Westpac

Institutional Bank

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# A new hope?

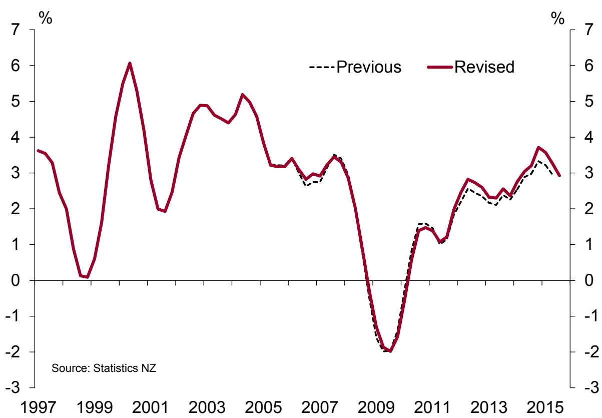
## GDP rose 0.9% in Q3

- GDP grew by 0.9% in the September quarter, in line with our forecast and slightly ahead of market expectations.
- The latest quarter provides a partial offset to the weak outturns over the first half of the year.
- Services and manufacturing accounted for most of the bounce, while agriculture and construction were soft.
- Data revisions revealed that growth over the previous two years was stronger than thought.
- But this also magnifies the degree to which economic growth has slowed this year, even more so in per capita terms.

**Key results**

| | Actual | Previous | Q3 forecasts | |
|---|---|---|---|---|
| | Q3 | Q2 | Westpac | Market |
| GDP q/q | 0.9 | 0.3 | 0.9 | 0.8 |
| GDP ann % chg | 2.3 | 2.4 | 2.4 | 2.3 |
| GDP ann avg % chg | 2.9 | 3.3 | 2.7 | - |

**GDP, annual average % change**




The September quarter GDP report was widely expected to provide a new chapter in the New Zealand economy's ongoing saga, with growth reawakening after a dormant patch in the first half of this year. And while today's release certainly delivered on that front, it actually proved to be more compelling as a 'prequel', retelling past events in a new light.

With that force(d) analogy out of the way, let's look at the details. GDP grew by 0.9% in the September quarter, right on our forecast but ahead of the median market expectation of 0.8% and well ahead of the 0.6% forecast by the Treasury and the Reserve Bank. The strength in the latest quarter goes some way toward making up for the surprisingly soft outturns in the two previous quarters (June quarter growth was revised down a touch to 0.3%, taking it even further from what we initially expected).

More interestingly, the annual round of benchmarking and revisions led to a substantial upgrade to the economy's pace of growth over 2013 and particularly 2014. That new profile actually fits better with the acceleration in New Zealand's population growth over that time. But it also paints the economy's underperformance this year in an even harsher light. Our view is that the pace of growth will remain modest, with the gradual winding-down of the Christchurch rebuild and a possible drought providing further challenges next year.

## Details

The production measure of GDP grew by 0.9% in the September quarter. Economic activity was more domestically-oriented this time, with services accounting for most of the growth. Many of the sectors that recorded the largest gains – such as transport, wholesaling and retailing – were the same ones that were notably soft in the previous quarter.

Food manufacturing was the standout, with a 4.7% increase. Some of this was driven by meat processing, with an unusually high number of dairy cows being sent to slaughter in response to the low expected dairy payout and possibility of drought this season. However, there were also strong gains in fruit and beverages.

Business services were supported by growth in legal and accounting services, and a lift in real estate services as homebuyers rushed in ahead of the new property investment regulations that came into force in October.

Agricultural output fell by 1.5%, with 6% drop in milk production due to dairy farmers scaling down and poor pasture growth at the start of the new season. Forestry contracted for a third straight quarter – another sector scaling back in response to low world prices.

The biggest sour note for the quarter was an unexpectedly large 2.9% fall in construction. This was largely due to a drop in heavy and civil construction, which is quite volatile and difficult to track.

## Data revisions

The revisions to history confirm that the economy had a belter over 2014, with annual growth revised up from 3.3% to 3.7%. While this is a positive development, to some degree it deepens the conundrum faced by the Reserve Bank: with growth so strong, why has inflation been so subdued?

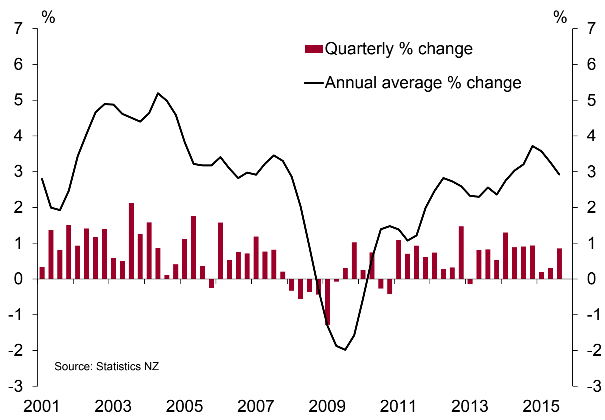
Part of the answer is that solid GDP growth needs to be seen in the context of very strong population growth. Led by a sharp upturn in net migration, New Zealand's population growth accelerated from 0.9% in 2013 to 1.6% in 2014. In that light, the economy's performance in recent years reflects an acceleration in both actual and potential growth.

As for the year to date: with GDP growth slowing to around a 2% annualised pace, and with population growth also pushing towards 2%, we've effectively slowed to zero growth in per capita terms. So it's not surprising that domestic inflation pressures have remained soft, and the unemployment rate has reversed course and headed higher this year.

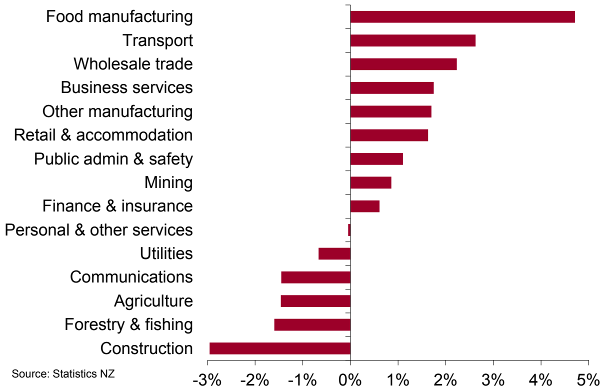
Another part of the answer is that the economy has suffered more of an income shock, via a sharp decline in world prices for our dairy exports. Real gross national income – an alternative calculation that accounts for shifts in the terms of trade – fell by 0.2% in per capita terms, and is down 0.4% in the last year. And in light of the recent discussion of nominal GDP growth as an alternative target for the RBNZ, it's worth noting that this measure has also slowed sharply, from 5.1%yr in 2014 to 2.7%yr today.

**Michael Gordon**
Senior Economist

**Production-based GDP growth**




**Q3 GDP growth by sector**



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