Westpac

Institutional Bank

11 December 2013

A change of pace

Preview of September 2013 quarter GDP (19 Dec, 10:45am) and current account (18 Dec, 10:45am)

- We estimate that GDP rose 1.4% in the September quarter, following a 0.2% rise in the June quarter.
- This turnaround reflects the impact of a short but intense drought in the first half of the year, and a swift rebound in agricultural production.
- The current account deficit widened in the September quarter, with a record high terms of trade not enough to offset a big jump in import volumes.
- Revisions to the history of both series will paint a more flattering picture of the New Zealand economy, with faster GDP growth in the last few years and a permanent improvement in the international trade position.

	Jun-13 (previously published)	Jun-13 (expected revisions)	Sep-13 (Westpac forecast)
Balance of payments (18 Dec)			
Current account balance $m (s.a.)	-2,157	-1,850	-2,890
Annual balance $m	-9,099	-8,030	-8,840
% of GDP	-4.3	-3.8	-4.1
GDP (19 Dec)			
Quarterly % chg	0.2	0.2	1.4
Annual % chg	2.5	2.9	3.8
Annual average % chg	2.7	3.1	3.4

The September quarter national accounts published next week will be notable for two changes. The first is that the economy's performance over the quarter will look markedly different to the first half of the year, with the agricultural sector now bolstering rather than detracting from overall GDP growth. We also expect the current account deficit to widen after two quarters of narrowing, although to some degree this will also be the product of a strengthening economy.

The second change is that recent history will look quite a bit different to what was previously reported. Statistics NZ has made some significant improvements to the measurement of a few sectors, which we detailed in a previous bulletin ("The benefit of hindsight", 27 November). For GDP the main revisions date back to 2010, implying a faster rate of growth over the last few years. The revisions to the current account are even more significant, with the deficit-to-GDP ratio being revised down by almost a full percentage point on average going back to 1988.

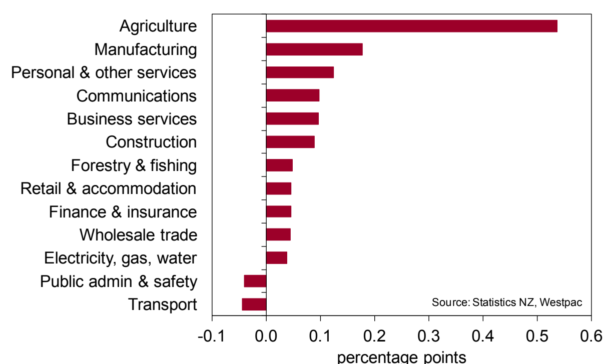
The revisions to history mean that some care will be required in interpreting the September quarter results, particularly on an annual basis. Guidance from Statistics NZ suggests that annual GDP growth may already be running above the 3% mark (compared to a previously reported peak of 2.7%), even before we consider the stronger pace of growth in Q3. And the improved starting point for the level of the current account deficit means that, while we expect the revised figures to show a widening in the year to September, it will still be narrower than what was initially reported for the year to June.

Q3 GDP, 19 December

We estimate that GDP rose by 1.4% in the September quarter, after increases of just 0.4% and 0.2% in the two previous quarters. A short but intense drought constrained growth over the first half of this year, with the greatest impact falling in the June quarter (knocking an estimated 0.5 percentage points off GDP growth).

Milk production fell by 21% over the first half of this year, on a par with the severe 2008 drought. However, the fact that

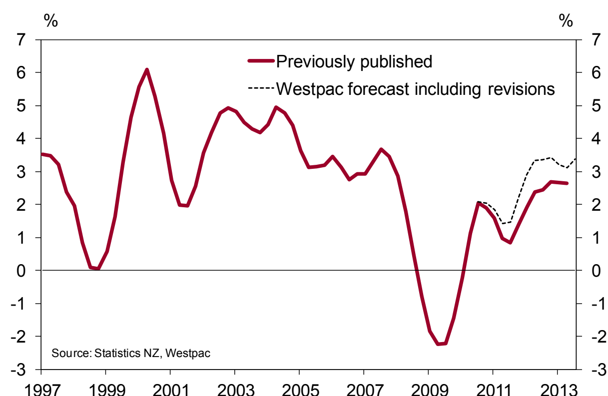
Percentage point contribution to Q3 GDP growth



this year's drought was shorter-lived and occurred later in the dairying season meant that farmers weren't forced to significantly cull their herds, and the industry was positioned for a swift rebound once the rain returned. We estimate that milk production rose 35% in the September quarter alone, driving a 13% increase in total agricultural production. Along with the associated rebound in dairy product manufacturing, this suggests that the recovery from drought will contribute 0.6 percentage points to quarterly GDP growth.

But it's not just a dairying story; stripping out the drought impact still leaves underlying quarterly growth of 0.8%, implying an acceleration from the first half of the year. Quarterly indicators point to several sectors clocking up growth of 1% or more, including non-food manufacturing (up 1.6%), construction (up 1.8%), electricity (reflecting a shift towards more-efficient hydro generation), forestry, communications and personal services.

Annual average GDP growth



The revisions incorporated in next week's release will reflect two major changes – an improved estimate of the level of construction activity since the Canterbury earthquakes, and a new way of measuring the rapidly-evolving communications sector since 2010 – as well as a bunch of minor tweaks and the usual annual update of the sectoral benchmarks. As a result, annual growth over the last few years will be marked higher, although we only have a rough guide as to the net impact. There could also be some sizeable changes to the quarterly profile of growth, though that's not the primary aim of the revisions.

Q3 current account, 18 December

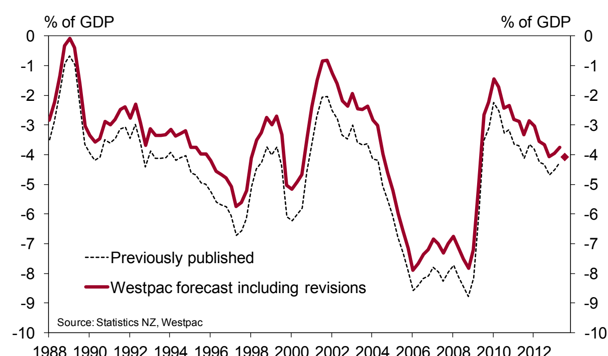
Statistics NZ has already published the revised current account history on a year-to-March basis; we've used this to estimate a quarterly profile in the chart below. The two significant changes are an improved estimate of spending by overseas visitors (adding about $2bn to exports of services in the last year), partly offset by a new estimate of low-value imports, such as online purchases, which are not captured by Customs (adding about $1bn to imports of goods).

The net impact is a reduction in the current account deficit of about $1bn or 0.5% of GDP in the last year (and even more in previous years, going back to 1988). This means that the June quarter deficit, originally reported as 4.3% of GDP, will be revised to 3.8% of GDP. Based on that improved starting point, we see the deficit widening by 0.3ppts to 4.1% of GDP in the September quarter.

The main driver is a downturn in the goods balance over the September quarter. Exports rose about 6% in seasonally adjusted terms, as a sharp rise in prices offset a modest drought-induced drop in volumes. However, imports surged about 11% by value (and about 8% by volume). Some of this increase was due to one-off items (Defence Force helicopters and a floating oil platform), but there was also a jump in imports of consumer goods and capital equipment, which is a positive omen for future growth.

We also expect a small decline in the services balance, due to a dip in spending by overseas visitors, and a widening of the investment income deficit. Profits of overseas-owned firms (a negative for the investment income balance) were surprisingly low in the June quarter, but we expect them to regain some ground in September.

Annual current account balance



Market implications

We've yet to see the range of market forecasts for GDP, but given the widespread strength of the activity indicators over the quarter we expect that many forecasters will be picking growth of 1% or more. We'll find out what the Reserve Bank is expecting in tomorrow's *Monetary Policy Statement,* but its comment in October that "the New Zealand economy is estimated to have grown by more than 3 percent in the year to September" suggests that its forecast will be similar to ours.

Our guess is that an outturn of 1.4% would be a modest upside surprise to markets, nudging swap rates and the NZ dollar higher on the day. The upward revisions to recent history may also come as an upside surprise, if the market is not fully aware that these revisions are coming. Our view is that the revisions will have limited implications for monetary policy; changing the measurement doesn't change the reality, which is that inflation pressures have been subdued and that the economy has been running below its potential over the last couple of years.

It's harder to anticipate the market response to the current account figures – again, it depends on the market's level of awareness about the stronger revised starting point. That said, the current account doesn't tend to be a big market mover on the day. We think the more important implication is around the perception of New Zealand's international position: we have long been singled out for having a persistently large current account deficit. With these latest revisions, the deficit remains large but is no longer the outlier that it once appeared to be. In fact, the average deficit since 1988 is now narrower than Australia's – 3.9% of GDP compared to 4.3%.

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

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