Economic Research
Sydney
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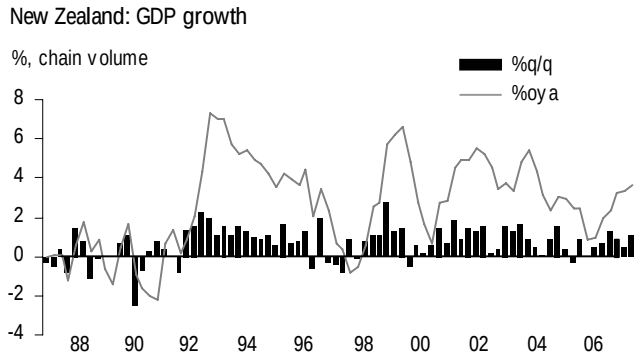
New Zealand economic update

4Q GDP

The New Zealand economy grew an unexpectedly firm 1.0%q/q in the December quarter (JPMorgan and consensus 0.8%), following on from 0.5% in 3Q. The solid rate of expansion follows data yesterday showing a significant narrowing of the current account deficit. The sharp improvement in the current account balance in the final three months of last year was driven by increased export volumes, which prompted us to revise up our 4Q GDP forecast from 0.6%q/q to 0.8%. On a year ago basis, economic growth accelerated to 3.7% in the fourth quarter from 3.3% in 3Q.



The main drivers of growth in 4Q were exports and capital spending. Exports added significantly to growth, rising 5.4%q/q (after falling slightly in 3Q) on the back of increased dairy production and petroleum shipments. Dairy exports were up 23.3%q/q and exports of coal, crude petroleum and ores, minerals and gases recorded strong growth. Imports were up 4.3%q/q.

Business investment surged 6.2%q/q, after a flat reading in 3Q when credit market jitters weighed heavily on business sentiment. Business investment was driven by increased investment in non-residential buildings; plant, machinery and equipment; and, intangibles. According to Statistics New Zealand (SNZ), the increase in intangibles resulted from increased exploration activity. Note that production at the Tui oilfield began in 3Q but reached full production in the December quarter, according to SNZ.

Government consumption growth slowed from 2.1%q/q to 0.4% in 4Q. This moderation was surprising given the government is running large surpluses and the upcoming election. Government spending will likely accelerate this year with government members embarking on a potentially vote-winning

spending spree ahead of the election (to be held in late 2008). Spending on education and health services, among other things, will pick up considerably.

%q/q	1Q	2Q	3Q	4Q
Private spending	2.1	0.5	0.4	0.5
Government spending	0.5	1.2	2.1	0.4
Residential buildings	-0.1	3.1	1.9	-1.6
Business investment	4.1	-1.6	0.0	6.2
Gross national expenditure	1.3	1.8	0.3	0.6
Exports	2.6	-0.8	-0.1	5.4
Imports	4.2	2.6	0.7	4.3
GDP (expenditure-based)	**1.0**	**0.7**	**0.3**	**0.8**
GDP (production-based)	**1.2**	**0.9**	**0.5**	**1.0**

Private consumption held relatively steady in 4Q, rising 0.5%q/q, although will moderate in 2008. Consumers are reining in spending amid record high interest rates, rising petrol prices, a deteriorating housing market, and increased financial market volatility. Drought conditions in key dairy producing areas has also started to dampen spending, and local banks recently have started to pass on higher funding costs resulting from credit market tightening, even though the official cash rate has remained steady since July.

Residential investment took a hit from higher lending rates as expected in 4Q, falling 1.6%q/q and reversing the previous quarters' gain. The housing market has turned significantly, with the median house price falling to a 12-month low in January and the annual rate of house price appreciation dropping to just 0.7%, according to REINZ. With house prices forecasts to decline 5% in 2008 (according to our forecasts and the forecasts of the RBNZ), further deterioration in residential investment can be expected, especially given that net-permanent migration is likely to turn to a net outflow in coming months.

JPMorgan expects the Kiwi economy to grow a below-trend 2.3% in 2008. Private consumption, residential investment, and business investment will likely slow under the weight of record high interest rates. Tight labour market conditions, rising commodity prices, and the government's expansionary fiscal stance will keep upside pressure on inflation, however, leaving little room for the central bank to cut interest rates. Exports should continue to favour from the forecast decline in the Kiwi dollar, although the harsh drought poses a key downside risk to the export outlook, as does a sharper than expected slowdown in global demand.