

# NZ Q2 GDP: We're out

Q2 GDP rises 0.1% q/q

- Recession ends in Q2, just.
- Expansionary policy, net migration and energy impulse positives.
- Construction, manufacturing, wholesale, transport still contracting.
- Massive inventory unwind points to more production ahead.
- Upside surprise to provoke thought at RBNZ.
- Current economic slack means no imminent hike in OCR.

### Key results

	Q1	Q2	WBC	Mkt	RBNZ
GDP q/q	-0.8	0.1	-0.2	-0.2	-0.1
GDP y/y	-2.6	-2.1	-2.7	-2.6	
GDP annual average	-1.1	-1.8	-1.9		-1.9

### Commentary

The rot has stopped; economic activity is no longer falling in New Zealand. This is good news, but the 0.1% economic growth in Q2 is hardly great news. Still, it is difficult not to get excited about the first positive growth figure, even if it is minuscule, since the final quarter of 2007.

The substantial interest rate cuts over the past year, expansionary fiscal policy, and a strong increase in net migration have all given general support to economic activity, while specific factors in the energy sector gave a strong impulse to Q2. The positives only just outweighed the negatives for the quarter.

The 1.5% increase in real estate and business services stands out as lower interest rates and net migration gave a strong boost to house sales. Maari oil helped boost mining activity 2.4%, while the exceptionally cold months of May and June saw electricity demand rise strongly (with value added amplified by a greater use of hydro generation given abundant water levels).

Surprisingly, government consumption on the expenditure side of the national accounts and government admin and defence on the production side both made negative growth contributions

Figure 1: Production Based GDP

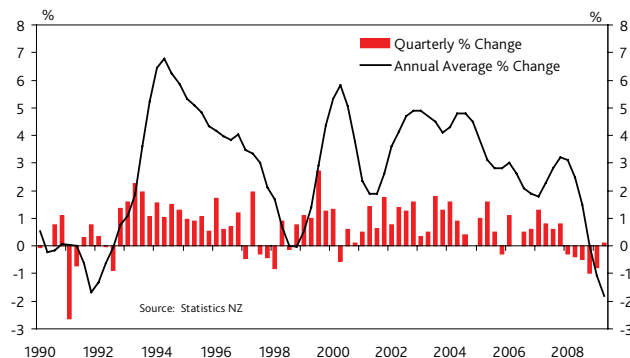


Figure 2: GDP Production Components

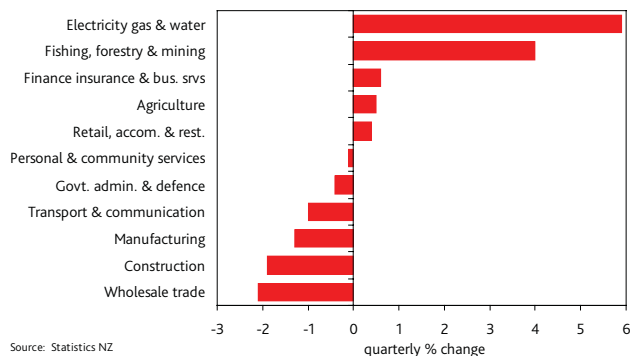
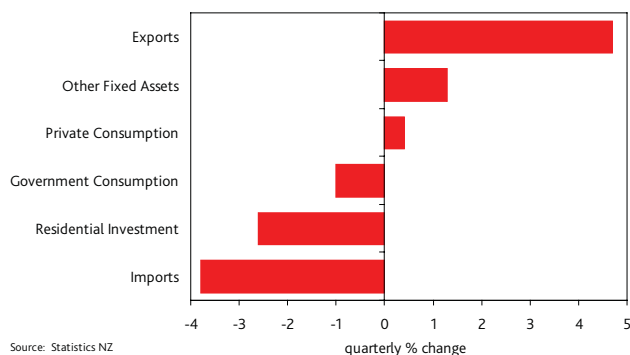


Figure 3: GDP Expenditure Components



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in Q2. Expansionary fiscal policy showed up elsewhere, with infrastructure investment dampening the decline in the construction sector and the April 1 tax cut helping lift consumer spending by 0.4% with matching growth in retail trade.

However, there were still plenty of negatives around in Q2 with large contractions in construction (-1.9%), manufacturing (-1.3%), wholesale trade (-2.1%) and transport and storage (-3.3%). The recovery, if we can call 0.1% growth that, is clearly not widespread. Technically, at least, Q2 marks the end of the 5-quarter recession. But these hefty declines illustrate it will be some time before the feeling of recovery becomes widespread. This is true for consumers as well as business, as we need substantially stronger growth than 0.1% a quarter to get the unemployment rate heading down.

Perhaps the most encouraging aspect of the Q2 figures is that the detail point to more growth to come. A truly massive inventory unwind is a case in point. We expected the largest unwind in inventory since the series began in 1987 and the \$1.1 billion (2.5% of GDP) did not disappoint. The stock reduction coincided with a 4.7% increase in exports as demand was met through existing product rather than new production. Dairy products were likely a significant component of this, but certainly not all. Lower manufacturing production and reduced imports also contributed to low stock levels.

Importantly, production will need to lift to replenish depleted stock piles, especially now that consumer spending is rising again. As such we have nudged up our estimate for growth in Q3 from 0.2% to 0.4%.

### Market implications and outlook

The positive result caught the market on the hop, judging by the strong immediate increases in the NZD and wholesale interest rates. Importantly, it is an upside surprise to the RBNZ, both in the current quarter and the 0.2% upward revision to Q1, and will have them seriously questioning their view that they will not lift the OCR until late in 2010. Even so, we should not get too carried away. The current degree of economic slack means an interest rate hike is not imminent. The level of economic activity is still 2.8% below its peak in Q4 2007, suggesting it will take some time before any recovery generates significant inflationary pressure. The key for monetary policy though, is to being removing monetary stimulus before the slack actually dissipates, given the lags involved. We still think this is more likely around mid-2010 or a touch earlier, not later.

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**Figure 4: GDP level and growth**

