

Worse by far

Q4 GDP preview: released 27/3 10:45am NZT

- The fourth quarter of 2008 is expected to be the worst quarter in an awful year.
- Private sector demand down across the board with production following suit.
- Government spending and agriculture (drought recovery) look the only positives.
- Easier monetary conditions required.

GDP expectations

	GDP q/q	GDP y/y	GDP ann ave
Q3 actual	-0.4%	-0.1%	1.7%
Q4 Westpac forecasts	-1.1%	-2.0%	0.2%
Q4 RBNZ forecasts	-0.8%		0.3%
Q4 Market forecasts	-1.0%	-1.9%	0.3%

We expect GDP fell by 1.1% in Q4 2008, completing four consecutive declines in economic activity. Q4 is not only on track to be the worst quarter for growth of last year but the worst since 1991. Combined with the mild declines in the first three quarters of 2008, economic activity in Q4 2008 is expected to be down 2.0% from the same quarter a year earlier.

The horrible headline figures will be backed up by equally awful details. For the second consecutive quarter, consumers spent less, businesses invested less and we sold less to the rest of the world. Demand is weak right across the private sector. Growth bright spots appear to be limited to more government spending and agriculture, as recovery from last summer's drought continues. Even the 1% lift we have pencilled in for agriculture is not a given, with the risk that fewer lambs outweigh increased milk flow.

Consumers were cautious in 2008 as falling house and share prices hit their balance sheets and job security faded as unemployment rose. Watching extreme volatility overseas, even if from afar, has added to the nervousness. We expect consumer spending contracted by 0.4% in Q4 with purchases of big ticket items hit hardest. Spending on durable goods was likely down 1.2% in Q4. A drop in overall spending implies the

Figure 1: Production Based GDP

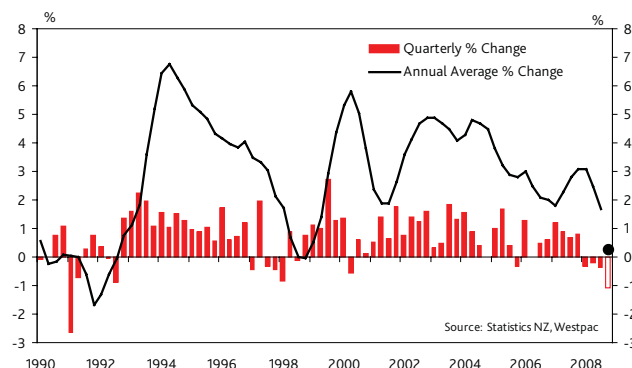
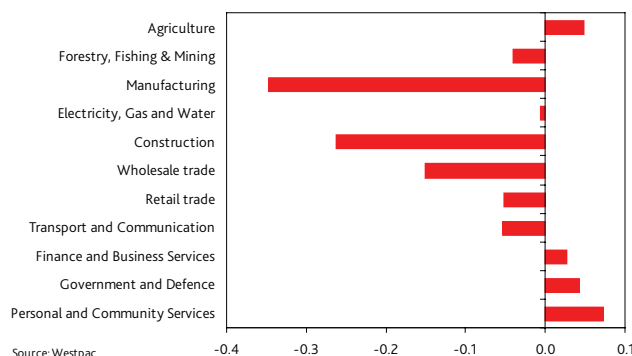


Figure 2: Percentage point contribution to Q4 GDP growth



cash flow benefits from lower fuel prices, interest rate cuts and tax cuts in the fourth quarter were saved.

Lowlights

Weak consumer demand will be reflected in falls in retail and wholesale trade. The knock on effects will also show up in less activity in transport distribution and manufacturing. House and apartment building took another – sharper – leg down in Q4. This will weigh heavily on the construction sector, despite a small rise in non-residential building.

Manufacturing is expected to make the largest negative contribution to growth in Q4, despite an expected increase in dairy and meat processing. Very weak domestic and external

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demand, the lagged effect of a high New Zealand dollar and intense foreign competition has hit manufacturing sales hard. Broad-based weakness in underlying manufacturing production was amplified by a shutdown at Tiwai Point aluminium smelter during the quarter. We estimate this shutdown will knock around 0.15% off Q4 GDP. Less manufacturing production will be reflected in lower electricity generation.

Market implications

The economic vibe has moved on considerably since the end of last year continuing the rapidly changing landscape in recent times. A hint at the speed of change can be gleaned from the outlook for world growth being slashed by a gob-smacking 4.4 percentage points in the space of six months – a truly remarkable statistic, but a sign of the times.

An outcome for Q4 on our expectation would be a downside surprise to the RBNZ. Risks around our 1.1% forecast seem evenly balanced. A weaker starting position for the economy than anticipated by the central bank would put downward pressure on wholesale interest rates and the New Zealand dollar. Confirmation that consumers were saving the increases in cashflow, businesses were hunkering down and exporters were struggling before the full force of the international meltdown hit would certainly argue for easier monetary conditions. The tightening in monetary conditions since the March MPS certainly seems the wrong medicine and in direct contrast to the balance of conditions outlined by the RBNZ.

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