbury region are now growing even faster than we expected – building activity in the region rose by more than 20% in the March quarter alone. But homebuilding is also picking up in the rest of the country in response to rising prices and a lack of supply, particularly in Auckland.

Ex-food manufacturing appears to have been weaker than we had assumed, with only the petroleum and chemicals sector reporting a rise in production (notably, this was the only sector in the whole economy that didn't grow in the December quarter). The weakness in plant and machinery production in particular is a slightly concerning sign for future growth.

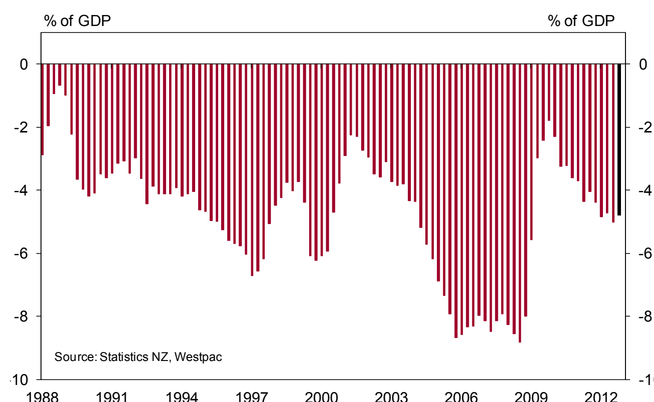
The service sectors appear to have recorded steady gains in the March quarter, which has been a consistent story over the last couple of years. Retail sales rose 0.5%, wholesale trade rose 1%, finance and real estate services were boosted by higher housing turnover and lending growth, and transport will have benefited from increased tourist movements, both in and out of the country.

Q1 current account, 19 June

We expect a narrowing of the current account deficit from 5.0% to 4.8% of GDP for the year to March. The goods balance increased in seasonally adjusted terms as export values improved, while import values remained flat. Export volumes likely continued their strong run. March quarter export volumes reflected the strong dairy production up to the end of 2012; the drought is likely to be more keenly felt in dairy export volumes in the June quarter.

The investment income deficit is expected to have widened in Q1, as profits for overseas-owned firms strengthened in line with the rest of the economy. Continued economic growth this year and higher interest rates next year are likely to see this deficit widen further over the next couple of years.

NZ annual current account deficit



Current Account Components ($millions)

	Jun-12	Sep-12	Dec-12	Mar-13 (forecast)
Goods Balance (s.a.)	352	131	341	800
Services Balance (s.a.)	-201	-280	-405	-200
Investment Income Balance	-2,811	-2,213	-2,462	-2,600
Transfers Balance	-106	-147	-84	-100
Current Account Bal (s.a.)	-2,795	-2,528	-2,655	-2,100
CAB Ann Total	-10,087	-9,861	-10,509	-10,100
Ann CAB, % of GDP	-4.8	-4.7	-5.0	-4.8

Market implications

GDP is typically the more significant release for markets. Our pick of 0.5% growth is at the middle of a fairly narrow range of market forecasts, and is also in line with the Reserve Bank's estimate in yesterday's Monetary Policy Statement. The main uncertainty in our forecast is around the impact of the drought on the agriculture sector – bearing in mind that the initial estimate for this sector is often heavily revised over time. However, any downside surprise on this front will probably be overlooked by markets, recognising that the drought has long since broken.

Similarly, our current account forecast is right in line with market expectations. A short-term narrowing in the annual deficit is unlikely to attract much attention given the widespread expectation that the balance will widen over the longer term. Low interest rates, a strengthening housing market, domestic demand generated by the Canterbury rebuild and a still-high exchange rate all favour the re-emergence of economic imbalances in coming years.

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