

Economic Review

New Zealand

23 September 2009

Gross Domestic Product – June 2009 quarter

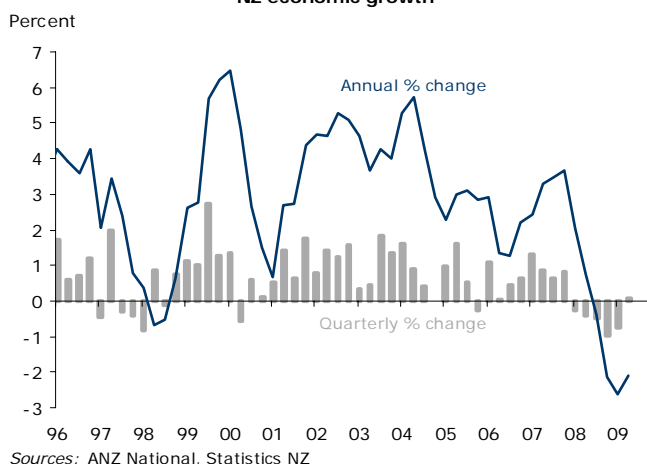
Key points

- > A small increase in Q2 GDP marks an end to the recession in a technical sense. This is positive news.
- > Forward indicators are pointing to further positive growth over H2 2009 and an inventory-induced rebound in production will be a big contributor.
- > While welcome, we continue to question the sustainability and quality of the pending recovery path given the mix of growth and an elevated currency.

Assessment

The NZ economy grew 0.1 percent in the June quarter. In a “technical” sense, this implies the economy is now out of recession – a quarter earlier than we (and most commentators) had expected and comes after five consecutive contractions. This is positive news. On top of this, the March quarter was revised upwards from -1.0 percent to -0.8 percent, though downward revisions to earlier data leave the total loss of output during the recession unchanged at 2.9 percent. Statistics NZ did state that the GDP increase was actually less than 0.1 percent and so is within the realms of future potential revisions. Because of this, there is still a possibility that future downward revisions could see the June quarter revert into negative territory.

NZ economic growth



Sources: ANZ National, Statistics NZ

Primary industries were the big driver of growth in the quarter, up 1.5 percent. Forestry and logging rose by a strong 8 percent thanks to increased demand for logs from China, while mining also posted an increase of 2.3 percent. Goods producing industries fell 0.5 percent, led by manufacturing (down 1.3 percent) and construction (down 1.9 percent), while this was partly offset by an increase in electricity and gas production (up 5.9

percent). Services industries were flat in the quarter.

	GDP (qtr % chg)	GDP (ann % chg)	GDP (ann ave % chg)
Jun-07	0.8	3.3	2.3
Sep-07	0.6	3.5	2.9
Dec-07	0.8	3.7	3.2
Mar-08	-0.3	2.0	3.1
Jun-08	-0.4	0.8	2.5
Sep-08	-0.5	-0.4	1.5
Dec-08	-1.0	-2.1	0.1
Mar-09	-0.8	-2.6	-1.1
Jun-09	0.1	-2.1	-1.8
ANZ	-0.3	-2.8	-1.9
<i>RBNZ</i>	<i>-0.1</i>	<i>-2.6</i>	<i>-1.9</i>
<i>Market</i>	<i>-0.2</i>	<i>-2.7</i>	<i>-1.9</i>

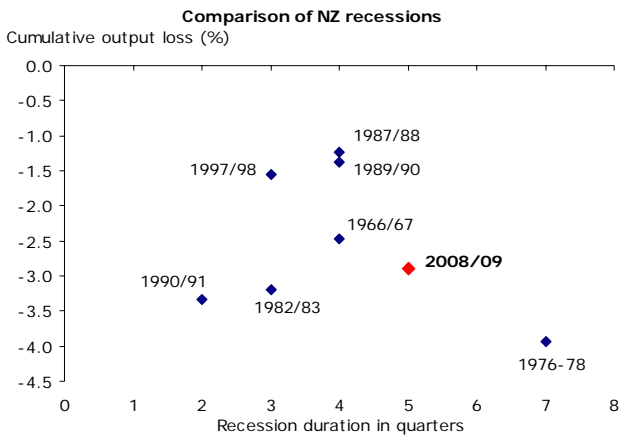
On an expenditure basis, the economy expanded by 0.4 percent. Private consumption rose 0.4 percent – the first quarterly increase since December 2007, while other fixed asset investment rose 1.3 percent, which was entirely driven by a large 13.2 percent increase in government investment (related to infrastructure projects such as roading). Private non-residential business investment remains weak, down 3 percent. Net exports made a 2.5 percentage point contribution to growth in the quarter as export volumes rose, while imports fell. However, this was almost fully offset by a massive rundown in inventories, which knocked 2.5 percentage points off growth in the quarter. The inventory rundown was the largest on record and largely occurred in manufacturing (we suspect dairy) and distribution stocks.

Positives from today's data need to be acknowledged.

- > **The level of export volumes is now above that of imports.** This is the first time this has occurred since the March 2003 quarter and

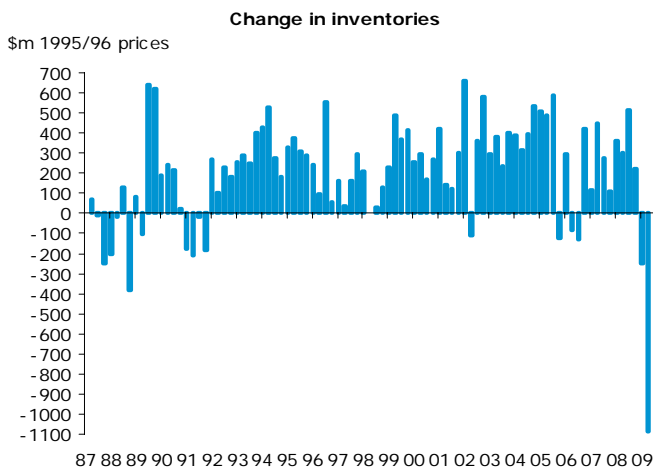
highlights that the economy has moved somewhat down the path of rebalancing that it requires. While much of this has been driven by the 22 percent capitulation in imports to date, export demand has held up encouragingly well (rising 4.7 percent in the quarter), courtesy of solid demand for some products from China but also due to NZ's export mix.

- > **The recession was shorter and shallower than expected.** While five quarters in length and a cumulative loss of 2.9 percent is still a painful adjustment, this is not as bad as what some of NZ's major trading partners have experienced. It is certainly not as deep as the early 1990s recession.



Sources: ANZ National, Statistics NZ, RBNZ

- > **Inventories have been rundown massively, which will underpin growth over H2.** An inventory rebound is pending. We suspect some of this will be offset by volatility in export and import performance over the coming quarters. We doubt dairy export volumes can repeat the 21 percent Q2 quarterly increase. And imports will start to recover as retailers look to re-stock their shelves. Nevertheless, this has all the traits of a classic inventory cycle that will underpin GDP growth over H2.

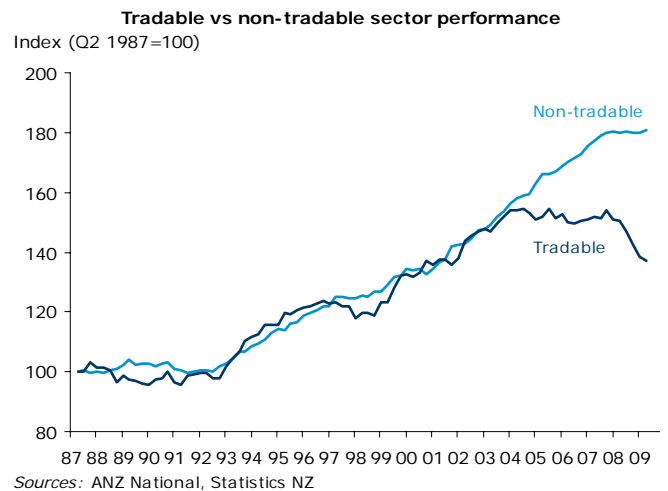


Sources: ANZ National, Statistics NZ

Forward looking indicators are pointing to a better near-term performance. Rising consumer and business confidence, alongside the pick-up in the housing market, point to further forward momentum taking hold. Improving asset prices (houses and equities) and news of an end to the recession have the potential to unleash pent up demand as a better feel good factor permeates. Behavioural aspects to the economic cycle need to be acknowledged.

But there are still a number of factors that we remain wary of:

- > **The level of activity remains very low.** It will be sometime before the "size" of the economy returns to pre-recessionary levels. For some sectors, the path to recovery is likely to be a long one. The manufacturing (ex-food, beverage and tobacco) and construction sectors for example have experienced cumulative losses of 19 and 15 percent respectively.
- > **The "mix" to growth does not yet have a sustainable feel about it.** Domestic or the non-tradable sectors of the economy have fared better than their tradable sector counterparts. Forward looking gauges suggest this is set to continue for a while. For the economy to embark on a more sustained and robust recovery, we need to see a switch in the drivers of growth towards the tradable and productive sector. This is still lacking in today's data, which showed the tradable sector contracting by 0.9 percent in the quarter, for a cumulative loss of 11.1 percent. While improving dairy prices and a recovering global economy will assist, the elevated NZD remains a key headwind.



Sources: ANZ National, Statistics NZ

- > **The recovery won't really feel like one until the labour market begins to improve.** For the average New Zealander, an inventory induced recovery won't feel like better times when household incomes remain under

pressure and the unemployment rate continues to move higher. The economy may have stabilised, but it will be some time before the resource slack in the economy is fully absorbed.

Implications

Today's GDP data continues the recent run of positive news. While the return to positive growth was better than what the RBNZ had forecast in their September *Monetary Policy Statement*, it is unlikely to change the Bank's cautious view about the outlook. Indeed, NZ's better than expected June quarter GDP outturn is in line with the upside surprises seen in many other economies. Yet, policymakers around the world continue to make cautious statements about prospects. The recession may be over, but it is too soon to bank on a strong recovery just yet.

Composition of Expenditure GDP

QoQ	Consumption	Government	Inventories*	Residential Investment	Other Investment	Exports	Imports	GDP (E)
Q1 2008	-0.4	1.5	0.7	-4.3	-1.2	-2.2	1.7	-0.8
Q2 2008	-0.5	0.7	-0.2	-9.5	5.5	-0.7	1.2	-0.4
Q3 2008	0.0	0.0	0.6	-6.8	-8.7	-2.4	-5.6	-0.6
Q4 2008	-0.2	1.6	-0.9	-14.5	-1.1	-3.2	-6.7	-0.4
Q1 2009	-1.2	0.3	-1.4	0.2	-6.9	0.6	-8.3	-0.5
Q2 2009	0.4	-1.0	-2.5	-2.6	1.3	4.7	-3.8	0.4

* Percentage point contribution to GDP growth

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- Placed in statutory management or receivership.

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