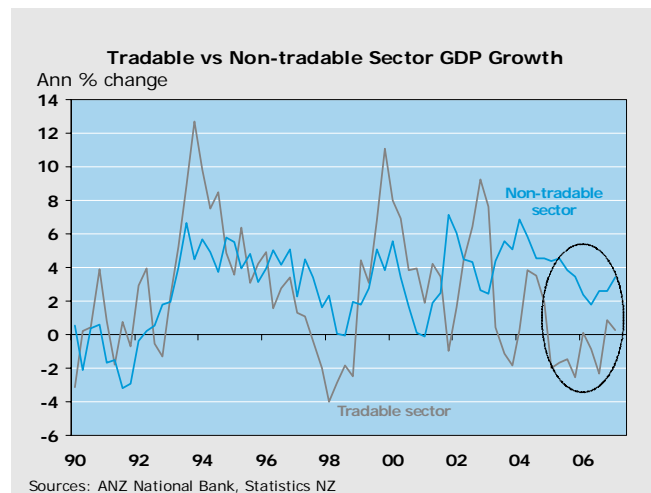
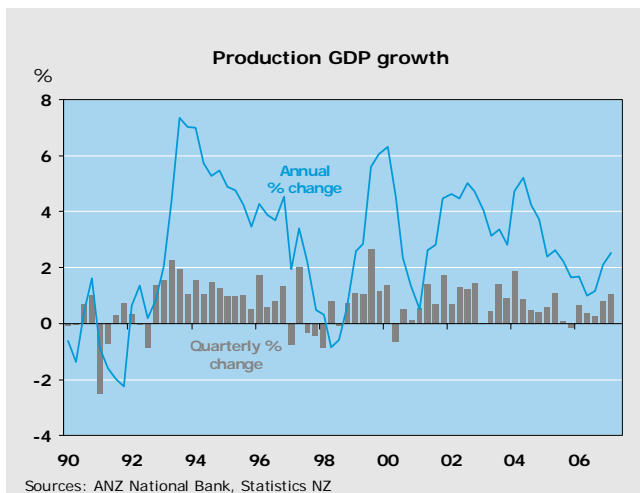


GROSS DOMESTIC PRODUCT – MARCH 2007 QUARTER

Key points

- **Headline GDP printed at 1.0 percent, in line with our and market expectations.**
- **The expenditure measure came in below the production measure at 0.6 percent, reversing the trend of the last two quarters when expenditure printed above the production measure.**
- **At the margin, today's GDP report looks a tad higher than the Reserve Bank's core forecast. But we note that their Q2 GDP forecast of 0.8 percent is looking high. On balance, we see no smoking gun to push the panic button.**
- **While the Reserve Bank will not be too distressed by today's data, the fact that the net external sector continues to be a drag on growth, domestic demand remains strong and the Reserve Bank is yet to see clear signs of a sustained slowdown, means they will remain very watchful. Q2 CPI due on July 16 remains the key for the July OCR Review.**

	Actual	ANZ-National	RBNZ	Market
Gross Domestic Product	1.0% qoq 2.5% yoy 1.7% ann.	1.0% qoq 2.4% yoy 1.7% ann.	0.8% qoq 2.2% yoy 1.6% ann.	1.0% qoq 2.4% yoy 1.7% ann.



Today's GDP report confirmed that economic activity rebounded strongly in the first quarter of this year. Headline production GDP grew by 1.0 percent in the quarter, in line with our and market expectations. This took the annual pace of growth to 2.5 percent and annual average growth to 1.7 percent. In line with previous quarters, growth was once again driven by the services industries, which expanded by 1.2 percent in the quarter. Industries leveraged to households again performed well, with the retail and finance, insurance and business services sectors accounting for most of the growth in the quarter. The manufacturing sector managed to reverse the previous three quarterly declines, posting a 1.1 percent increase in the March quarter.

On an expenditure basis, GDP growth recorded a more modest 0.6 percent increase. Domestic demand was once again the main driver, with GNE recording a 1.2 percent increase in the March quarter, following on from the 2.5 percent increase in the previous quarter. Strength in domestic demand was despite a rundown in inventories which shaved 0.6 percentage points off GDP growth. Both private and public consumption grew strongly, up 2.1 and 0.9 percent respectively. Residential investment activity was soft, but investment in other assets grew strongly. The external sector was a drag on growth despite a 2 percent increase in export volumes, with imports growing by a stronger than expected 4.3 percent.

The implicit price deflators are showing a faster rate of increase for the GNE deflator compared to GDP on an annual basis. As the GDP deflators are the broadest measure of overall price changes in the

economy, they point to domestically generated inflation continuing to remain high and persistent. For the quarter, the GDP deflator increased by 0.9 percent while the GNE deflator rose by 0.7 percent.

Expenditure GDP Components – March 2007 quarter	Percentage change from previous quarter	Percentage point contribution to change	Percentage change in annual values
Private Consumption	2.1	1.3	2.4
Public Consumption	0.9	0.2	4.2
Residential Investment	-0.3	0	-2.1
Other Investment	5.2	0.9	-3.6
Exports	2.0	0.6	3.2
Imports	4.3	-1.4	-1.3
Change in Inventories and Balancing Item	..	-1.0	..
Gross Domestic Product (Expenditure)	0.6	2.7	2.0
Gross Domestic Product (Production)	1.0	2.5	1.7

Assessment and implications

We are not reading too much into the weaker expenditure GDP number. While the 0.6 percent increase in expenditure GDP is below the Reserve Bank's 0.8 percent forecasts, this should not be read as giving them any comfort. We note that expenditure GDP has been growing stronger than production GDP over the past two quarters, and a reversal was always going to happen at some stage. The production GDP measure remains the preferred series, and confirms that economic activity rebounded strongly early this year.

The tradable sector continues to struggle, while activity in the non-tradable sector has been picking up. Despite a rebound in manufacturing production, the tradable sector remains effectively in recession mode and has been for the past few years. It is not only exporters that are straining under the high NZD, but also domestic firms having to compete against cheaper imported alternatives. In contrast, the non-tradable sector has seen activity rebound in recent quarters – a development that will continue to concern the Reserve Bank. The Bank has been trying to engineer a rebalancing of growth away from the non-tradable towards the tradable sector, but this adjustment process is yet to take hold. Although yesterday's Balance of Payments data showed an improvement in the annual current account deficit, the seasonally adjusted and trend measure of the current account showed a deterioration in the last two quarters.

The fact that domestic demand was once again the main driver of expenditure GDP, with private consumption up 2.1 percent in the quarter, means the RBNZ cannot afford to drop its guard. The expenditure GDP measure was also pulled lower by stronger than expected imports and an inventory rundown that shaved 0.6 percentage points off growth. This indicates that growth over Q2 will benefit from a rebound in stock building, although this should be countered in part by softening in domestic demand and higher imports.

Net on net, growth looks to be panning out in line with the Reserve Bank's expectations. At the margin, the composition to today's GDP figures is slightly stronger than what the Reserve Bank was forecasting in their June *Monetary Policy Statement*. But we note that the Reserve Bank are forecasting a 0.8 percent increase in Q2 GDP, which is looking on the high side given the decline in April retail sales and softening in other partial indicators relating to Q2, such as easing confidence and a flattening in house sales.

On balance, today's GDP report looks a tad higher than the Reserve Bank's core forecast, although we see no smoking gun to push the panic button. Overall, while the RBNZ will not be too distressed by today's data, the fact that the net external sector continues to be a drag on growth, domestic demand remains strong and the Bank is yet to see clear signs of a sustained slowdown, means they will remain very watchful. Q2 CPI due on July 16 remains the key for the July OCR Review.

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