

Showing resilience

Q1 GDP preview

- We estimate that GDP grew by 0.5% in the March quarter, following a 0.2% rise in Q4 last year.
- The February earthquake severely disrupted activity in the Canterbury region, with the impact expected to be most apparent in the construction and personal services sectors.
- But momentum has clearly been building in the rest of the economy since the start of the year.

GDP expectations

	GDP q/q	GDP y/y	GDP ann ave
Q1 actual	0.4%	0.5%	1.2%
Q1 Westpac forecasts	0.5%	0.7%	1.2%
Q1 RBNZ forecasts	0.3%	0.4%	1.2%

The March quarter was one of contrasts for the New Zealand economy. There is ample evidence that the economy turned a corner early this year, after a disappointing performance in 2010. However, the 22 February earthquake severely disrupted activity in the Canterbury region, weighing on what would otherwise have been one of the strongest quarters of growth in recent history.

We estimate that the February quake detracted about 0.3 percentage points from GDP in the March quarter. That's a lot less than we feared in the immediate aftermath of the quake, and surprisingly small compared to the brief, sharp downturns that followed recent natural disasters in other parts of the world, such as Chile in early 2010 or Australia and Japan this year. However, in those cases the hit to GDP largely stemmed from a disruption to exports, which wasn't an issue in Canterbury.

That said, the impact of the quake will be quite apparent in the details of the GDP report (as well as the two-week delay in its release). We expect a sharp drop in non-housing construction, which had been boosted in the December 2010 quarter partly by infrastructure repairs following the September quake. While

Figure 1: Production based GDP

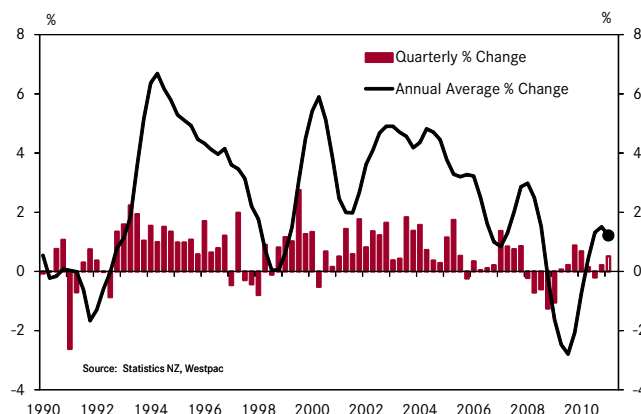
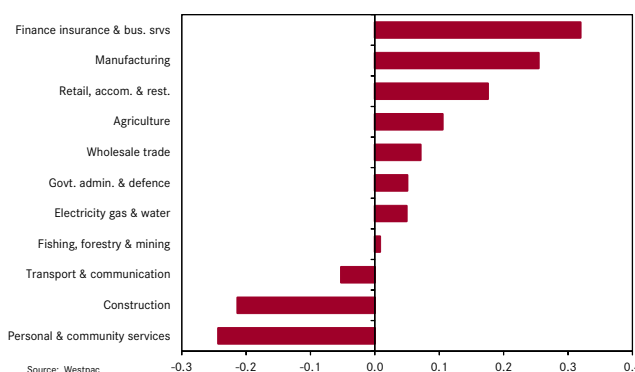


Figure 2: Percentage point contribution to Q1 GDP growth



some of that would have continued in the first half of the March quarter, it would have been significantly disrupted in the second half.

The other area where the impact of the quake will be most noticeable is in personal and community services. We don't have much of a feel for how Statistics NZ will treat this sector – 'activity' tends to be based on input measures such as hours worked in the Quarterly Employment Survey, which was conducted just before the February quake. But our forecast of -2% would be the biggest quarterly drop on record, a notion

For further information, questions or comments contact Dominick Stephens, telephone (09) 336 5671, email dominick_stephens@westpac.co.nz

For all clients: Westpac Institutional Bank is a division of Westpac Banking Corporation ABN 33 007 457 141, incorporated in Australia ("Westpac"). The information contained in this report: does not constitute an offer, or a solicitation of an offer, to subscribe for or purchase any securities or other financial instrument; does not constitute an offer, inducement or solicitation to enter a legally binding contract; and is not to be construed as an indication or prediction of future results. The information is general and preliminary information only and while Westpac has made every effort to ensure that information is free from error, Westpac does not warrant the accuracy, adequacy or completeness of the Information. The Information may contain material provided directly by third parties and while such material is published with necessary permission, Westpac accepts no responsibility for the accuracy or completeness of any such material. In preparing the Information, Westpac has not taken into consideration the financial situation, investment objectives or particular needs of any particular investor and recommends that investors seek independent advice before acting on the Information. Certain types of transactions, including those involving futures, options and high yield securities give rise to substantial risk and are not suitable for all investors. Except where contrary to law, Westpac intends by this notice to exclude liability for the information. The information is subject to change without notice. Westpac expressly prohibits you from passing on this document to any third party. Westpac Banking Corporation is registered in England as a branch (branch number BR000106) and is authorised and regulated by The Financial Services Authority. Westpac Europe Limited is a company registered in England (number 05660023) and is authorised and regulated by The Financial Services Authority. © 2011 For Australian clients: WARNING - This document is provided to you solely for your own use and in your capacity as a wholesale client of Westpac.

that we're comfortable with. The swathe of school closures in Christchurch would have been a major drag on activity, as would the subsequent drop-off in overseas tourist numbers in the South Island.

On the positive side, some of the recent quarterly activity indicators suggest that whatever disruption there was in the Canterbury region, it was more than offset by the momentum building in the rest of the country. Retail sales rebounded sharply after a post-GST slump in the December quarter, which in turn would have spurred at least a partial rebound in wholesale turnover. Manufacturing (which in Christchurch tends to be clustered in the less quake-affected regions) gained further ground in the March quarter, particularly in the more export-oriented industries.

Elsewhere, better climatic conditions should translate into decent growth in agricultural production for the quarter. Financial services benefited from a lift in both lending and deposit growth, and a pickup in house sales from their late-2010 lows boosted property services.

Market Implications

The median market forecast is for 0.4% growth, with most local forecasters clustered around 0.3-0.5%. The RBNZ and Treasury are both expecting a 0.3% increase. This suggests there's significant scope for a surprise outcome – beyond the usual margin of error for forecasts, Statistics NZ will be making some fairly opaque assumptions about post-quake output in a few sectors.

Given current market positioning and the uncertainties around this week's figure, financial markets are likely to react more strongly on the day to a positive surprise than a negative one. Over the last few months interest rates have been driven as much by concerns about European sovereign debt woes as by the recent run of stronger local data; to the extent that the former has reached some (temporary) resolution, a strong GDP outturn at this point should catch investors' attention. A weak outturn could be more easily written off as quake disruptions, which should be reversed in the following quarter.

However, from the RBNZ's point of view, a weak result (relative to its below-market forecast) would probably be more significant than a strong one. The June Monetary Policy Statement confirmed that the timing of rate hikes was no longer seen as being linked to the start of reconstruction in Christchurch, and the interest rate projections were consistent with a December hike. A strong Q1 GDP outturn is unlikely to bring this timing any further forward; but a weaker than expected starting point for the economy would add to the risk of hikes being delayed until next year.

Dominick Stephens, Chief Economist, Ph: (64-9) 336 5671

Michael Gordon, Senior Economist, Ph: (64-9) 336 5670