Westpac Institutional Bank

Weebles wobble but they don't fall down

Q4 GDP rose 1.5%, rebounding from a soft Q3

- **GDP rose by 1.5% in the December quarter, well ahead of market forecasts and above our top-of-the-range pick of 1.2%.**
- **Growth was broad-based but particularly strong in the service sectors, reflecting the domestically-led nature of the current upturn.**
- **The results are in line with our long-held view that low interest rates and the Canterbury rebuild would be a massive stimulus to the domestic economy.**
- **However, we wouldn't extrapolate growth rates of this magnitude for the near future, particularly with drought likely to hollow out growth through mid-2013.**

Key results

	Actuals		Q4 expectations		
	Q3	Q4	WBC	Mkt	RBNZ
GDP q/q	0.2	1.5	1.2	0.9	0.8
GDP ann % chg	1.9	3.0	2.6	2.3	2.2
GDP ann avg % chg	2.4	2.5	2.5	2.4	2.4

The New Zealand economy sprang back much harder than expected in the December 2012 quarter, beating even our top-of-the-range forecast of a 1.2% increase. There were gains across almost every industry but particularly in the service sectors, underscoring the domestically-led nature of this upturn. In some ways that mix is problematic, as we noted in yesterday's current account review "Something to worry about". But it doesn't come as a surprise – low interest rates and a massive spending injection from the Canterbury rebuild are increasingly being felt across the domestic economy.

The sharp jump in the December quarter was to some degree making up lost ground, after growth slowed to just 0.2% each in the June and September quarters. Quarterly growth rates from here on are more likely to be sub-1% – and drought will scoop a little out of this profile particularly through the middle of this year. But that shouldn't detract from the fact that the New Zealand economy started the year on a much firmer footing than many realised.

We have long expected the Canterbury rebuild to promote a high rate of GDP growth, inflation pressures, and eventually interest rate hikes. Today's figures must surely dispel any lingering doubts in the market about the first phase of this process. Our view remains that OCR increases will be earlier and more aggressive than the market is currently pricing.

Figure 1: Production based GDP

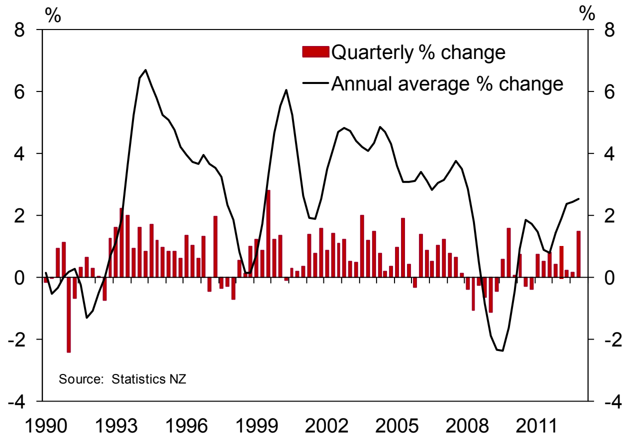
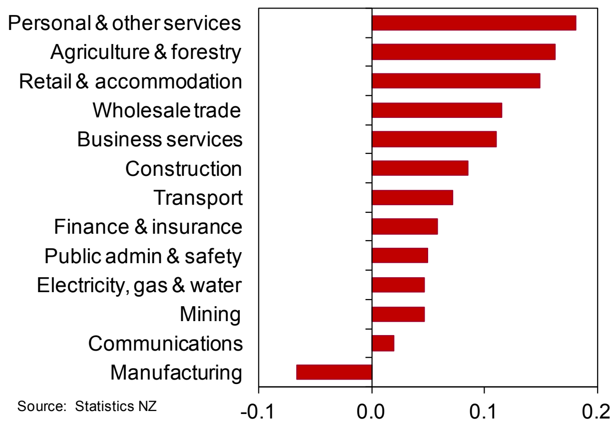


Figure 2: Percentage point contributions to Q4 GDP growth



Details

December quarter GDP rose 1.5% on the production measure and 1.4% by expenditure, well above the median market forecast of 0.9% and the Reserve Bank's pick of 0.8%. Over the 2012 calendar year, GDP was 2.5% higher than in 2011, the fastest pace of growth since the start of the recession in March 2008.

Growth was notably broad-based, with Statistics NZ reporting gains in all but one of the 16 main industry groups. The exception was a 0.5% drop in manufacturing, and that itself was dominated by a single group, the extremely volatile petroleum and chemical products sector (down 8.7%). Excluding this, non-food manufacturing grew by 1.7%.

There was particularly strong growth in the service sectors: up 1.1%, the biggest quarterly increase in six years. As shown in their respective surveys, wholesale and retail trade both rebounded by over 2% after declining in the September quarter. Transport rose 1.4% due to a rise in road transport, financial services grew 1.2% as credit growth picked up, and personal and business services generally grew in line with the strong rise in hours worked in the Quarterly Employment Survey.

The 1.8% increase in construction activity would have stuck out as a superb result in any other quarter; this time it was only middle of the pack. As we noted in the 6 March building activity survey, post-earthquake repairs and rebuilding in Canterbury region continue to gather pace, but activity is now rising across a number of regions. Our view is that with the Canterbury rebuild now well under way, the second-round effects are now starting to be felt across a range of connected industries, especially services.

Primary sector production was also very strong for the quarter – up 3.2% – although the details are less suggestive of a sustainable basis for growth. The main contributor was a 9% spike in forestry output, where there are two potential factors at play: rising demand from key export markets such as China, and increased deforestation as the value of carbon credits has collapsed. Rising log prices suggest that the demand story was more dominant.

Agricultural activity rose by 1.5%. Livestock farming rose, partly offset by a drop in dairy output as growing conditions shifted from excellent to average (and have obviously gotten much worse since). Related to this, food and beverage manufacturing rose by 1.1%. We think that the impact of the drought won't really hit the GDP data until the June 2013 quarter (higher meat production will mask some of the effect in the March quarter). Statistics NZ also notes that GDP may not fully capture the effects of drought on the first cut.

The 1.4% rise in the expenditure measure of GDP was led by a 1.5% increase in household consumption. Spending on durable goods rose 3.2% – households are clearly taking advantage of the high exchange rate, which depresses the prices of imported goods – and services had a particularly strong quarter, as already noted. Business investment rose 2.2%, with a 7.6% rise in plant and machinery investment boding well for the country's growth potential (though only partly reversing a steep drop in the previous quarter).

Market implications

The New Zealand dollar rose 40pts to 0.8260 and the two-year swap rate rose 3 basis points to 2.93% after the release. We would have expected a bigger reaction given the scale of the surprise versus market forecasts, but clearly there are other issues going on in the background, particularly the local drought and the unresolved rescue plan for Cyprus.

It would be easy to dismiss the GDP figures as a technical correction after a weak quarter previously. It's true that the economy was knocked down in the middle of 2012 – for reasons that are unclear, although global uncertainty could well have played a part – and there was a clear sense of things rebounding again by the end of the year. But that was already known before today; the news here is that activity was running at an even stronger pace than thought by the end of 2012.

From the RBNZ's point of view, today's result was a whopping 0.7% above their forecast. To put this in perspective: the most prominent downside risk to the RBNZ's growth forecasts is the drought. The March *Monetary Policy Statement* incorporated a preliminary impact of 0.2-0.3% of GDP, and worst-case scenarios of a 1% hit suggest that the RBNZ could build in as much as another 0.7% to the downside. The surprise to the RBNZ today effectively balances out whatever it may assume about the drought impact in its next set of forecasts.

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