NEW ZEALAND ECONOMICS
QUICK REACTION

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UNEVEN EXPANSION LOOKS SET TO CONTINUE

Market relevance: High

THE UPSHOT: The 0.3 percent quarterly rise in Q1 GDP was a touch softer than market expectations and the RBNZ pick (+0.5 percent). The details highlighted an uneven expansion, driven by lifting construction sector activity and a Census boost. While a drought impact was evident, drought also looks set to weigh on activity over the middle of 2013 and we continue to pencil in a softish Q2 GDP figure. Part of the softness in Q1 will reflect some payback from an outsized GDP surge in late 2012 so it needs to be kept in perspective. We're more focused on lead indicators and our timely nuances (ANZecdotes), and they look solid in terms of what they suggest for growth in the second half of 2013. We expect strengthening base momentum to eventually flow through into core inflation, but the current lack of pricing pressure suggests no immediate need for the RBNZ to raise the OCR: that remains a story for somewhat down the track. We continue to expect a March 2014 start to the tightening cycle, with a gradual pace of policy tightening and a low OCR endpoint this cycle.

DATA SUMMARY: 2013Q1 GROSS DOMESTIC PRODUCT

GDP	QoQ	YoY	Ann Ave%
Mar-11	0.7	0.8	1.6
Jun-11	0.6	0.6	1.0
Sep-11	0.8	1.7	0.8
Dec-11	0.3	2.5	1.4
Mar-12	1.1	2.8	1.9
Jun-12	0.3	2.6	2.4
Sep-12	0.3	2.0	2.5
Dec-12	1.5	3.2	2.7
Mar-13	0.3	2.4	2.5
ANZ	**0.4**	**2.4**	**2.4**
RBNZ	0.5	2.4	2.4
Market	0.5	2.5	2.4

KEY POINTS

- Q1 GDP growth at 0.3 percent sa was a touch weaker than the median market expectation and the June *MPS* pick (+0.5 percent). Expenditure GDP also rose 0.3 percent q/q. Annual growth eased to 2.4 percent (3.0 percent in Q4), with annual average growth at 2.5 percent.
- There were only mild historical revisions, with the level of real GDP about 0.5 percent higher in 2012Q4. This suggests the starting point capacity pressures are in a similar ballpark to the small negative output gap estimated in the June *MPS*.
- The Q1 GDP illustrated an uneven rate of quarterly expansion, with activity in 9 of 16 industries up. Strong increases were recorded for the goods (up 1.0 percent q/q sa), modest increases for services (up 0.5 percent q/q sa), with a 3.0 percent fall for primary sector value added.

- Despite recent strengthening, the level of activity is just 4.7 percent higher than late 2007 peaks, with per-capita output still 1.3 percent lower.
- Considering the Q1 result followed a very large increase in Q4, a milder pace of expansion was to be expected. While pending drought impacts and recoil from the 2013 Census are set to maintain quarterly volatility, lifting business and consumer sentiment point to a strengthening in annual growth momentum over 2013. The OCR will eventually need to move higher, but for now a contained inflationary backdrop and concerns over the NZD are expected to encourage the RBNZ to remain on the sidelines.

COMMENT AND ASSESSMENT

Production GDP components showed mixed readings, reflecting the offsetting shocks hitting the economy. Underpinning the Q1 lift in GDP was a 5.5 percent surge in construction value added, which contributed 0.3 percentage points to the quarterly lift in GDP. This sector looks set to be the major growth driver over next few years, underpinned by the $40bn rebuild and the 39,000 new dwellings earmarked for Auckland over the next 3 years. Signs of the early 2013 drought were evident with a sharp fall in dairy production contributing to a 4.7 percent fall in agricultural value added. Forestry also fell after strong Q4 rises, while mining continued to move higher (up 4.2 percent q/q). Electricity value added was down 4.4 percent. There were signs of a drought-induced lift for primary manufacturing (up 3 percent), underpinned by rising meat slaughter. A sharp contraction is in store for Q2. Non-primary manufacturing activity fell in Q1, with this sector yet to fully catch the updraft provided by strengthening construction sector activity.

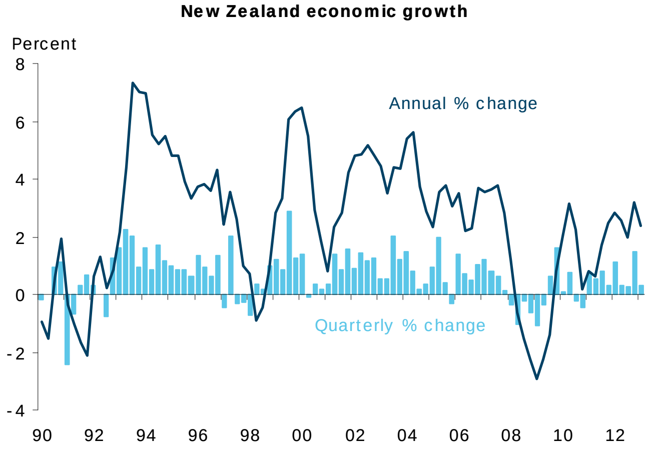
The services sector was a mixed bag. The 2013 census contributed to a 3.9 percent climb in professional, scientific, technical and administrative support services, contributing 0.4 percent to Q1 GDP, which looks set to reverse in Q2. Lifts in retail trade reflect early 2013 rises for consumer sentiment. Rises for accommodation and food services suggest the tourism sector is continuing to find ways to work around the high NZD. Despite higher paid hours, government administration declined in Q1 and gains in this sector look to be a stretch given fiscal pressures. Volumes fell for transport and media and communications, highlighting the unevenness of the expansion.

The expenditure-based GDP measure also highlighted offsetting influences. Private consumption volumes lifted 0.4 percent q/q off the strong Q4, underpinned by rises in durables, non-durables, and services. Residential investment activity surged 9.6 percent, the seventh consecutive quarter of growth, with the increase underpinned largely by more work in Canterbury. Despite this, residential investment activity is still 23.5 percent below its June 2004 peak. Business investment fell 2.2 percent, with falls in investment in plant and machinery equipment, intangible assets, other construction, and transport equipment. A 2.3 percent rise in import volumes was offset by a 2.5 percent climb in exports (supported by a 7 percent climb in services exports), imparting a positive contribution from net trade. Despite the build-up in manufacturing and forestry inventories adding to GDP, this was offset by a negative contribution from the seasonal balancing item.

Today's data confirmed the economy started 2013 on a mixed note, with recent quarterly volatility a reminder that the economy is navigating its way through various shocks. This volatility looks set to continue given the pending drought hit, with the required shift in resources to facilitate rising construction sector activity likely to create tensions. Moreover, the housing-induced uplift still looks difficult to sustain without a pronounced improvement in the labour market backdrop, and with pending fiscal tightening and a RBNZ prudential policy response.

The June *MPS* alluded to strengthening in economic activity, but also to the uneven nature of expansion. This looks set to be a major theme for the remainder of the year, and while we expect underlying momentum to strengthen, the growth mix looks to be domestic demand centric. Low inflation and the high NZD are providing the RBNZ with scope to remain on the sidelines. Increasing capacity pressures are likely to see the RBNZ lifting the OCR from early 2014, but we continue to expect a gradual pace of policy tightening by historical standards, with a low OCR endpoint this cycle.

ANZ QUICK REACTION



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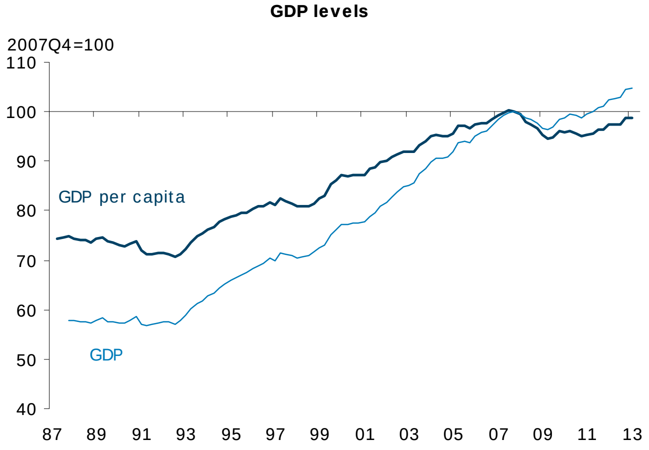

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