

NZ Q4 GDP: Recession deepens

Q4 GDP falls 0.9% q/q

- Demand weak across the board.
- Production follows suit.
- Government, some services and agriculture provide pockets of growth.
- Economy needs looser – not tighter – monetary conditions.

Key results

	Q3	Q4	WBC	Mkt	RBNZ
GDP q/q	-0.5	-0.9	-1.1	-1.1	-0.8
GDP y/y	-0.1	-1.9	-2.0	-2.0	
GDP annual average	1.7	0.2	0.2	0.3	0.3

Commentary

The New Zealand economy contracted in every quarter of 2008, saving the steepest fall for the final quarter. The 0.9% drop in GDP in Q4 2008 is the largest quarterly decline since 1992, although the decline was not quite as bad as the 1.1% fall feared by the market.

Weak or falling demand remained the general theme in Q4 2008. Household spending was flat, house and apartment building contracted sharply, other investment retreated and exports fell. Across the major sectors, Government was the only source of demand growth during the quarter. Consumers have clearly saved the extra cashflow from lower interest rates, the October tax cuts, and lower petrol prices. While the full impact of interest rate cuts takes time to come through, the benefits from tax cuts and especially lower petrol prices are immediate. Rising unemployment and falling house prices have consumers cautious. Recent indicators such as consumer confidence suggest this has continued into Q1.

Weak demand in Q4 filtered through into weak retail trade, a slump in wholesale trade and manufacturing and a consequent reduction in transport activity. Apart from food processing, manufacturing production was negative throughout. The underlying weakness was amplified by lower aluminium production from Tiwai Point because of a transformer failure and an almost 2 month shutdown for regular maintenance at

Figure 1: Production Based GDP

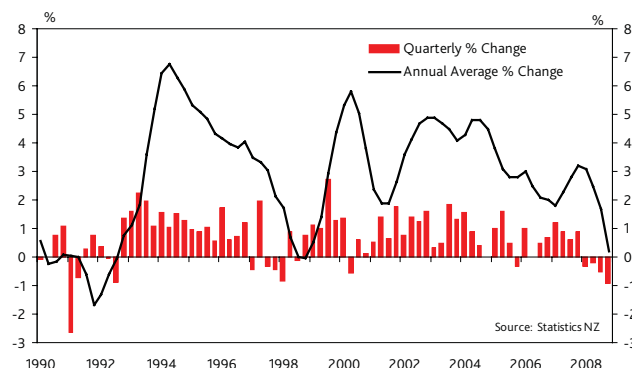


Figure 2: GDP Production Components

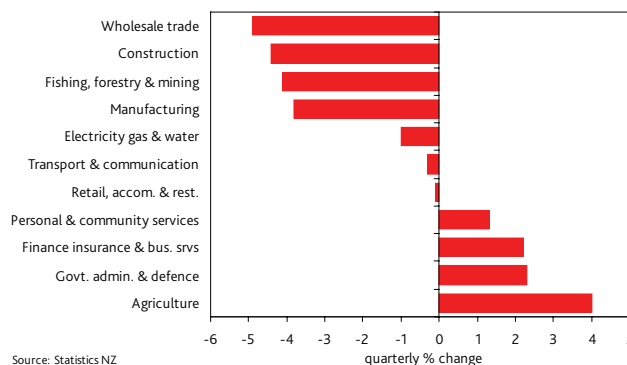
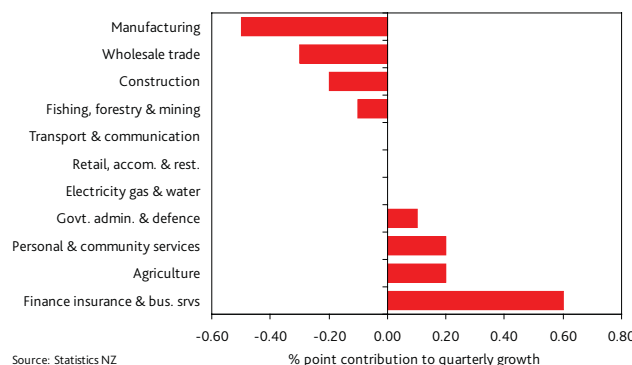


Figure 3: GDP Production Components

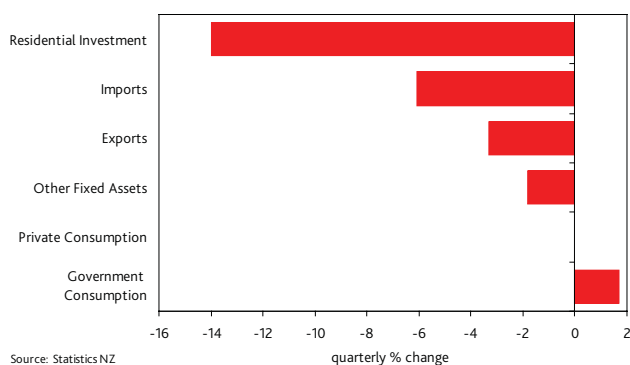


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the Kapuni urea plant. As expected, agriculture provided one of the few bright spots on the production side, driven by more milk production as the dairy sector recovered from last summer's drought. The finance, insurance and business services sector also posted stronger growth than expected.

Figure 4: GDP Expenditure Components



Outlook and market implications

The growth outlook remains weak. We suspect the economy contracted by around 1% in Q1 2009 and expect another small contraction in Q2. Weak world demand and fading agriculture production recovery from drought will dampen export volumes. Business investment is expected to retreat further following the slump in demand to date, and consumers will likely remain cautious through 2009.

The small positive growth rates we have pencilled in for the second half of 2009 are based on considerably looser monetary conditions than those currently prevailing. A strong lift in wholesale interest rates over recent weeks has pushed retail rates higher. This, along with the hefty rise in the NZD, threatens the forecast mild economic recovery later this year.

Likewise, the late 2009 growth rebound that the RBNZ forecast in their March *Monetary Policy Statement* was also predicated on considerably easier monetary conditions than currently exist. To encourage the required looser conditions we continue to expect the RBNZ to cut the OCR by 50 basis points on 30 April. A weaker starting point for the economy than the RBNZ thought adds some weight to this view. Not only was the growth outcome in Q4 2008 a tick lower than their -0.8% forecast, but Q3 was revised down from -0.4% to -0.5%. Key data between now and the OCR review is the outlook for world growth and domestically the *Quarterly Survey of Business Opinion* on 7 April. We expect both to make fairly grim reading.

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