ANZ RESEARCH

NEW ZEALAND ECONOMICS
QUICK REACTION

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SERVICES SECTOR AND CONSTRUCTION TO THE RESCUE

Market relevance: High

THE UPSHOT: The 0.2 percent quarterly rise in Q2 GDP was close to market expectations (+0.2 percent) and the RBNZ pick (+0.4 percent). The details highlighted an uneven expansion, with the drought hit to agricultural and manufacturing production being offset by strength in the construction sector and strengthening services sector activity. The scene is set for a strong second half of 2013. The key will be the extent to which supply side capacity will be able to accommodate the strengthening demand backdrop. A still-volatile global scene, contained core inflation backdrop and a NZD heading into the stratosphere should keep immediate OCR increases on the backburner. 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: Q2 2013 GROSS DOMESTIC PRODUCT

GDP	QoQ	YoY	Ann Ave%
Mar-11	0.7	0.8	1.6
Jun-11	0.6	0.7	1.0
Sep-11	0.8	1.7	0.8
Dec-11	0.3	2.5	1.4
Mar-12	1.0	2.8	1.9
Jun-12	0.4	2.5	2.4
Sep-12	0.3	2.0	2.5
Dec-12	1.6	3.4	2.7
Mar-13	0.4	2.7	2.7
Jun-13	0.2	2.5	2.6
ANZ	**-0.1**	**2.0**	**2.4**
RBNZ	0.4	2.5	2.5
Market	0.2	2.3	2.4

KEY POINTS

- Q1 GDP growth at 0.2 percent sa was in line with the median market expectation and slightly below the September *MPS* pick (+0.4 percent). Expenditure GDP rose 0.1 percent q/q. Annual growth eased to 2.6 percent, with annual average growth at 2.7 percent.
- There were only mild historical revisions, with the level of real GDP about 0.3 percent higher in 2013Q1. This suggests the starting point capacity pressures are in a similar ballpark to the small negative output gap estimated in the September *MPS*.
- The Q2 GDP data illustrated an uneven rate of quarterly expansion, with activity in 8 of 16 industries up. The drought contributed to a 3.7 percent fall in primary sector value added, whilst unexpected strength in the construction sector underpinned a 0.2 percent rise in the goods sector. There was a strong 1.0 percent climb in services value added, with most sub-sectors picking up.

- Lifting business and consumer sentiment point to a strengthening in growth momentum over 2013. The onus will be on supply-side capacity to keep up. The OCR looks set to move higher over 2014, but for now a contained inflationary backdrop, forthcoming changes to prudential policy, and concerns over the strengthening NZD are keeping OCR moves on ice.

COMMENT AND ASSESSMENT

Production GDP components showed mixed readings, reflecting the offsetting shocks hitting the economy. The early 2013 drought resulted in a 6.4 percent fall in agricultural sector value added, which along with lower forestry and logging activity, contributed to a 3.7 percent fall in primary value added. Partly offsetting this was a 0.2 percent rise in mining, reflecting higher oil and gas extraction and coal mining.

Value added for goods-producing sectors managed a tepid 0.2 percent increase. The major surprise was the 2.3 percent rise in construction sector activity. This outturn was stronger than suggested by the work put in place figures and cement production and was driven by surging heavy and civil engineering construction. Construction value added was up 15.4 percent on a year ago, and prospects remain for a continued strong lift underpinned by the Canterbury rebuild and more construction activity in Auckland. Drought-related falls in food, beverage and tobacco manufacturing volumes (down 3.8 percent) contributed to a 0.1 percent decline in manufacturing value added, with the increase in chemical, polymer, and rubber product manufacturing and transport equipment, machinery and equipment manufacturing consistent with improving sentiment in that sector. **Manufacturing and construction sector activity remains well below historical peaks (8.6 percent and 5.3 percent respectively) but looks set to be the major growth drivers over the next few years.** Electricity value added declined 2.4 percent, reflecting falling demand for electricity due to the warmer than usual autumn.

Services sector value added rose 1.0 percent, with growth spread across most sectors. There were strong increases for professional, scientific, technical and administrative support services (up 2.6 percent), with the strengthening labour market backdrop and high consumer confidence underpinning a 2.1 percent rise in retail trade and accommodation. These were partly offset by falls in wholesale trade and information, media and telecommunications.

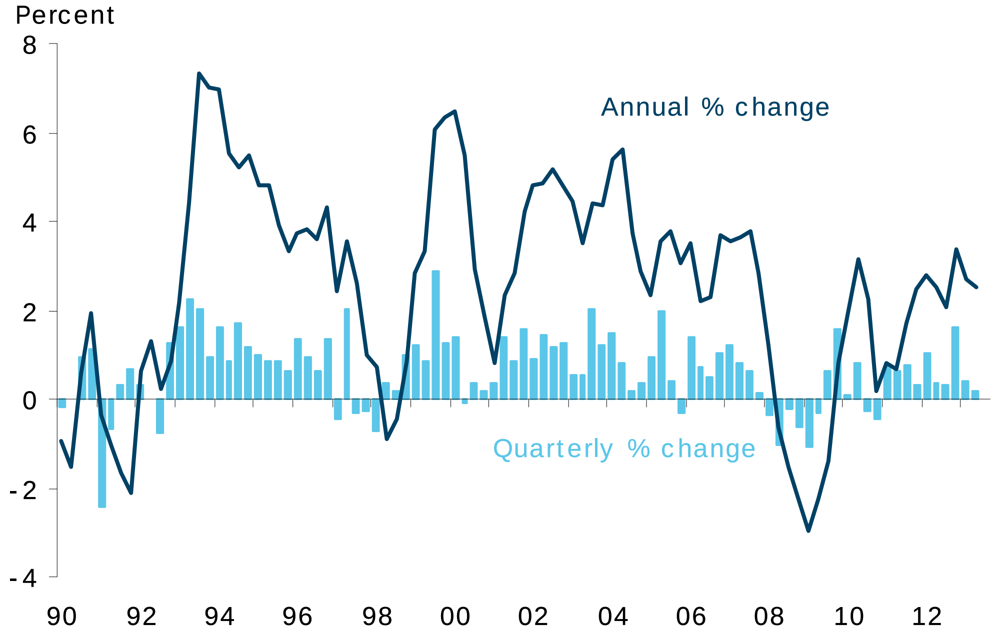
The expenditure-based GDP measure also highlighted offsetting influences. Private consumption volumes surged 1.5 percent q/q, underpinned by rises in durables (up 4 percent) and services (1.4 percent). Following a series of strong increases, residential investment activity fell 1.6 percent, but looks to step up in the second half of the year underpinned by more construction work in Canterbury and Auckland. Business investment rebounded 5.7 percent, led by a 23.9 percent increase in other construction activity, a 13.2 percent rise in transport equipment, a 1.5 percent gain in plant and machinery, a 4.1 percent rise in intangibles, and 1.0 percent rise in non-residential investment. Offsetting the strong domestic demand backdrop was the drought-related fall in export volumes (-5.9 percent) and rising import volumes (up 1.3 percent), which together imparted a large negative trade contribution of around 2.5 percentage points. Inventories made a broadly neutral contribution.

Today's data confirmed the economy traversed the first half of the year in 1st gear, with sector volatility a reminder that the economy is navigating its way through various offsetting shocks. **Our view is that the economy hit an inflexion point midway through the year and the scene is set for a stronger second half of the year.** This is consistent with the spirit of the September *MPS*, which alluded to strengthening in economic activity. The recovery is expected to be broad based, with the strengthening labour market backdrop, rising net immigration, and housing market tailwinds expected to underpin consumer spending, the mild winter expected to lift dairy production and export activity, and the $40bn Canterbury rebuild and lift in construction sector activity elsewhere expected to filter through into wider economic activity.

The key will be the extent to which supply side capacity will be able to accommodate the strengthening demand backdrop. At the moment, however, a still-volatile global scene, contained core inflation backdrop and a NZD heading into the stratosphere are encouraging the RBNZ to remain on the sidelines, with forthcoming prudential policy changes to directly address areas of financial stability and inflation risk. A rising trajectory for core inflation is likely to trigger OCR increases, and we continue to expect a March 2014 start, a gradual pace of policy tightening, and a low OCR endpoint by historical standards this cycle.

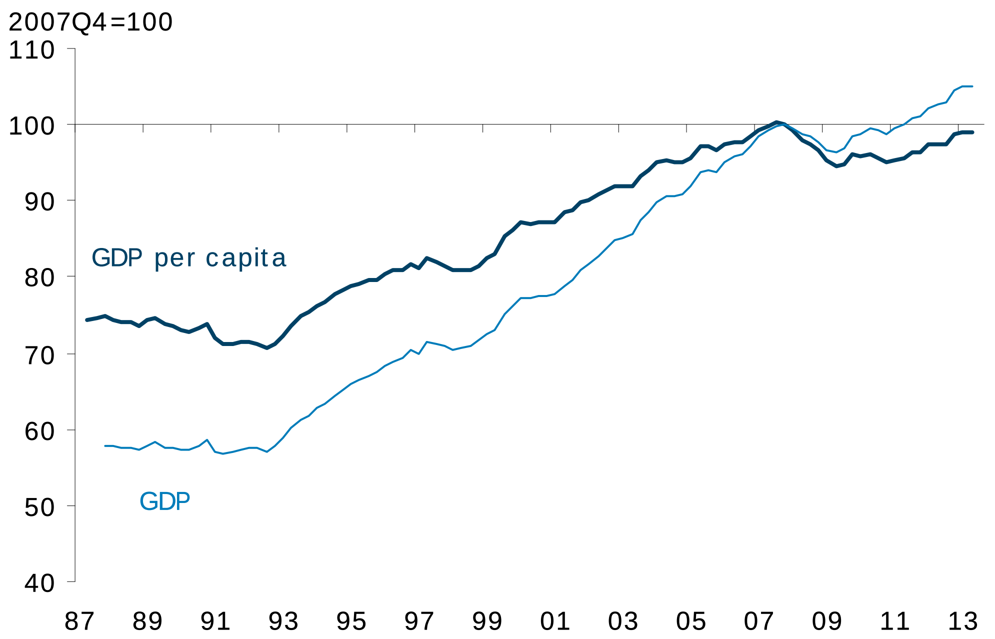
ANZ QUICK REACTION

New Zealand economic growth



Sources: ANZ, Statistics NZ

GDP levels



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