

Technical recovery

Q4 GDP preview: 24/03 10:45am NZT

- We estimate that GDP growth was mildly positive in Q4, following a 0.2% contraction in Q3.
- There is room for easy gains in many sectors that were weighed down by the autumn drought and the September earthquake.
- But the fact remains that the economy stalled over the course of 2010.

GDP expectations

	GDP q/q	GDP y/y	GDP ann ave
Q3 actual	-0.2%	1.4%	1.4%
Q4 Westpac forecasts	0.4%	0.9%	1.5%
Q4 RBNZ forecasts	0.0%	0.5%	1.4%

Next week’s GDP report for the December 2010 quarter is probably as low a priority as this release can get – sandwiched as it is between two quake-afflicted quarters, and with markets far more concerned with developments overseas at this moment. The main point of interest is likely to be whether the economy met the ‘technical’ definition of a recession by contracting for a second straight quarter.

Our forecasts suggest just the opposite: a ‘technical’ recovery, not due to any underlying strength in the economy, but to the fact that there are easy gains to be had in many sectors relative to their depressed September quarter levels. In particular, drought conditions and the first Canterbury earthquake weighed on activity in Q2 and Q3; these influences are likely to have washed out by Q4. We expect a 0.4% increase in the production measure of GDP.

Our forecast is more uncertain than usual, as we’re missing a few major indicators. The 22 February earthquake severely disrupted Stats NZ’s operations, and it appears that in some cases – namely the manufacturing and wholesale trade surveys – preparing the figures for internal use in the GDP calculations has taken priority over external publication.¹ This is especially frustrating because manufacturing (around 12% of GDP) is one of the biggest swing factors behind our Q4 GDP forecast.

Figure 1: Production Based GDP

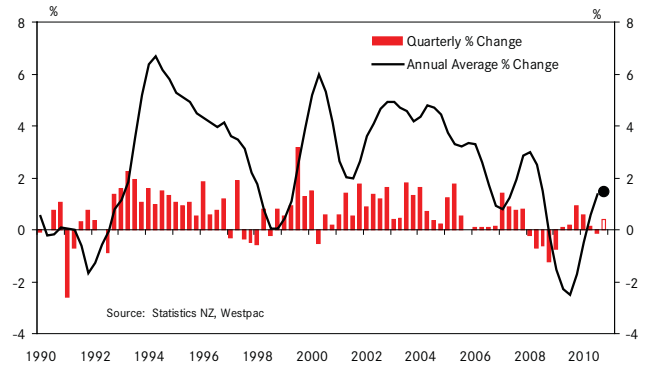
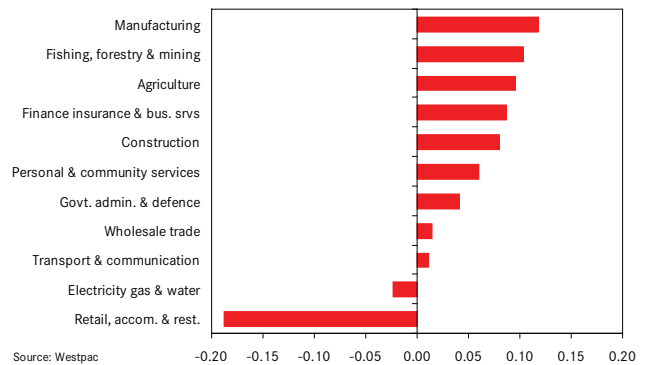


Figure 2: Percentage point contribution to Q4 GDP growth



The primary and goods-producing sectors have the most scope for a rebound in the December quarter. Agriculture and food processing will have benefited from better growing conditions, compared to the autumn drought and the September snowstorms. We know that there was a sharp rebound in food exports in Q4, especially in meat and dairy, and we find it unlikely that this was achieved by running down inventories – that trick was already exhausted earlier in the year, to maintain

¹ The problem is that the manufacturing and wholesale surveys were due to be reported under the updated ANZSIC06 industry classifications, which are not yet used for GDP. Stats NZ was already under pressure to produce two sets of numbers before the earthquake struck.

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the level of exports during the drought. So a rebound in food production seems a given, and the risks are probably to the upside of our assumptions. Outside of food processing, the Quarterly Survey of Business Opinion suggested an upturn in the manufacturing sector, following a weak Q2 and (probably quake-disrupted) Q3.

Forestry is also likely to have made a sizeable positive contribution to growth, given the 11% rise in export volumes for the quarter. Finally, we expect a pickup in the volatile construction sector. On top of the 1.1% rise in building work put in place (with a jump in non-residential buildings outweighing a further slump in housing construction), we've assumed some contribution from land clearing and repairs as part of the initial post-quake cleanup in the Canterbury region.

Now the not-so-good news: retail sales volumes were down sharply in Q4 – much more so, we believe, than the 0.4% drop in the retail trade survey (reported on an ANZSIC06 basis, which differs from the GDP treatment as previously noted). There was, however, a sizeable buildup in retailers' stocks, which suggests that the hit to other parts of the supply chain (such as wholesaling and transport) wasn't as large.

The service sectors are generally where it's most difficult to measure 'real' activity, and in recent quarters these have tended to undershoot our forecasts. But this is another area where there's room for easy gains compared to Q3, as the post-quake disruption to businesses, schools, hospitals and so on will have fallen in the September month. There may have been some outright positive contributions relating to the quake as well. Retail spending in Canterbury was running ahead of the rest of the country in Q4, which may reflect the replacement of broken household items. Local government spending rose, partly due to the clean-up in Canterbury. And EQC payouts helped to boost the finance sector's 'output' of deposit services.

Balance of risks and implications

Given the lack of some key information, and the hard-to-gauge influence of the September earthquake, we'd put a wider than usual margin of error around our forecast. However, we take some comfort from the fact that our top-down indicators, based on business and consumer confidence, were pointing to an outturn of around 0.4% several months back.

Understandably, market forecasts are relatively widely scattered this time. The median forecast is for 0.2% growth, with our 0.4% at the top end of the range and a -0.5% at the bottom end. The RBNZ assumed exactly zero growth in its March Monetary Policy Statement.

It's hard to gauge the likely market reaction to the GDP release. A small surprise either way could easily be ignored – recent events have captured the market's attention and underscored just how dated this release is. On the other hand, the lack of some sectoral indicators means that there will be more 'new' information content in this GDP release than usual, and the wider margin of error means more chance of a large, market-moving surprise.

Even if GDP turns out to have shrunk again in Q4, we think the implications for monetary policy would be limited. Were it not for the 22 February earthquake, we doubt that the RBNZ would be in a rate-cutting mood, as it would still be eyeing an imminent surge in reconstruction activity following the September quake. And last week's 50bp rate cut was, in part, a buffer against the potential for bad news over the short term. It was already clear that the economy stalled over the course of 2010; whether or not it met the 'technical' definition of a double-dip recession is a moot point.

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