

# NEW ZEALAND ECONOMICS DATA REVIEW

## Gross Domestic Product – September 2010 quarter

23 December 2010

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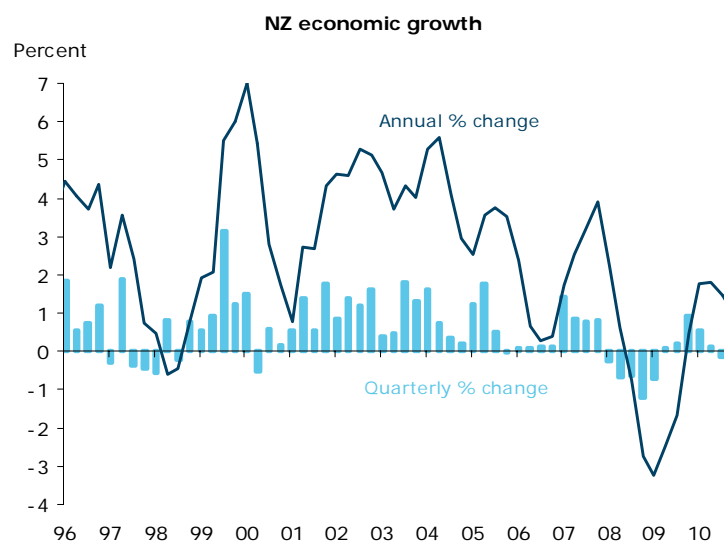
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## NZ ECONOMY STALLS OVER THE WINTER MONTHS

### KEY POINTS

- The NZ economy continued to lose momentum in the winter months of 2010, with a 0.2 percent fall in economic activity weaker than market expectations but in line with our pick.
- Despite increasing durable consumption household spending was subdued, with a sizeable decline in residential investment. Business investment was flat with stronger plant and machinery investment, offset by lower transport and non-residential construction. While inventories made a positive contribution to growth, this was partly offset by a negative contribution from net exports.
- The production based measure show wide sector divergences, with large falls in the primary (down 2.6 percent) and goods producing sectors (down 1.6 percent). Lower agricultural, manufacturing, and construction sector output were influential. Services output managed a 0.3 percent increase.
- The RBNZ is well and truly on hold until at least June next year, and a later resumption of the tightening cycle cannot be ruled out. There are a number of headwinds still facing the New Zealand economy, with deleveraging still a powerful growth suppressant. We still see better prospects but this is very much a second half of 2011 story



Sources: ANZ, National Bank, Statistics NZ

## DATA REVIEW

## DATA WRAP

**GDP in Q3 was weaker than market expectations declining by 0.2 percent.** It was also weaker than the 0.3 percent that the RBNZ forecast in the December *Monetary Policy Statement*.

GDP	QoQ	YoY	Ann Ave%
Q2 2008	-0.7	0.6	2.5
Q3 2008	-0.6	-0.7	1.5
Q4 2008	-1.2	-2.7	-0.2
Q1 2009	-0.7	-3.2	-1.5
Q2 2009	0.1	-2.5	-2.3
Q3 2009	0.2	-1.7	-2.5
Q4 2009	0.9	0.5	-1.7
Q1 2010	0.6	1.8	-0.5
Q2 2010	0.1	1.8	0.6
<b>Q3 2010</b>	<b>-0.2</b>	<b>1.5</b>	<b>1.4</b>
<b>ANZ</b>	<b>-0.1</b>	<b>1.6</b>	<b>1.5</b>
<i>RBNZ</i>	0.3	1.9	1.6
Market	0.1	1.7	1.6

**Expenditure GDP fell by 0.4 percent. There were some large offsetting movements but the spirit is of economic weakness.**

**Household consumption growth expanded 0.5 percent.** While there was certainly a rise in durable spending (up 0.9 percent) as consumers got in before the GST rise, services and non-durable spending was flat. It is a sign that households remain cautious and continue to focus on repairing balance sheets.

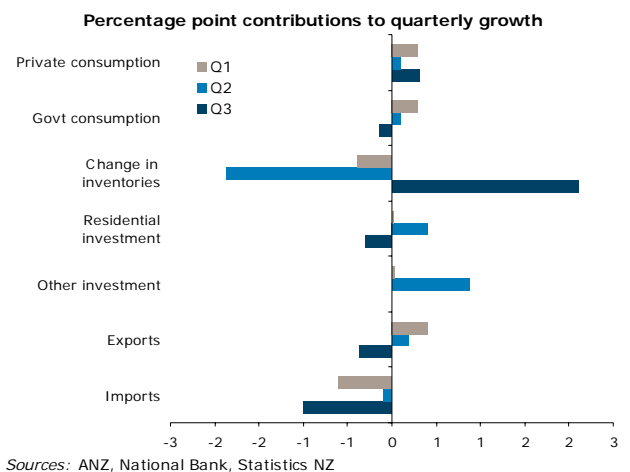
**Spending on housing also appears to be taking a back seat** going by the 7.4 percent decline in residential investment. Lower work put in place and the 13 percent Q3 decline in house sales weighed. Forward looking indicators suggest residential activity will remain subdued over the remainder of 2010. While earthquake related construction work will support residential activity from the second half of 2011, residential construction prospects until then look subdued. **A cautious household sector matters for growth as it accounts for around two-thirds of GDP.**

**Government consumption declined 0.6 percent,** but this was due to the acquisition of military equipment, which had boosted the previous two quarters. Higher government spending has been one of the key supports to the New Zealand economy over the last few years. However, it has come at a cost with rising fiscal deficits highlighting our external vulnerability. With the focus of the

government on adhering to expenditure restraint, the upshot will be that such increases in 2011 will be hard to find.

**Business investment was mixed, illustrating an economy at the cross-roads.** Encouragingly for supply-side capacity, plant and machinery investment managed a further increase, but this was offset by weaker transport equipment and lower non-residential building activity. Business investment still remains 13 percent below its mid-2008 peak. The addition of productive capacity is sorely needed to achieve decent medium-term growth performance and ensure that medium-term inflation trends remain contained.

**Inventories contributed 2.1 percent to growth.** This was to be expected after the large negative contribution in Q2. However, it only masks weak underlying momentum within the economy. About half of the inventory contribution was due to the seasonal balancing item, which should reverse in the coming quarters. **Weaker net exports partly offset this, making a 1.2 percent negative contribution.** Export volumes declined 1.1 percent, with export volumes for meat, wool and wood products, and dairy declining (by 17, 8.9, and 6 percent respectively). Exports of services managed a 0.9 percent increase, largely on account of more overseas visitor arrivals. Import volumes continued to recover from low levels, rising 3.0 percent, with strength evident in plant and machinery imports.



**On the production side, the GDP release highlighted sector divergences.** Output was weighed down by weaker primary and goods sector production. Primary sector output fell 2.6 percent. Due to lower livestock production, agricultural activity declined 1 percent. Mining activity slumped 6.9 percent, due to a decline in extraction and exploration activity. Dairy production managed a

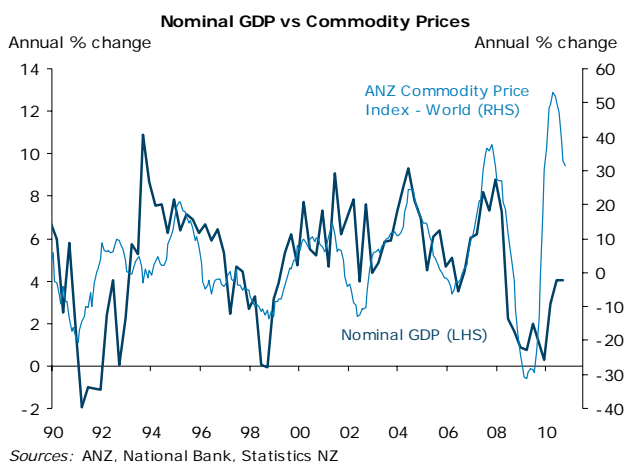
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small increase as production recovered from drought related disruptions from earlier in 2010.

**Goods production fell 1.5 percent.** Weaker construction (down 2.5 percent), manufacturing (down 1.7 percent) and mining (down 6.9 percent) were influential. Weakness in manufacturing activity was particularly evident in machinery and equipment manufacturing (down 4.2 percent), and wood and paper products (down 1.6 percent). Offsetting this was a 1.2 percent increase in the electricity, gas and water component, due to higher generation and supply.

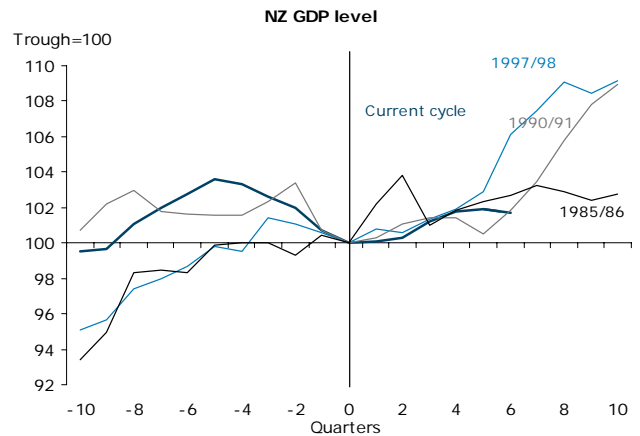
**Activity in the services sector was mixed, rising 0.3 percent.** Stronger transport and communications activity (up 2.1 percent) and wholesale trade (up 2.4 percent), offset a 0.2 percent fall for the finance, insurance and business services sector.

**The improving terms of trade helped offset weakness in expenditure activity, with nominal GDP managing a 0.1 percent quarterly increase.** Given the extent of export commodity price increases, there is scope for more to come. Rising national incomes are a key medium-term positive development for the New Zealand economy. For the moment, however, ongoing deleveraging and a number of other short-term headwinds appear to be having more influence.



**Since the end of the recession, economic activity has been subdued, with growth only averaging 0.3 percent a quarter.** Considering the degree of economic slack that normally emerges during a recession, this growth performance is very poor indeed. It is a sign that deleveraging is holding growth back, and given that there is still some way to go in this regard, economic performance over the next few quarters is likely to remain modest. Earthquake related

reconstruction will provide a boost to activity but there does not appear to be signs of a broad-based recovery emerging just yet.



There were some revisions to the historical GDP estimates. In effect these were minor, lowering the level of GDP by 0.1 percent by 2010Q2.

## ASSESSMENT

**After starting the year on a more promising note, the New Zealand recovery has run out of puff.** The more subdued pace of activity is in marked contrast to most other cyclical recoveries that the New Zealand economy has experienced over the past few decades. Since emerging from recession, growth has been anaemic and not of the above-trend variety normally expected from typical cyclical rebounds. Accommodative monetary policy and high commodity prices are helping, but the headwinds of a strong NZD/USD currency, the move to contractionary fiscal policy, a dead housing market, adverse weather and ongoing debt reduction will continue to have the upper hand in the short-term.

**Next year will be a year of "grumpy growth", focused in the second half of the year.** The global economy is not out of the woods by any stretch of the imagination. The process of balance sheet repair has further to run and, in combination these factors will continue to dampen demand over the first half of 2011. **Based on today's GDP numbers, the RBNZ is well and truly on hold until at least June and possibly later.**

**Nevertheless, we continue to expect a better 2011.** The more the economy undertakes the necessary adjustment now, the sooner it will set the stage for a more robust and sustainable recovery. The Rugby World Cup and reconstruction of Canterbury will assist growth next year as well, **but these appear to be a later in 2011 story.**

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