

NEW ZEALAND ECONOMICS DATA REVIEW

Gross Domestic Product – December 2015 quarter

17 March 2016

CONTRIBUTORS

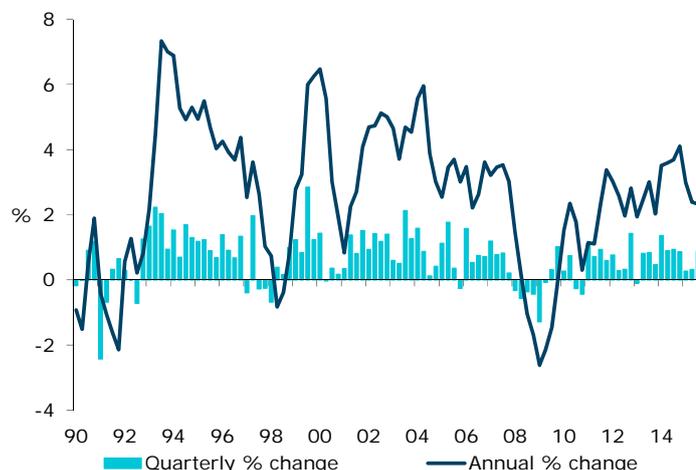
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STRONG END TO 2015 BUT LOTS OF UNCERTAINTY AHEAD

KEY POINTS

- The 0.9% q/q rise in production-based GDP (+2.3% y/y) was stronger than the 0.7% q/q March *MPS* and consensus pick, and our own 0.6% expectation. Eleven of the 16 broader production components rose.
- But despite the headline surprise, growth in the services (+0.8% q/q, 2.4% y/y), goods (+0.3% q/q, 1.7% y/y), and primary sectors were broadly in line with our expectations.
- To us, the main surprise was mainly technical in nature (balancing item) so it needs to be downplayed a little. Even so, the solid outturn was consistent with the spirit of our proprietary indicators, which flagged a strengthening in underlying growth momentum in the second half of the year.
- Expenditure-based GDP rose a stronger 1.1% q/q (+3.7% y/y), underpinned by inventory accumulation. This points to potential recoil over early 2016.
- Low inflation and the declining terms of trade are sapping nationwide incomes, with quarterly nominal GDP falling 0.1% q/q (+3.5% y/y). Real gross national disposable incomes were up a tepid 0.4% q/q in Q4, with annual average growth slowing to 1.4%. On a per-capita basis, the economy hardly moved over 2015.
- But this data is historical, and we are now well into 2016. Slowing global growth, dairy wobbles and tightening financial conditions are flagging downside risks. Viewed in combination with low inflation and easing inflation expectations, that's an environment where the odds favour an even lower OCR.

FIGURE 1. PRODUCTION-BASED GDP



Source: ANZ, Statistics NZ

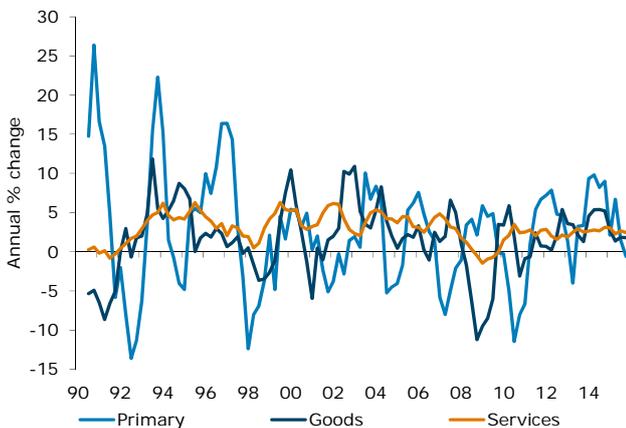
DATA REVIEW

DATA WRAP

The 0.9% q/q rise in production-based GDP in Q4 was stronger than the 0.7% q/q pick in the March *MPS* and the market consensus. Annual growth was steady at 2.3% y/y, with annual average growth slowing to 2.5% for the 2015 calendar year. This is down from the 3.7% expansion over 2014.

The increase was also above our 0.6% q/q expectations. However, the major surprise to us was the stronger-than-expected contribution from the seasonal balancing item (+0.3ppts), so the "miss" has some statistical noise in it. Growth in the services (+0.8% q/q, 2.4% y/y), goods (+0.3% q/q, 1.7% y/y), and primary sectors were broadly in line with our expectations.

FIGURE 2. PRODUCTION-BASED GDP COMPONENTS



Source: ANZ, Statistics NZ

That said, the strength in Q4 was consistent with the positive signs from many of our proprietary indicators. And notwithstanding some statistics quirks, the economy clearly had reasonable underlying growth momentum in the second half of last year, with the services sector picking up the growth baton.

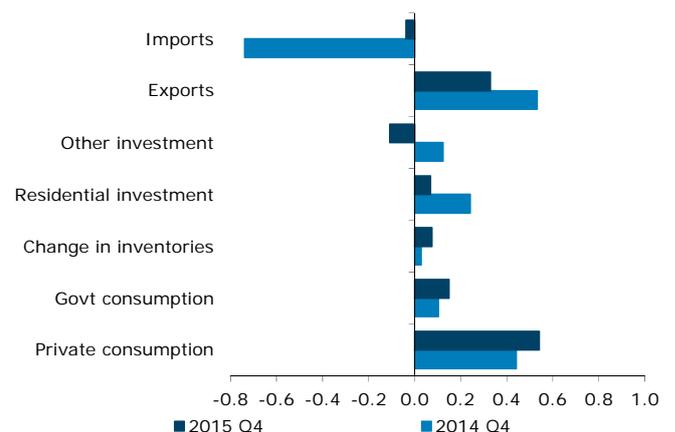
Eleven of the 16 broader production components rose in Q4. Ten of the 11 services industries saw lifts. Strength was particularly evident in the business services sector, likely benefiting from strengthening employment (arts & recreation services, and "other" services). Support from increasing borrowing (finance & insurance) and the booming tourism sector (retail & accommodation) was also evident. The Q4 lull in house sales activity coincided with more moderate moves in rental, hiring & real estate services, and business services activity. There was also some evidence of recoil in sectors that were strong in Q3, particularly transport, postal & warehousing. Areas of weakness look to be related to climatic conditions (falls in agriculture (-1.7%

q/q), food & beverage manufacturing (-4.1% q/q), and electricity (-1.3% q/q).

Expenditure GDP posted a 1.1% increase, with annual growth rising to 3.7% – its strongest rate in four years. Stronger inventory accumulation and consumer spending were evident over the latter part of 2015. After a run-down in Q3, inventories contributed 1.3 percentage points to quarterly growth in Q4, led by higher manufacturing and distribution inventories. This is all fine and well if firms have correctly predicted that the demand environment will continue to strengthen. It becomes more of a problem if firms find it more difficult to offload stock. This is when it has implications for future production.

The combination of strong population growth, historically low interest rates and solid labour income growth have clearly supported consumer spending, with sizeable increases in durable, non-durable and services consumption in the quarter. There was an element of recoil for fixed asset investment following the Q3 surge, with sizeable falls in transport equipment and plant & machinery overshadowing climbs in construction investment. The recent bout of global market volatility and increasing concerns over the global outlook could well contribute to ongoing hesitancy over capital investment despite the low interest rate environment. Overall, investment in fixed assets slipped 1.1% q/q, but this followed a 2.6% lift in Q3.

FIGURE 3. CONTRIBUTIONS TO EXPENDITURE-BASED GDP



Source: ANZ, Statistics NZ

Export volumes tracked sideways over the quarter (+0.2% q/q, +3.5% y/y). There were offsetting movements for goods (+0.7% q/q), with rises for meat, coal & petroleum, and other food & beverage exports, offset by large falls for metals products & equipment and smaller falls for dairy and textiles. Services exports were down 0.9% on lower

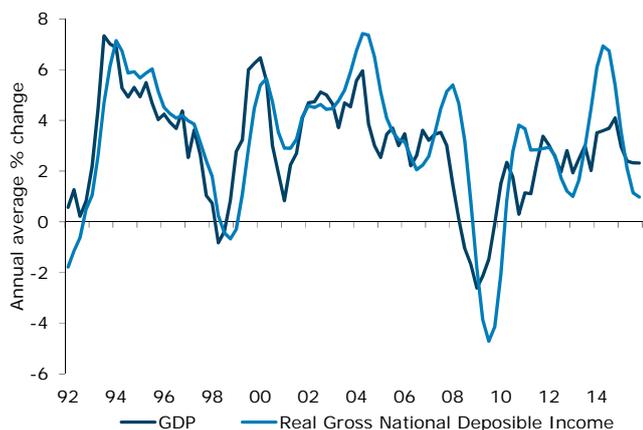
DATA REVIEW

visitor spending, but were still up close to 7% compared a year ago. Import volumes managed a 0.7% q/q rise but were up just 0.4% over the last 12 months, with the progressive slowing evident in services imports.

Low inflation and the declining terms of trade are sapping nationwide incomes, with quarterly nominal GDP falling 0.1% q/q (+3.5% y/y). Real gross national disposable incomes were up a tepid 0.4% in Q4, with annual average growth slowing to 1.4%.

The GDP result clearly highlighted the support provided by stronger population. We note that real GDP per capita increased just 0.3% over the quarter, with real gross disposable nationwide incomes down 0.4% on a year ago.

FIGURE 4. GDP & REAL GROSS NATIONWIDE DISPOSABLE INCOME GROWTH



Source: ANZ, Statistics NZ

IMPLICATIONS

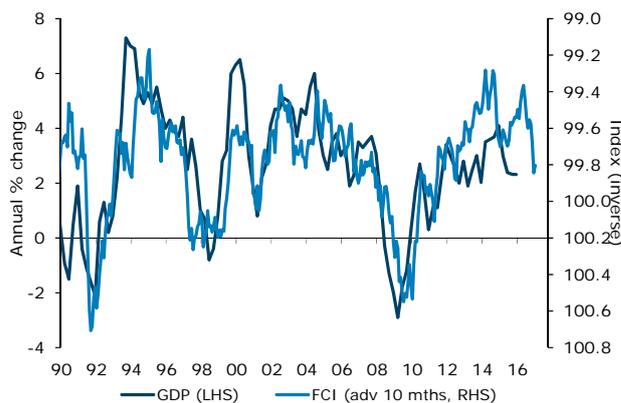
Today's report confirmed the economy ended the year with reasonable momentum after a sluggish first half. At the margin, the stronger result suggests a slight upward starting point surprise to the RBNZ's estimates of capacity pressures, although it does not appear to be sufficiently large to suggest a change of tack from the Bank.

But this data is historical and we are now well into 2016, with slowing global growth, dairy wobbles and tightening financial conditions flagging downside risks. Viewed in combination with low inflation and easing inflation expectations, that's an environment where the odds favour an even lower OCR. We expect 50bps of cuts over 2016.

IMMEDIATE MARKET REACTION

The stronger-than-expected GDP result was partly overshadowed by the dovish Fed announcement. NZD initially spiked about 80 pips following the data, but the reaction was fleeting, with the NZD soon back to where it was immediately prior to the release. The reaction in the local rates market was minimal, with a 1-2bp lift in wholesale rates, with moves again overshadowed by the Fed.

FIGURE 5. GDP FINANCIAL CONDITIONS



Source: ANZ, Statistics NZ

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