ANZ RESEARCH

NEW ZEALAND ECONOMICS
DATA REVIEW
Gross Domestic Product – March 2015 quarter

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CONTRIBUTORS

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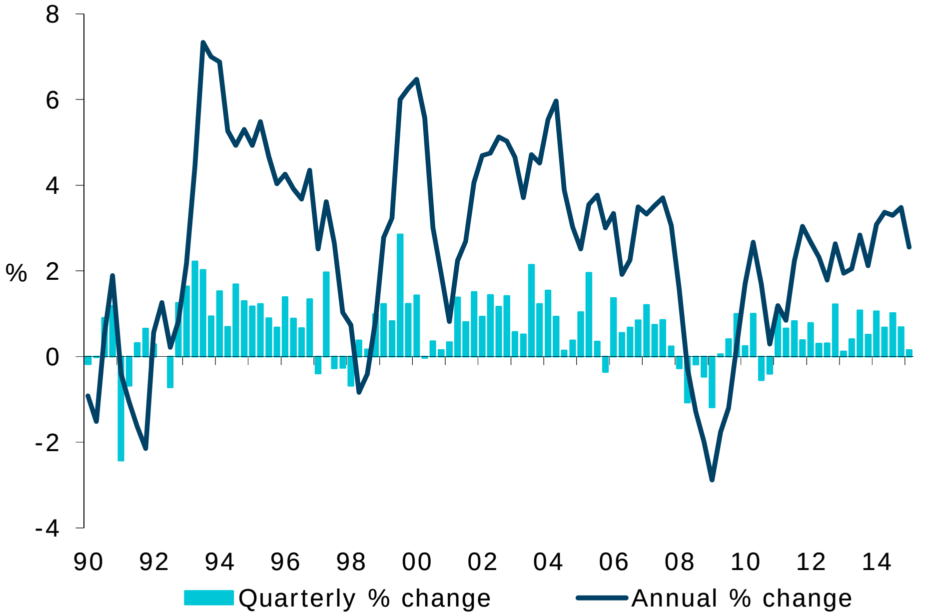
GROWTH DRYING UP

KEY POINTS

- The 0.2% quarterly rise in Q1 GDP was much weaker than the median market expectation and the RBNZ's pick (0.6%).
- Annual growth eased to 2.6% – the lowest rate since the end of 2013.
- Softer signs were evident in the primary sector (-2.9% q/q), which drove much of the moderation in activity. Activity in the goods sector rose a modest 0.6%, while services sector activity rose a more moderate-than-expected 0.7%.
- While an element of modest recoil is to be expected in Q2, and part of today's weakness was due to one-off factors (drought), it is apparent that growth momentum is sluggish. Local and external headwinds are building and we see a sub-trend pace of growth momentum persisting into mid-2015.
- Today's data cements our expectation of a further RBNZ OCR cut in July. However, we now expect an additional 25bp rate cut beyond this before the end of the year, taking the cash rate to 2.75%.

FIGURE 1. PRODUCTION-BASED GDP



Source: ANZ, Statistics NZ

DATA REVIEW

DATA WRAP

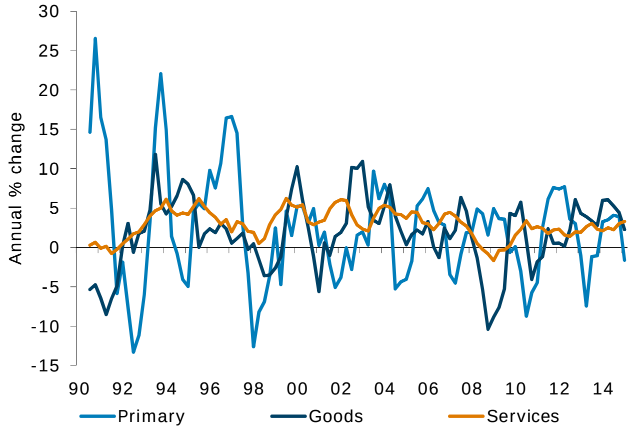
The New Zealand economy started the year on a soft note, with the 0.2% q/q sa rise in Q1 production-based GDP much weaker than the 0.6% q/q median consensus expectation and RBNZ's June *MPS* pick. It was also below our 0.5% expectation. Quarterly growth was the lowest since the start of 2013, and annual growth eased to 2.6% – the softest since the end of 2013. Annual average growth remained reasonably firm at 3.2% in the March 2015 year.

GDP	QoQ	YoY	Ann Ave %
Mar-13	0.1	1.9	2.2
Jun-13	0.4	2.1	2.1
Sep-13	1.1	2.8	2.4
Dec-13	0.5	2.1	2.2
Mar-14	1.1	3.1	2.5
Jun-14	0.7	3.4	2.9
Sep-14	1.0	3.3	3.0
Dec-14	0.7	3.5	3.3
Mar-15	**0.2**	**2.6**	**3.2**
ANZ	0.5	3.0	3.3
RBNZ	0.6	3.1	3.3
Market	0.6	3.4	3.3

A number of catalysts contributed to the low GDP result, with falls in 7 of the 16 production-based GDP components. The sharp 7.8% decline in mining GDP was led by a decline in oil exploration activity and oil & gas extraction, which is consistent with the lower oil price backdrop. The impact of dry weather conditions at the start of the year was clear, hitting agriculture (-2.3% q/q), food & beverage manufacturing (-1.6% q/q) and electricity value added (-0.5% q/q). Forestry & logging GDP fell 1.4%, with activity 3.3% lower than a year ago. There was a scattering of falls amongst other production components, including information, media & telecommunications (-2.7%), and wholesale trade (-2.1%). Manufacturing GDP overall fell 0.5% q/q (+2.4% y/y), with falls for furniture and other manufacturing (-3.8%), and metal products (-1.1%) perhaps suggesting less of a tailwind from the construction sector.

The quarter saw growth in just 9 of the 16 production GDP components. Retail trade rose 2.4% q/q, assisted by the Cricket World Cup and Chinese New Year tourism boost, as well as the boost that lower petrol prices provided to households. Strong increases were also evident for arts, recreation & other services (+2.4%) and transport, postal & warehousing (+2.5%). Strong employment gains appeared to underpin the 1.2% increase in financial & insurance services GDP. Slowing housing market activity was likely a catalyst behind the flat-lining in rental, hiring & real estate services GDP. Construction value added rose 2.5% q/q, but the rate of annual increase slowed to 3.6% – a 3½ year low.

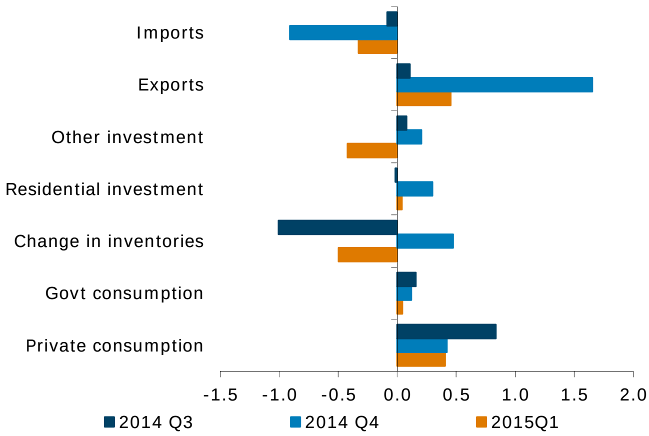
FIGURE 2. PRODUCTION BASED GDP COMPONENTS



Source: ANZ, Statistics NZ

Expenditure-based GDP rose just 0.1% sa q/q (+2.9% y/y), considerably weaker than we had expected. The major area of surprise was weaker-than-expected investment spending (-1.9% q/q), with sharp falls for plant & machinery and transport equipment spending. Intangibles investment was also weaker. Partly offsetting this were increases for other construction and non-residential construction. Residential investment activity rose just 0.6%, with the 5% annual growth in the sector the lowest since the start of 2012. **Still-solid surveyed investment intentions suggest a rebound in Q2, but we note that sentiment measures can turn quickly and may temper investment spending over 2015.**

FIGURE 3. CONTRIBUTIONS TO EXPENDITURE BASED GDP



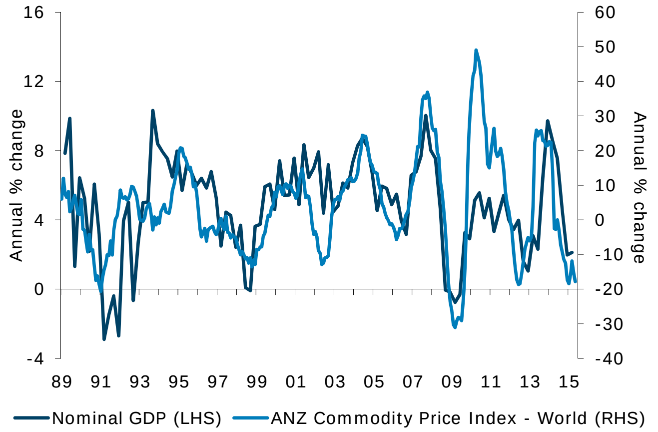
Source: ANZ, Statistics NZ

DATA REVIEW

In terms of other expenditure GDP components, strong employment growth and high net immigration continue to benefit consumer spending (+0.7%), with services, non-durables and durable spending the major drivers over the quarter. A tourism-assisted boost to services exports (+3.6% q/q) contributed to a 1.5% q/q rise in export volumes, outstripping the 1.0% q/q rise in imports. Lower inventories made a negative contribution, and are likely to be rebuilt in future.

The slowing in annual growth in nominal GDP (2.1% y/y) appears to have been partly checked by the Q1 lift in the goods terms of trade. But **with inflation still low and with the terms of trade set to fall sharply over the remainder of the year, the outlook is for a further hit to the income base of the economy.** Our estimates suggest that annual growth in real gross national disposable income slowed to just 0.6% in the 12 months to March (3.2% annual average rate). It was running at an annual rate of closer to 8% 12 months ago. Recall, the hit to purchasing power and incomes from the weaker terms of trade outlook was a major consideration behind the RBNZ's decision to cut the OCR earlier this month.

FIGURE 4. NOMINAL GDP & COMMODITY PRICES



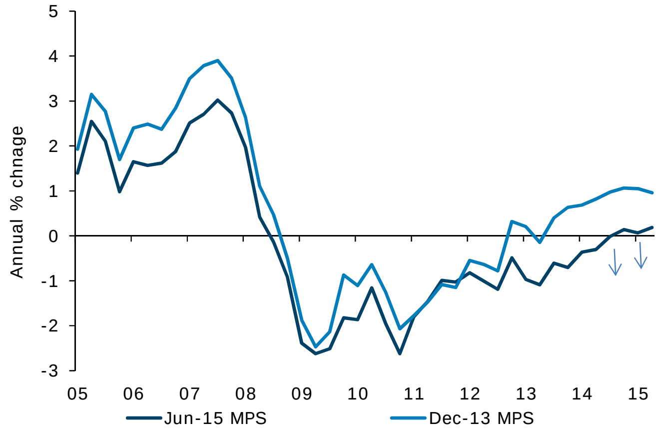
Source: ANZ, Statistics NZ

IMPLICATIONS

Today's data is historical, but it matters in terms of forming an assessment of how the economy has fared. **Clearly the starting point appears weaker than the RBNZ had expected.** Although there were minimal historical revisions to the level of real GDP (0.1% lower by 2014 Q4), the considerably weaker-than-expected Q1 GDP result suggests the economy was likely running with a negative output gap at the start of the year. That of course ties in with the low inflation readings we have been detecting of late.

Looking forward, we note that some of the sectors that were weak in Q1 are likely to reverse their falls in Q2. On the other hand, we believe that the tourism boost in Q1 – which held up some of the services components – is likely to wane. Hence we feel there is only a small likelihood of a sharp rebound in Q2 GDP. Rather, we expect another sub-trend result. This will mean even less pressure on capacity at a time that inflation is already low. In addition, more of our proprietary leading activity indicators are starting to roll over, and all up we expect the economy to moderate, with growth of 2-2½% growth forecast over 2015. Clearly, this points to downside risks to the RBNZ's June *MPS* 3.1% growth forecast.

FIGURE 5. RBNZ OUTPUT GAP ESTIMATES



Source: ANZ, Statistics New Zealand, RBNZ estimates

A lower OCR is needed to lift (low) inflation towards the RBNZ inflation target. **Today's data strongly reinforces our call for a follow-up cut in July, and we now expect a third rate cut before the end of the year.** Still, ahead of Q2 CPI data it is a stretch for the market to move to fully price in a July cut, so in the interim we expect the market to slowly gravitate towards 75/25 odds.

IMMEDIATE MARKET REACTION

There was considerable market reaction to the weaker result, with both the NZD and interest rates falling. The NZD was down heading into the result and fell 70 pips immediately following the release. Short-term interest rates eased 6-7 points.

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