24 June 2010

Paying our dues

Q1 GDP rises 0.6% q/q

- **Recovery on track, but growth slower than Q4.**
- **Strong exports, weak consumer maintains rebalancing theme.**
- **On-expectations data leaves RBNZ on track for hikes.**

Key results

	Actuals		Q1 expectations		
	Q4	**Q1**	**WBC**	**Mkt**	**RBNZ**
GDP q/q	0.9	0.6	0.7	0.6	0.8
GDP y/y	0.5	1.9	2.0	1.9	
GDP annual average	–1.6	–0.4	–0.3	–0.4	–0.3

GDP data from the first quarter of 2010 was broadly in line with expectations. New Zealand's economic recovery remained on track, but a consumer slowdown saw the pace of growth wobble.

This recovery is shaping up as emphatically export-led and oriented towards primary and goods production. Strong global demand for commodities, combined with Australian demand for manufactured goods, was behind the 3.4% growth in exports of goods. The strongest production growth was found in key export industries like mining, forestry, agriculture, metal product manufacturing (mostly aluminium) and machinery and equipment manufacturing.

By contrast, private consumption growth was just 0.2%. Consumers were weighed down by rising interest rates, the weak housing market, and rising petrol prices. Consumption of durable goods continued to rebound from the recession, but consumption of services and non-durable goods was basically flat. This showed up as either declining production or weak growth in most of the service industries, including a 0.8% fall in retail trade. There was a 2% fall in communication services, due to fewer minutes spent on cell phones – network outages were a possible contributing factor.

The external orientation of the economy also showed up in the make-up of investment. Investment in intangibles (mining exploration) was up 10%, while investment in non-residential

Figure 1: Production Based GDP

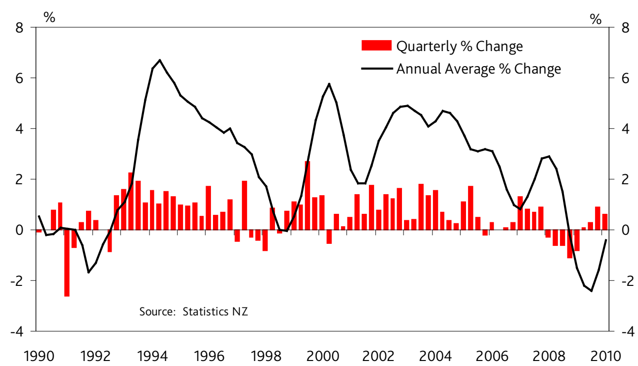


Figure 2: GDP Production Components

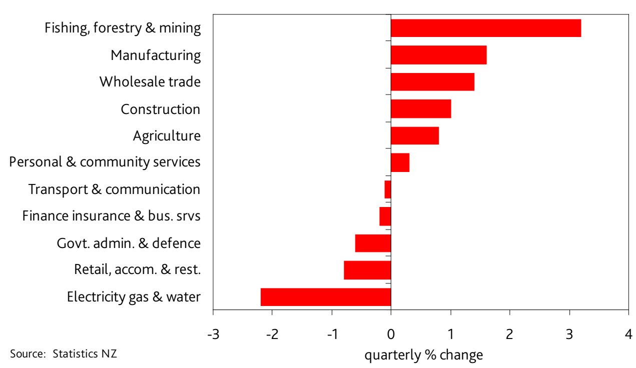
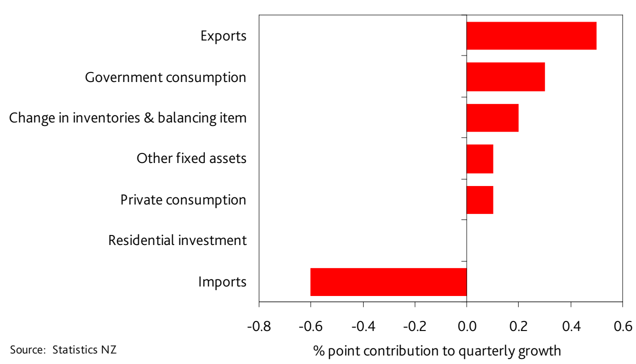


Figure 3: GDP Expenditure Components



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building and transport equipment, which are more oriented toward the domestic economy, fell sharply. Investment in residential housing expanded just 0.5%, off a miserably low base.

As far as domestic spending was concerned, Government was the only real bright spot. The HMNZS *Otago* was imported in Q1, boosting the figures for government consumption and imports. Government also featured heavily in the 2.5% increase in "other construction", which is mainly roads and bridges.

The one export sector that fared poorly was tourism. Exports of services fell a whopping 2.4% in the quarter. Visitor arrivals held up, but tourists appear to be spending less freely when they are here. Slow tourist spending will have contributed to weakness in retail trade and other services.

The industry breakdown was quite different to the forecasts we laid out in our preview (which were based on partial data and indicators). Manufacturing and agriculture were stronger than forecast, while retailing and services were weaker. Those were surprises in one sense, but not in another. In the bigger scheme of things, the make-up of the published data fits more naturally with our overall understanding of the economy – goods production and exports are doing well, services and consumption are doing poorly.

Inventories were an important driver of both the recession and the early recovery, but they appear to have settled down this quarter. Stock levels fell slightly, mainly because drought affected inventories of agricultural product. Note that the positive contribution from the "Change in inventories and balancing item" was all down to the balancing item, not inventories.

Implications

The robust export sector is a clear long-run positive for New Zealand, and suggests the recovery will have legs. Historically, NZ recoveries have always begun in the export sector and have radiated out to consumers later.

The data was one notch weaker than our forecast, but bang on the economists' median forecast, so markets barely reacted. It was a slight downside surprise for the RBNZ, but that will not be nearly enough to dissuade them from the plan to steadily hike the OCR over the next two years. A key factor behind the RBNZ's decision to delay OCR hikes was the judgement that consumer spending was weak in early-2010. Today's data was certainly consistent with that judgement. However, the validity of the RBNZ's assumption that consumers will remain relatively subdued is still an open question.

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