Westpac

Institutional Bank

10 June 2015

Tapping the brakes

Preview of March 2015 quarter GDP (18 Jun, 10:45am) and current account (17 Jun, 10:45am)

- We estimate that GDP rose by 0.6% in the March quarter, a slower pace than in the previous quarter due to the impact of dry weather on milk production and a slowdown in the oil sector.
- We expect the annual current account deficit to widen to 3.6% of GDP as the fall in dairy export prices continues to flow through. However, this was tempered in the March quarter by cheaper oil imports and surging tourist spending.

	Dec 14 actual	Mar 15 Westpac f/c
Balance of Payments (17 Jun)		
Current account balance $m, s.a.	-2,621	-1,800
Annual balance $m	-7,818	-8,720
Annual balance % of GDP	-3.3	-3.6
GDP (18 Jun)		
Quarterly % chg	0.8	0.6
Annual % chg	3.5	3.1
Annual average % chg	3.3	3.3

Next week sees the release of the March quarter national accounts: the balance of payments (Wednesday) and GDP (Thursday). The latter is typically the more important event for financial markets. We estimate that GDP growth slowed to 0.6% for the quarter, which we suspect will put us in the lower half of the range of market forecasts. The widening in the current account deficit is the lagged result of the plunge in dairy export prices, and shouldn't come as a surprise.

How the market would react to a softer GDP read depends on where things stand after tomorrow's *Monetary Policy Statement*. In its April OCR review the Reserve Bank said that it would be appropriate to lower the OCR if demand weakens. The slower pace of growth that we're forecasting for the March quarter does not, in our view, constitute such a weakening in demand. Indeed, the details suggest that domestic demand remained in fine form, with the slowdown largely coming from temporary hits to production in the primary sectors. But that could prove to be a moot point, if the RBNZ decides that the case for OCR cuts now rests on other factors.

Q1 GDP, 18 June

Our forecast of a 0.6% increase in GDP for the March quarter compares to a 0.8% rise in the December quarter, and an average quarterly pace of just under 0.9% in the last year. Even so, our forecast would be enough to maintain the annual pace of growth above 3%, a pace that until recently hadn't been achieved since 2007.

The factors weighing on our growth forecast for the March quarter are centred in the primary sectors. The first is in agriculture, specifically the spell of dry weather early this year which reduced milk production by 4% in seasonally adjusted terms. In fact the dry spell ended up being less severe than initially feared: three months ago we were expecting March quarter GDP growth to be dragged down to just 0.4%. The flipside of this is that the return to normal levels of farm output won't provide as much of a boost to growth over the rest of this year as initially thought.

The other potential negative is in the oil sector, though this is highly uncertain. Anecdotally, the plunge in world oil prices has knocked the stuffing out of onshore oil exploration and drilling. But we simply don't have any data on this to guide our forecast. We also know that the mining component of GDP is very volatile, so the 5% or so downturn for the sector that we've pencilled in is far from outlandish.

Looking past these temporary factors, the indicators point to solid growth almost across the board in the services sectors, which account for about 70% of the economy. Retail spending was a particular standout, recording a 2.7% jump in the March quarter on top of a 1.9% rise in the December quarter. Corroborating data shows a surge in overseas visitor spending over the last two quarters, implying that spending by New Zealanders grew at a solid but more sustainable pace.

The construction sector also managed a solid gain, although the days of rampant growth appear to be in the past, especially with the Christchurch rebuild now well advanced. We expect the level of quake-related building activity to peak by early next year, though within that total body of work there are already significant changes going on: housing repairs are nearing completion and new home builds look to be peaking, while commercial construction is due to ramp up.

We've also pencilled in a strong lift in the telecommunications sector – though as with the mining sector, it's based on anecdote more than hard data. The proliferation of on-demand film and TV services in recent months has reportedly led to a massive rise in broadband data usage, which is one of the indicators that Statistics NZ uses to calculate GDP for this sector.

Q1 current account, 17 June

We expect the annual current account deficit to widen from 3.2% to 3.6% of GDP. Reporting the deficit on an annual basis means that to some degree it's affected by what was happening the same time a year ago – that is, when both prices and volumes of dairy exports were hitting record highs. The subsequent steep fall in dairy export earnings will continue to drag the current account balance lower over the next year.

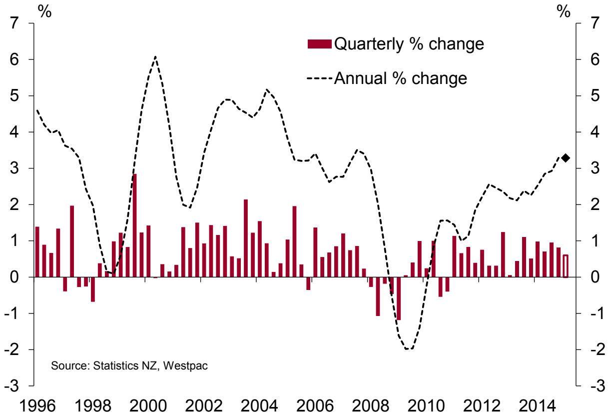
For the March quarter itself, however, we expect to see a modest improvement in the balance compared to December. As shown in the Terms of Trade earlier this month, the fall in export commodity prices in the March quarter was more than offset by a plunge in the price of imported fuel (which accounts for about a sixth of New Zealand's imports). There was also a modest lift in the volume of exports, while import volumes were flat. Together, these point to a swing in the quarterly goods trade balance from a deficit of $450m to a surplus of around $200m in seasonally adjusted terms.

The March quarter will also feature a major improvement in the balance of trade in services, reaching its biggest surplus in seasonally adjusted terms since 2004. Spending by overseas visitors to New Zealand has risen sharply in each of the last two quarters; inspecting the detailed data suggests that the March quarter growth was associated more with the Lunar New Year than the Cricket World Cup.

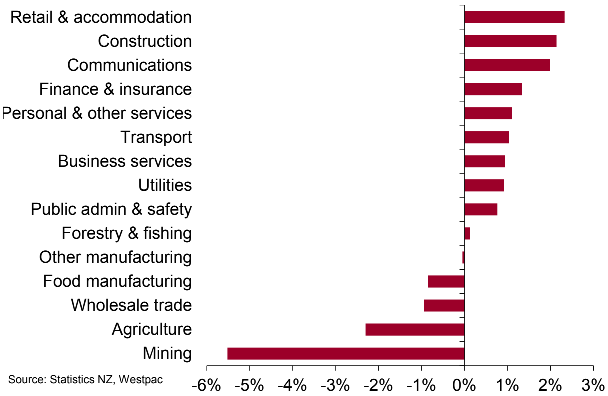
Against these two substantial improvements, we expect to see a modest widening in the investment income deficit. We expect a rise in the outflow of profits from overseas-owned firms operating in New Zealand, while lower interest rates in the rest of the world may have dragged down returns on New Zealanders' overseas investments.

Michael Gordon
Senior Economist

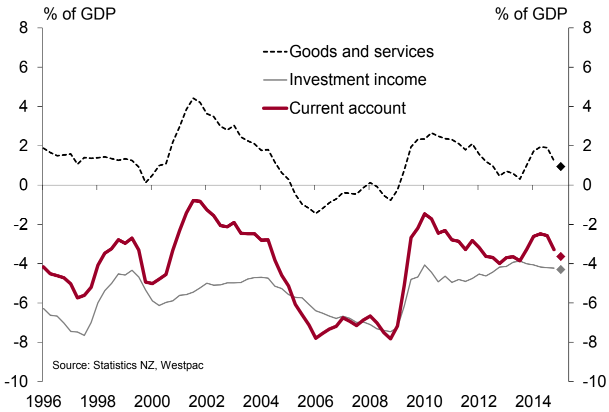
Production-based GDP growth



Q1 GDP growth by sector



Annual current account balance



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