Westpac

Institutional Bank

19 June 2014

Mr Consistency

NZ GDP rose 1% in Q1

- GDP rose by 1.0% in the March 2014 quarter, a little less than market expectations, but the third straight quarter of above-trend growth.
- A sharp lift in construction activity dominated the quarter, but a range of other sectors also recorded modest growth.
- With GDP growth consistently running above trend, the Reserve Bank will feel justified in continuing to lift interest rates back towards more normal levels.

Key results

	Actual		Q1 expectations	
	Q4	**Q1**	**Westpac**	**Market**
GDP q/q	1.0	1.0	1.2	1.1
GDP ann % chg	3.3	3.8	3.8	3.7
GDP ann avg % chg	2.8	3.3	3.1	3.1

The New Zealand economy continued to power ahead in the early part of this year, growing at around a 4% annualised pace for the third straight quarter. The construction industry was the major contributor, while a range of other sectors pitched in with modest gains.

While the March quarter result was a little shy of forecasts, upward revisions over the previous year meant that annual growth was ahead of what the market and the Reserve Bank were expecting. For the latter, today's figures will reinforce the sense that the economy has been running ahead of its sustainable pace, and hence that inflation pressures are likely to pick up further from here.

Our view for some time has been that the recent pace of growth is likely to be as good as it gets for this economic cycle. With interest rates rising, the housing market cooling, and the Christchurch rebuild moving closer to its peak level of activity, we should see the pace of growth start to slow, though not dramatically so – our forecast of 3.2% growth next year would still be above-trend, implying a further tightening in the economy's spare capacity and more upward pressure on prices.

Details

GDP rose by 1% over the March quarter, slightly less than our forecast of 1.2% and the median market forecast of 1.1%. (The RBNZ expected a 1.1% increase in its June *Monetary Policy Statement*, but is likely to have revised this up in light of subsequent data.) However, upward revisions to recent history were enough to lift the rate of growth for the year to March up to 3.3%, the fastest pace since the end of the last boom in late 2007.

As expected, a 12.5% jump in construction activity was by far the biggest contributor, accounting for two-thirds of the increase in GDP over the quarter. Given that construction had been effectively flat over the previous two quarters, we suspect that the March quarter surge reflects a catch-up period and/or survey noise. But there is no doubt that the building industry's upturn is well advanced, led by the Christchurch rebuild but increasingly spreading to other regions.

Elsewhere, growth was modest but fairly widespread. Information media and telecommunications rose by 2% (based on our own seasonal adjustment). Retail and hospitality chipped in with a 1.4% increase, though this was attributed to a lift in overseas visitor spending – in fact, on the expenditure measure of GDP, spending by New Zealand households was reported to be flat. There were also notable gains in agriculture (higher milk production), mining, transport and healthcare. Manufacturing was flat overall, with a 0.9% drop in food and beverage manufacturing offset by a 0.5% rise in other industries.

The biggest negatives were in wholesale trade and business services. The former is not of particular concern, as the 1.5% drop followed an outsized 2.7% gain in the previous quarter.

However, the latter is notable as an emerging point of weakness. Real estate and hiring services fell for a second straight quarter, reflecting the drop in house sales since the restrictions on high loan-to-value home loans came into effect last October. And professional services, which were a point of strength in the earlier stages of the upswing, have now fallen for three quarters in a row. Statistics NZ attributed the latest fall to a drop in demand for architects and engineers – a curious result given that both the level and complexity of work involved in the Christchurch rebuild are only heading up.

Market implications

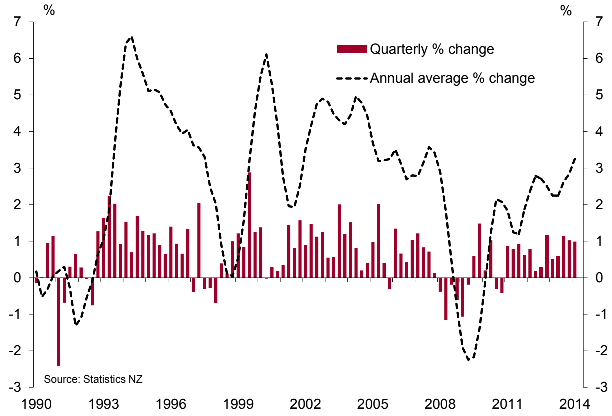
Financial markets edged down in response to the lower than expected quarterly result. The New Zealand dollar fell by around 20pts, while the two-year swap rate fell by four basis points.

Today's release has no major implications for our near-term outlook. The shortfall compared to our forecast seems to be more around technical details of the GDP calculation, rather than anything that you could hang a narrative on. Early indicators are certainly pointing to slower growth in the June quarter compared to March, though in part this may be due to a longer than usual lull in activity over the Easter period. We currently expect a 0.9% increase.

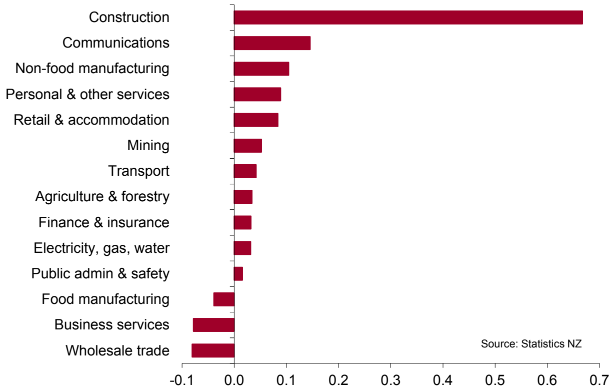
From the RBNZ's point of view, annual GDP growth is now running well ahead of its non-inflationary potential pace. That will only reinforce the RBNZ's view that home-grown inflation pressures are on the rise, even if the strong dollar is helping to dampen the headline rate of inflation. We continue to expect two more increases in the OCR this year, with the next move most likely to come at the July review.

Michael Gordon
Senior Economist

Production-based GDP



Percentage point contribution to Q1 GDP growth



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