NEW ZEALAND ECONOMICS
DATA REVIEW

Gross Domestic Product – March 2010 quarter

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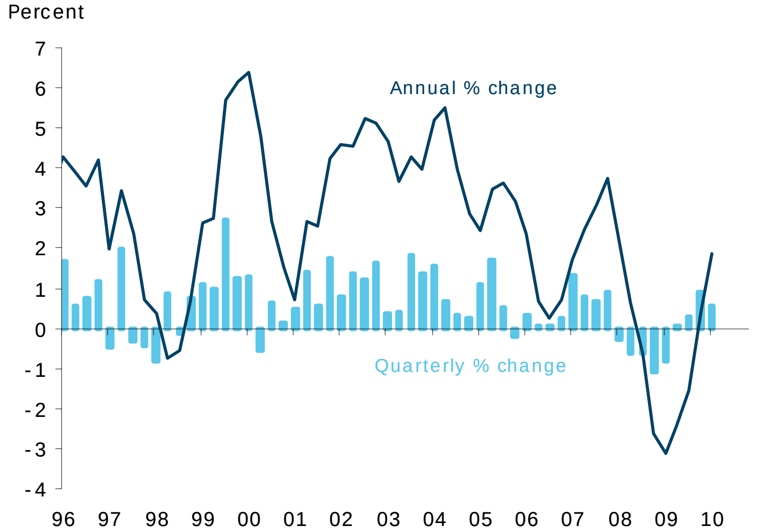
ECONOMIC RECOVERY CONTINUES

KEY POINTS

- Economic activity expanded by 0.6 percent in Q1, broadly in line with expectations. The economy has been expanding for four consecutive quarters, and is set to expand further.
- The manufacturing, wholesale and forestry sectors contributed most of the growth in the quarter. Strong demand for NZ's forestry products from China and a favourable NZD/AUD cross rate during the quarter no doubt assisting.
- Despite the economy now out of recession for a year, we are only halfway through in terms of recouping the lost output during the recession. The level of GDP is 1.6 percent below the Q4 2007 peak.
- But forward indicators point to accelerating momentum in the economy, particularly for nominal GDP.
- While today's GDP outturn was below the RBNZ's 0.8 percent forecast, it does not alter their outlook for policy. We continue to envisage a rate hike in July, followed by two more to take the OCR to 3.5 percent, before pausing to assess the impact.

NZ economic growth



Sources: ANZ, National Bank, Statistics NZ

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DATA WRAP

GDP growth of 0.6 percent was recorded for the first quarter of 2010, broadly in line with market expectations of a 0.5 percent increase. Activity in the December 2009 quarter was revised up by 0.1 percent (to 0.9 percent q/q) but this was offset by downward revisions in previous quarters, with the level of economic activity in the June 2009 trough now 0.1 percent lower.

The expansion was largely driven by higher production in the income generating parts of the economy.

Primary sector volumes increased by 1.7 percent in March. The forestry and logging sector also experienced strong activity (helped by strong demand from China), expanding by 5.3 percent in the quarter and contributing 0.1 percentage points to growth. Higher mining sector activity (up 4.5 percent) largely as a result of more extraction activity also boosted primary sector volumes. Despite dry weather conditions, agricultural production managed to eke out a 0.8 percent quarterly increase, largely on a count of higher dairy production.

Higher manufacturing sector output contributed 0.2 percentage points to the quarterly expansion in GDP. The standout performers were sizeable increases in machinery and equipment manufacturing (up 7.7 percent) and metal product manufacturing (up 7.2 percent). With around half of our manufactured exports destined for Australia, the strong growth in the Australian economy appears to be playing a key role in the revival of manufacturing sector activity in New Zealand. No doubt, the low NZD/AUD will be playing a supporting role. However, manufacturing activity remains nearly 10 percent below 2007 peak levels.

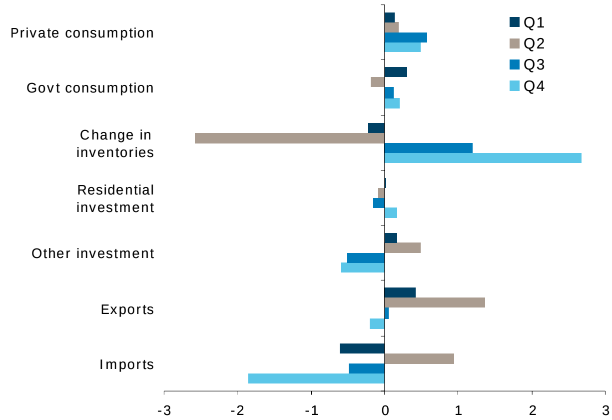
Activity in the services sector was a mixed bag increasing by 0.3 percent in the quarter. The continued rebound in wholesale trade (as distribution inventories were rebuilt) was mostly offset by lower activity in a number of services components. With discretionary consumer spending under pressure retail volumes fell, with lower communications activity weighing down on services volumes.

The expenditure based measure of GDP also increased by a quarterly 0.6 percent. Higher central government consumption made up most of the growth, growing by 1.9 percent and adding 0.3 percentage points. However, rather than reflecting increased core government spending, this was boosted by the delivery of a $93m offshore patrol vessel HMNZS Otago. Excluding this, central government expenditure would have grown by 0.8 percent.

GDP	QoQ	YoY	Ann Ave%
Q2 2008	-0.6	0.7	2.4
Q3 2008	-0.6	-0.7	1.5
Q4 2008	-1.1	-2.6	-0.2
Q1 2009	-0.8	-3.1	-1.5
Q2 2009	0.1	-2.4	-2.2
Q3 2009	0.3	-1.5	-2.4
Q4 2009	0.9	0.5	-1.6
Q1 2010	**0.6**	**1.9**	**-0.4**
ANZ	**0.5**	**1.8**	**-0.4**
RBNZ	0.8	2.0	-0.3
Market	0.5	1.8	-0.4

Private consumption growth was a modest 0.2 percent, which reflects the general cautious mood amongst consumers. The rise in durable consumption volumes (up 2 percent q/q) was no doubt influenced by aggressive retail discounting. Non-durable (down 0.7 percent) and services (down 0.1 percent) consumption were considerably more circumspect. Mostly as a consequence of the large fall in housing transactions, the 0.5 percent rise in residential activity was lower than implied by the increase in residential work put in place volumes.

Percentage point contributions to quarterly growth



Sources: ANZ, National Bank, Statistics NZ

Other investment growth was also fairly subdued, growing by 0.9 percent. Increasing exploration activity boosted intangible investment and increased investment in infrastructure provided support to other construction activity. These were partly offset by lower non-residential and transport equipment investment. Of some concern for the supply-side performance of the economy, plant and

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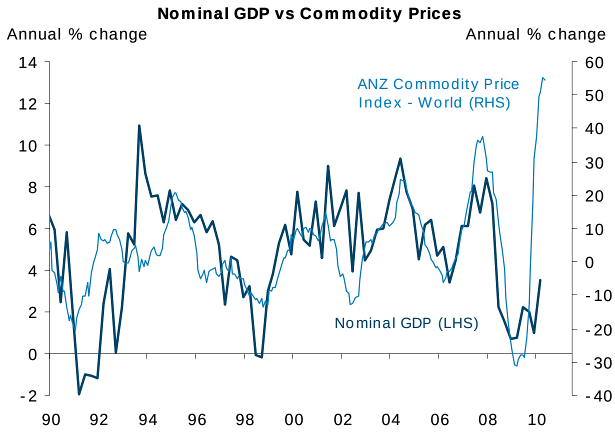
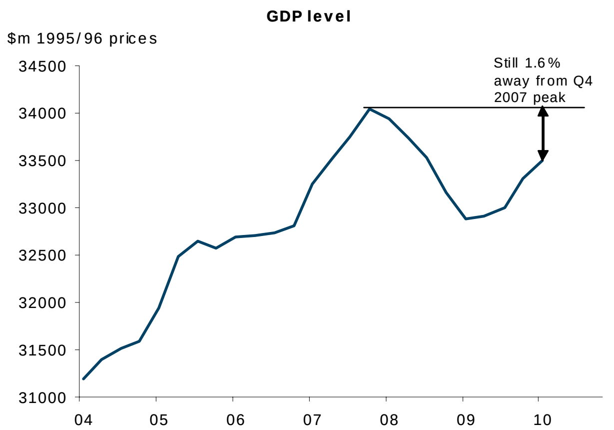
machinery investment barely moved this quarter (down 0.3 percent qoq), with the level of investment approximately 16 percent below March 2009 levels. With the economic expansion having been in place for at least a year, the productive capital stock will need to be added to so that growth in the economy's productive capacity can be maintained.

Higher primary and manufacturing volumes boosted good export volumes by 3.4 percent in March. Of some concern, however, lower spending by overseas visitors contributed to a 2.4 percent fall in services export volumes. We do not expect a rebound in services exports until the second half of 2010 given recent ructions in European financial markets and disruptions from Volcanic Ash.



Sources: ANZ, National Bank, Statistics NZ

The improving terms of trade was the key driver in delivering a 2.5 percent quarterly increase in nominal GDP. With New Zealand's commodity export prices having climbed further since March commodity prices, further strong growth in nominal GDP in the coming quarters is in prospect.



Sources: ANZ, National Bank, Statistics NZ

However, there is still someway to go. A year out from the recession, the level of GDP is still 1.6 percent below the Q4 2007 peak. We are only half way through recouping the output lost during the recession.

ASSESSMENT

Overall, the broad story from today's GDP release is that the economy continues to recover, but the speed of the recovery is more muted compared to past cycles. **This reflects the deleveraging nature of the recovery, and the need for the economy to continue rebalancing away from the spending side towards the earning side. The process has begun, but there is still some way to go.** We expect momentum to gather pace as record high commodity prices flow through into higher rural incomes, which in turn will lead to increased activity.

Today's GDP outturn was slightly weaker than the 0.8 percent increase expected by the RBNZ. However, they will be pleased that the income generating side of the economy continues to lead the expansion. The RBNZ will also be comforted that consumers are remaining circumspect in their spending decisions.

With the recovery still on track and forward indicators looking positive, we expect the RBNZ to continue removing policy stimulus with a hike in July, followed by two more to take the OCR to 3.5 percent. We envisage a pause thereafter as the Bank assesses the impact of the rate hikes on the economy.

Of some concern, however, will be the failure of business investment to play a more meaningful role in the expansion. With inflation set to move higher over the next year, partly due to government policy changes, the addition of productive capacity is sorely needed to ensure the medium-term trend inflation remains contained.

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- Associate Member of Investment Savings & Insurance Association of NZ;
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- Adjudicated bankrupt;
- Prohibited by an Act or by a court from taking part in the management of a company or a business;
- Subject of an adverse finding by a court in any proceeding that has been taken against them in their professional capacity;
- Expelled from or has been prohibited from being a member of a professional body; or
- Placed in statutory management or receivership.

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- Superannuation schemes and bonds;
- Group investment funds;
- Life insurance products;
- Derivative products including interest rate and currency forward rate contracts and options; and
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- Making an automatic payment or payment through another electronic delivery mechanism operated by the Bank.

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Any investment money lodged with the Bank for the purchase of securities offered by the Bank, its subsidiaries or any third parties will be deposited in accordance with your instructions, to your nominated account or investment. Such money will be held by the Bank according to usual banking terms and conditions applying to that account or the particular terms and conditions relating to the investment and will not be held by the Bank on trust unless explicitly accepted by the Bank on those terms. Any investment money or property accepted by the Bank on trust will be so held until disbursed in accordance with your instructions. Any investment property lodged with the Bank will be held by the Bank as bailee according to the Bank's standard terms and conditions for holding your property.

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