Westpac Institutional Bank

A strong finish

Preview of Q4 GDP (21 Mar, 10:45am) and Current Account (20 Mar, 10:45am)

- **We estimate that GDP rose 1.2% in the December quarter, making up lost ground after a slowdown in the June and September quarters.**
- **Agriculture, retail spending and business and personal services rebounded, while construction made a more modest contribution.**
- **The current account deficit is forecast to widen slightly to 4.8% of GDP, with an improved goods trade surplus offset by higher investment income outflows.**
- **Our GDP pick is at the top of the range of market forecasts. Although such an outturn should see a positive market reaction on the day, the recent onset of drought is now the market's primary concern.**

We expect this week's balance of payments (Wed) and national accounts (Thurs) to portray a much more growth-friendly picture for the December 2012 quarter, following a marked soft patch in mid-2012. We estimate that GDP bounced by 1.2%, after just 0.2% growth in the September quarter, with gains across a wide range of industries. Meanwhile, the balance of payments is likely to show that net exports made a positive contribution to growth, while profits of overseas-owned firms in New Zealand picked up.

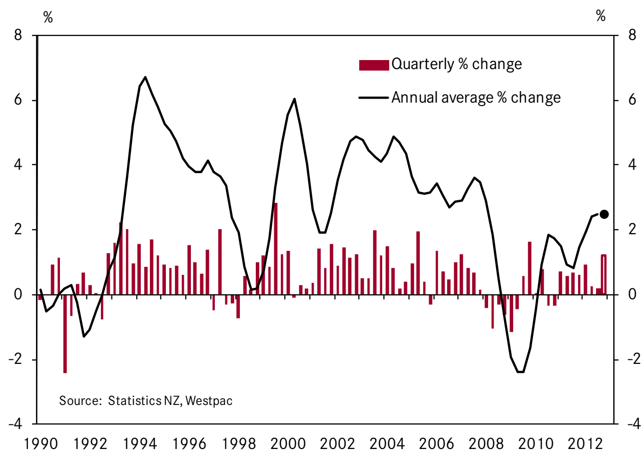
Q4 GDP, 21 March

Our forecast for a 1.2% jump in December quarter GDP largely reflects the economy making up lost ground after a soft patch in mid-2012. A broad range of monthly indicators suggested a short but sharp downturn from June to August in particular; the pickup since September was equally sharp and has continued at least into the first two months of this year.

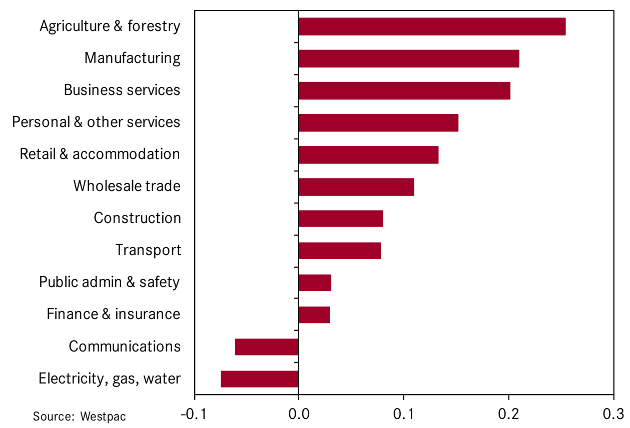
We estimate that the largest positive contribution for the quarter was from agriculture (and consequently food manufacturing). Within the context of excellent growing conditions over 2012, dairy output was down in Q3 compared to Q2; the pace picked up again in Q4. Meat production also rose, supporting the very strong level of exports in Q4.

The other major driver of growth was a bounce across a wide range of services – again, in many cases reversing a sudden decline in the previous quarter. The respective sectoral surveys showed 2% gains in both wholesale and retail trade. Air traffic and road user charges suggest a bounce in the transport sector. And output in many of the personal and business service sectors

Production based GDP



Percentage point contribution to Q4 GDP growth



is measured via hours worked in the Quarterly Employment Survey, which recorded very strong gains in Q4.

Construction was one of the few bright spots in the September quarter; we expect a smaller but still substantial contribution this time. The Building Activity Survey showed that repairs and reconstruction in Canterbury continued to forge ahead in Q4, but there were modest gains across most other regions as well.

The main downside factor for the quarter was electricity, with a drop in the share of higher value-added hydro generation. We've also assumed a 1% drop in communications though – we're not convinced it's well-measured on a quarterly basis, and it tends to get revised up over time.

Q4 current account, 20 March

We expect a widening of the current account deficit from 4.7% to 4.8% of GDP for the year to December. The goods balance is expected to improve in seasonally adjusted terms, with the value of imports falling by more than exports. Export volumes likely retained most of their 5.5% jump in the previous quarter, which was driven by a sharp rundown of meat and dairy product stocks. The fall in import volumes was led by petroleum products, probably due to variation in the timing of shipments.

The investment income deficit is expected to widen for Q4, as profits for overseas-owned firms bounced back from an unusually low level in the September quarter. Stronger economic growth and higher interest rates are likely to widen this deficit further over the next couple of years.

Putting the noise of the current quarter aside, we expect the goods balance to deteriorate over 2013. The drought is weighing on agricultural production. Dairy production is already on a downward slide, while the payback for the drought-induced surge in meat production will come next season (late 2013). Overall, export volumes will take a hit over the next year. Meanwhile, goods import volumes, particularly machinery and equipment, are likely to rise as the Christchurch rebuild continues to ramp up.

Current Account Components ($millions)

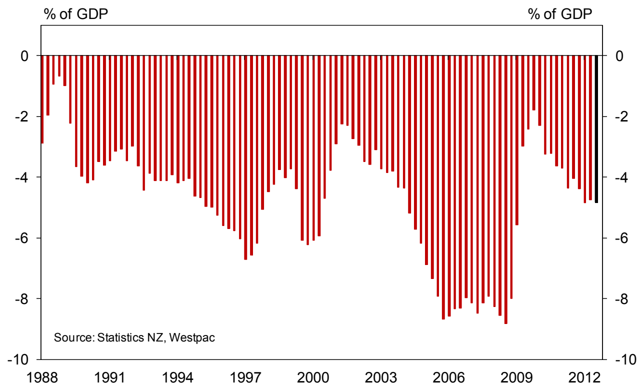
	Mar-12	Jun-12	Sep-12	Dec-12 (forecast)
Goods Balance (s.a.)	107	341	220	610
Services Balance (s.a.)	-218	-216	-303	-110
Investment Income Balance	-2,334	-2,840	-2,261	-2,650
Transfers Balance	-160	-106	-133	-100
Current Account Bal (s.a.)	-2,605	-2,821	-2,477	-2,270
CAB Ann Total	-9,032	-10,087	-9,893	-10,100
Ann CAB, % of GDP	-4.4	-4.8	-4.7	-4.8

Market implications

The GDP release will be of most consequence to markets. The median market forecast is for 0.9% growth; our pick of 1.2% is at the top of the range and we see risks to the upside. An above-market outturn should see a modest rise in interest rates and the exchange rate on the day. However, markets are unlikely to extrapolate growth prospects for 2013 from this number, with concerns about drought now coming to the fore.

Our pick for the current account deficit is similar to the market median of 4.9%, with the range of forecasts tightly bunched around this. Markets have tended not to react strongly to recent current account releases. That's not to say that the number can be ignored, though – the widening of the deficit in the last two years is a product of the re-emerging imbalances in the economy. Low interest rates and a strengthening housing market, combined with the high exchange rate and sluggish demand in many export markets, suggest that these imbalances will become even more pronounced over the next few years.

NZ Current Account Balance



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