

# NEW ZEALAND ECONOMICS DATA REVIEW

## Gross Domestic Product – March 2011 quarter

14 July 2011

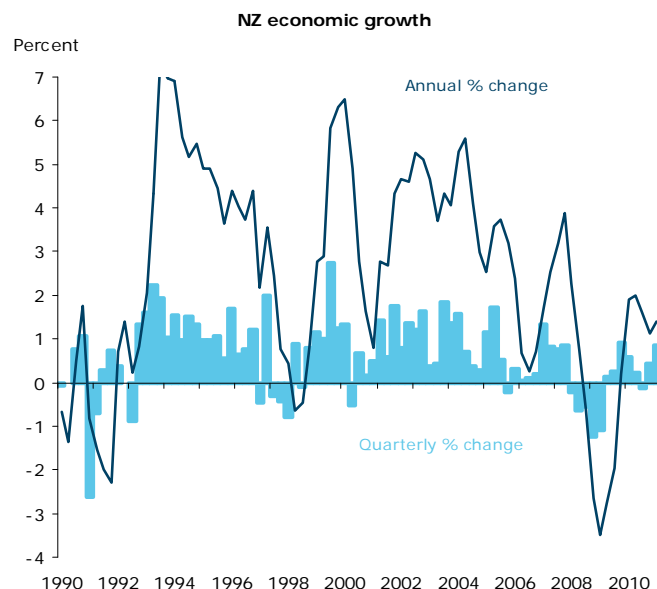
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### NZ ECONOMY DISPLAYS CONSIDERABLE RESILIENCE

- **The NZ economy displayed considerable resilience, registering an above trend growth rate in Q1** in spite of the considerable disruption caused by the February 22 Christchurch earthquake. Growth was considerably stronger than the market consensus and the RBNZ pick.
- **The production based measure showed generalised strength.** Activity in the goods producing industries increased 1.5 percent, with strong manufacturing sector activity offsetting lower construction sector output. Services sector activity still managed a respectable 0.4 percent increase. Primary sector activity dipped 0.6 percent.
- **There were also upward revisions to historical data.** In combination with the stronger than expected Q1 GDP outturn this implies the level of economic activity is far higher (1.1 percent) than the RBNZ assumed in June.
- Though the Q1 GDP data is dated (we are now at the start of Q3 after all), it still has important implications for monetary policy. **December remains our core view for the first rate hike. But the risks of a 50bp hike first up, or even an earlier move, has risen.**



Sources: ANZ, National Bank, Statistics NZ

## 2011Q1 GDP REVIEW

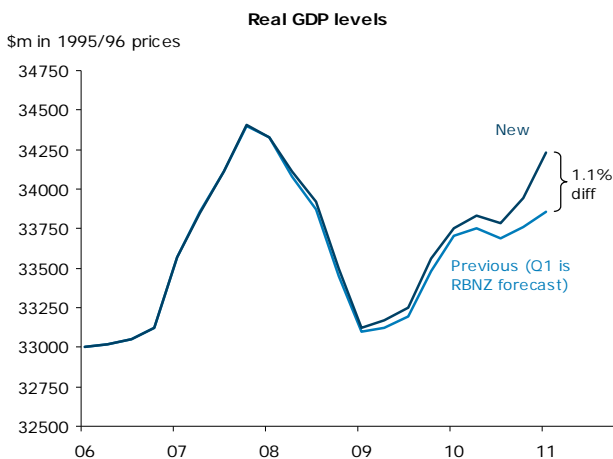
### DATA WRAP

The 0.8 percent increase in production based GDP was considerably stronger than the June MPS projection and the market consensus.

Expenditure GDP was also on an improving trajectory, increasing 0.6 percent.

GDP	QoQ	YoY	Ann Ave%
Q1 2010	0.6	1.9	-0.7
Q2 2010	0.2	2.0	0.5
Q3 2010	-0.1	1.6	1.4
Q4 2010	0.5	1.1	1.7
<b>Q1 2011</b>	<b>0.8</b>	<b>1.4</b>	<b>1.5</b>
<b>ANZ</b>	<b>0.4</b>	<b>0.6</b>	<b>1.2</b>
<i>RBNZ</i>	0.3	0.5	1.2
Market	0.3	0.5	1.2

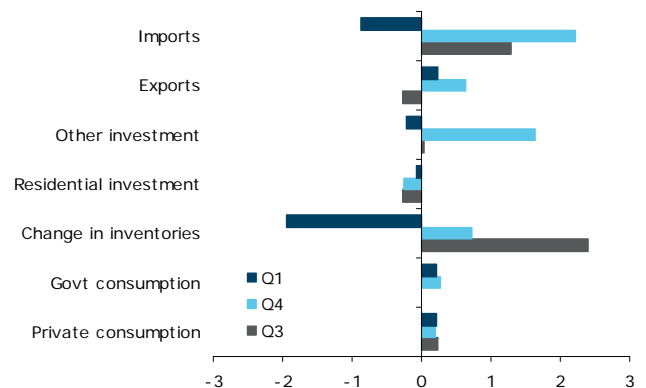
**Details of the release confirmed widespread strength.** Activity in primary sector industries eased 0.6 percent but this was due to a large fall in fishing, hunting and forestry output, with agricultural production (up 1.0 percent) a major beneficiary from good climatic conditions for dairy. Solid manufacturing sector activity (up 3.6 percent) underpinned higher goods sector activity, despite the 4.3 percent fall in construction sector output. Services sector activity showed resilience, with firmer retail and wholesale trades activity (up 1.1 percent and 1.6 percent respectively) and more activity in the finance and insurance services sector (up 0.5 percent), offsetting a 0.5 percent fall in personal and community services sector activity. Government services increased 2.1 percent in the March 2011 quarter, part of which was due to civil defence and emergency management activity.



There were also upward revisions to historical data, with the 0.2 percent increase in Q4 revised up to a 0.5 percent increase. In combination with the stronger than expected Q1 GDP outturn this implies the level of economic activity is far higher (1.1 percent) than the RBNZ assumed in June.

**The expenditure based measure also showed improvement.** Private consumption activity managed a 0.4 percent increase, a 2.9 percent increase on durable good volumes offsetting a subdued 0.2 percent increase in services activity. Higher central and local government activity underpinned a 1.2 percent increase in Government consumption. Residential investment activity declined further to be 38 percent below its mid 2007 peak. Other investment declined 1 percent, with a slump in non-residential investment (down 15.5 percent) and transport equipment (down 6.7 percent) offsetting further strengthening in plant and machinery investment. Inventories made a negative contribution, with a 0.8 percent increase in export volumes underpinning a 1.1 percentage point contribution to net trade.

Percentage point contributions to quarterly growth



**It is not possible to isolate the impact of the earthquake and estimate how much of an effect it had on GDP.** We know that there were severe disruptions to economic activity in the affected areas following the earthquake. But a lot of activity simply took place elsewhere. The manufacturing hub in Christchurch was largely unaffected by the earthquake, which is a key reason why manufacturing GDP managed a strong 3.6 percent increase in the quarter. In addition, both the local and central government's response to the earthquake resulted in additional activity which was captured in GDP, leading to a 2.1 percent increase in government administration and defence. These

## 2011Q1 GDP REVIEW

include the ramping up of activity by EQC, increased work by Civil Defence, and the clean up work which was mainly undertaken by local government. Preparation by Statistics NZ for the 2011 Census, which was subsequently cancelled, also added to central government activity in the quarter.

We should note however, that while the Government's response to the earthquake was counted as a positive for GDP, it is not the sort of activity that we want. **The earthquake has resulted in significant damage to the country's capital stock, and as a result, the country's wealth has reduced.** We should view the rebuilding of Christchurch in the same vein. The reconstruction will result in a massive boost to economic activity, but all it is really doing is replacing destroyed capital stock. The shift in resources to the construction sector will also eventually crowd out activity elsewhere, particularly in the tradable sector where it is needed more if the NZ economy were to continue to rebalance.

**The GDP report not only shows the considerable resilience of the NZ economy in coping with such a large shock, but also the fact that underlying activity was more robust at the end of last year than initially thought,** and that this momentum carried over into the early part of this year. The latter was certainly consistent with the anecdotes we had been picking up early this year. We think this increasing momentum, and the immediate response from the RBNZ and the Government following the earthquake in stabilising confidence, were key factors behind the strong Q1 result. The recent dataflow has been reasonably upbeat and suggests a strengthening in economic activity in Q2. As such, the RBNZ pick for Q2 GDP (+0.4 percent) may be a little light. Earthquake reconstruction and the Rugby World Cup will add to the impetus provided by accommodative financial conditions.

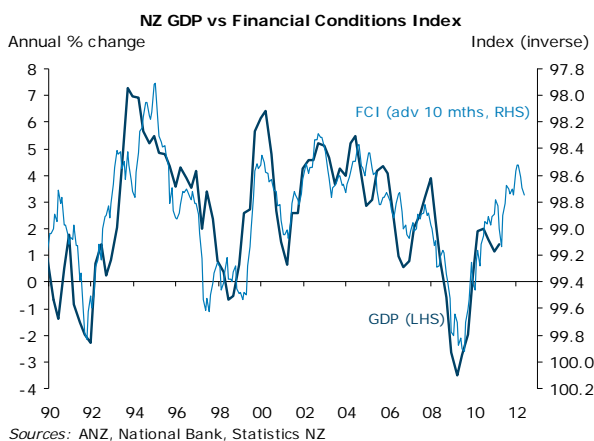
### ASSESSMENT

**We congratulate Statistics NZ for going the extra mile in putting together the Q1 GDP estimates.** While the delays to the release was frustrating, it was more important to ensure that the number was robust and not subject to significant revisions after the fact (or indeed, subject to any suspicions as to their veracity). Given that the February 22 earthquake occurred right in the middle of Q1, there was always going to be an impact on GDP - the question is by how much. Just look at the effects the Queensland floods had on Australian Q1 GDP (-1.2 percent q/q).

**After sitting through the lock-up and talking to senior Statistics NZ officials, we have no doubts about the accuracy of the 0.8 percent expansion in NZ's Q1 GDP.** Statistics NZ has undertaken additional analysis to try and incorporate the earthquake impact as best they can. They directly surveyed 800 Canterbury businesses to obtain additional information on the impact of the earthquake, revisited their methodologies, sought out other information, and undertook some scenario testing to ensure that the estimates at the national level were robust.

**Though the Q1 GDP data is dated (we are now at the start of Q3 after all), it still has important implications for monetary policy.** Stronger than expected Q1 data suggest there is less spare capacity in the economy than previously thought. With recent indicators pointing to an ongoing recovery, this is likely to further erode remaining spare capacity. **As such, inflationary pressures should start to emerge as the recovery emerges.** With the economy set to strengthen over the course of this year, an OCR at 2.5 percent is on borrowed time.

**We do not think that next week's Q2 CPI data will provide any smoking gun for the RBNZ** (we are forecasting a 0.8 percent increase, slightly above the 0.7 percent forecast in the June MPS). But with signs that the labour market is improving and our view that inflation expectations will prove to be more sticky than the RBNZ assets, the Q2 HLFs data (due on August 4) and RBNZ inflation expectations survey (due on 23 August) are set to be critical releases. Of course, ongoing global jitters are a counter to the improving domestic dataflow. But it is increasingly clear that a 2.5 percent OCR is on borrowed time. December remains our core view for the first rate hike. **But the risks of a 50bp hike first up, or even an earlier move, have risen.**



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