

### Gross Domestic Product – December 2008 quarter

#### Key points

- > **The economy contracted for the fourth consecutive quarter.**
- > **Further weakness to come as production weighed by inventory de-stocking, but also as global headwinds being to fully manifest.**
- > **Weak import number for February points to further weakness in domestic demand in Q1.**
- > **While today's data was in line with the RBNZ's expectations, recent moves in swap rates and the NZD do them no favours and this could yet force the Bank to do more.**

#### Assessment

**The economy contracted for the fourth consecutive quarter.** On a production basis, GDP fell by 0.9 percent, slightly below market expectations of a 1.0 percent fall. However, considering the September quarter was revised down to -0.5 percent (from -0.4 percent), today's numbers could be classed as being broadly in-line with expectations. The contraction in activity in the December quarter was the largest one of the recession to date, and is also the largest quarterly fall in GDP since the September 1992 quarter.

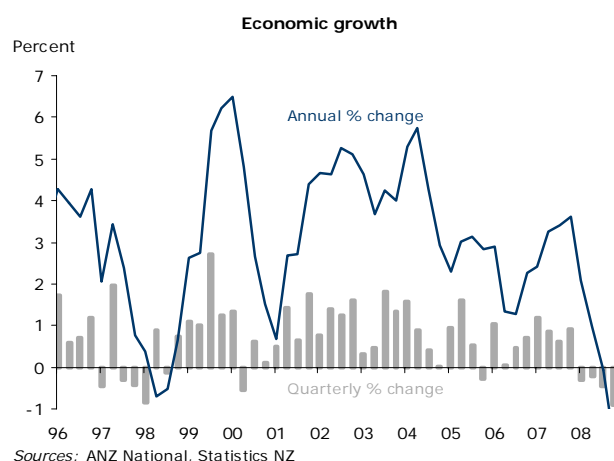
**Weakness in manufacturing, construction and wholesale trade dragged down activity, but strength in financial services was a surprise.**

Goods producing industries fell 3.6 percent in the quarter. Services industries rose 0.8 percent, led by a surprising 2.2 percent rise in finance, insurance and business services, which contributed a massive 0.6 percentage points to growth. Statistics NZ report that is was due to increased activity in the banking sector. Considering weak housing market activity and slowing demand for credit, this is somewhat of a surprise, and the key reason why the outturn was better than our -1.2 percent pick. We are at a loss to explain why the finance and insurance sector GDP is up 5.8 percent from a year ago, when overall GDP is down 1.9 percent. Timing issues perhaps? In which case, an unwind could be on the cards in the coming quarters.

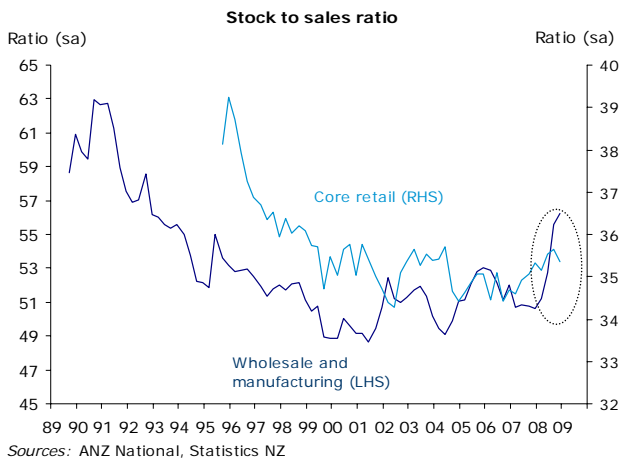
**Expenditure GDP growth contracted by a smaller 0.6 percent.** For the first three quarters of 2008, expenditure GDP growth was weaker than the production measure, reflecting the domestic demand driven nature of the recession. The contraction in production GDP was larger in the December quarter, as it plays catch-up. We expect this pattern to continue in the next few quarters. In terms of the expenditure components, private

consumption was flat, residential investment tumbled 14 percent and other investment fell 1.8 percent. Inventories shaved 1.2 percentage points off growth, mainly due to de-stocking in the distribution sector. Government expenditure (up 1.7 percent) and net exports (contributing 1.1 percentage points) were the components to partly offset weakness from other areas.

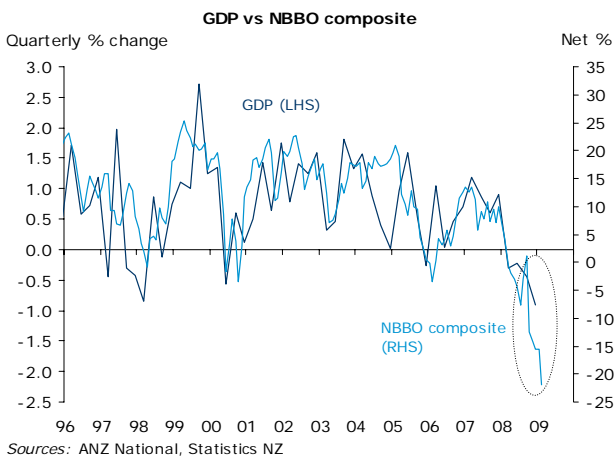
	GDP (qtr % chg)	GDP (ann % chg)	GDP (ann ave % chg)
Dec-06	0.7	2.3	2.0
Mar-07	1.2	2.4	1.8
Jun-07	0.9	3.3	2.3
Sep-07	0.6	3.4	2.8
Dec-07	0.9	3.6	3.2
Mar-08	-0.3	2.1	3.1
Jun-08	-0.2	1.0	2.5
Sep-08	-0.5	-0.1	1.7
<b>Dec-08</b>	<b>-0.9</b>	<b>-1.9</b>	<b>0.2</b>
<b>ANZ</b>	<b>-1.2</b>	<b>-2.1</b>	<b>0.2</b>
<b>RBNZ</b>	<b>-0.8</b>	<b>-</b>	<b>0.3</b>
<b>Market</b>	<b>-1.0</b>	<b>-1.9</b>	<b>0.3</b>



**Inventory de-stocking should continue to weigh on production.** Despite the negative contribution from inventories in today's data, the level of inventories across the economy remains high. The sharp slowing in domestic demand at a time when imports were still at an elevated level (although this is also now adjusting), left plenty of stock on shelves and is only now starting to be reduced. Production levels will obviously be adjusted accordingly and see activity remain weak for a time yet.



**In fact, we expect the March quarter to record another, if not larger, fall in activity.** Certainly, our National Bank *Business Outlook* composite index is pointing to that. While there are some very early signs of stabilisation in the housing market (at least on the volume side), other pockets of the economy remain under pressure. Car registrations continue to fall, and building consents are at levels last seen in 1965. The weakness over 2008 was largely domestic led. The first half of 2009 will be where the full brunt of the global recession will impact on the NZ economy.



**If anything positive can be taken from the numbers today, it is that the economy is slowly rebalancing.** We have long argued for the need to shift from spending towards the earnings side of the economy. While it is very early days, today's data does show that this process has

begun. Consumption growth remains subdued, residential investment has capitulated and imports are now tumbling. While far from painless, this is an adjustment the economy needed to embark on to correct massive imbalances (current account deficit and household debt-levels). The trouble at present though, is that the weaker global economy will hamper the ability for exports to fill the domestic demand void. This leaves the economy without any "growth engines" in the near term.

**The trade data today also reinforces this theme.** Released at the same time as the GDP data today was overseas merchandise trade data for February, showing a \$489 million surplus. While February typically records a trade surplus, the weaker domestic economy is now clearly weighing on imports, which are down 14.2 percent from a year ago – the sharpest fall since February 1993. However, exports are also weakening, to be down 6.6 percent on a year ago. The improvement in the trade data bodes well for the March quarter current account, which is likely to show an improvement. But the recent resurgence in the currency, if sustained, could yet hamper the export recovery we are relying on.

**Implications**

**Data aside, recent financial market developments may mean the RBNZ has to do more.** The GDP data today was broadly in line with the RBNZ's March *Monetary Policy Statement* projections of -0.8 percent. However, recent moves in the NZD and in swap rates have tightened monetary conditions significantly – and at a time when the economy is yet to show sustained signs of stabilisation. It may yet force the RBNZ's hand to do more, either on the rate cut front, or in signalling the potential for rates to remain at low levels for an extended period. We believe a combination of both is likely.

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