

New Zealand economic update

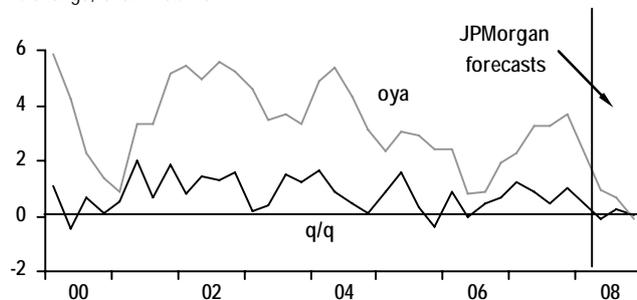
1Q GDP

Owing to widespread weakness, the New Zealand economy contracted 0.3%q/q (JPMorgan -0.4%, consensus -0.3%) in 1Q, following a revised 0.8% expansion in 4Q (previously 1.0%).

It now appears that the New Zealand economy is in the midst of a recession. Our forecast calls for another contraction in the economy in 2Q, with a 0.1%q/q decline in GDP expected. In particular, private consumption will continue to face significant headwinds as high borrowing costs and rising prices eat into households' disposable incomes. Negative wealth effects from the rapidly deteriorating housing market and the recent softening in labour market conditions will also have dampened consumer confidence and spending. Exports should continue to benefit 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. JPMorgan expects the Kiwi economy to grow a below-trend 0.8% in 2008.

New Zealand: GDP growth

% change, chain volume



Of the production-based GDP measures, the agriculture and construction industries were the main drags on growth in 1Q. The agriculture industry fell 5.6%q/q, the largest decline in agriculture since 1Q 1998, as drought conditions in key agricultural industries dragged down output. The main driver of the 1.9%q/q decline in the goods producing industries was construction, down 5.2%, due to falls in both residential and non-residential construction.

GDP (%q/q)	1Q07	2Q07	3Q07	4Q07	1Q08
Private spending	1.9	0.4	0.5	0.5	-0.4
Government spending	0.7	1.0	1.8	0.2	1.1
Residential buildings	0.7	3.0	1.7	-2.2	-5.5
Business investment	3.2	-1.3	0.1	5.1	-1.2
Gross national expenditure	1.1	1.9	0.2	0.5	0.2
Exports	3.1	-1.2	0.0	4.5	-1.8
Imports	4.2	2.6	0.8	3.8	1.2
GDP (expenditure-based)	1.0	0.6	0.2	0.5	-0.6
GDP (production-based)	1.3	0.8	0.5	0.8	-0.3

The expenditure-measure of GDP fell 0.6%q/q in 1Q. Reflecting the sharp housing market downturn, residential investment was the largest drag on growth in the March quarter. Residential investment took a hit from higher lending rates, falling 5.5%q/q. The housing market has turned significantly this year, with house sales falling to a 16-year low in May and the median house price falling 1.4% from a year earlier. With house prices forecast to decline further in 2008, residential investment will continue to fall, especially given that net-permanent migration probably will be a net outflow in coming months.

Ongoing financial market uncertainty also deterred business investment. Business investment fell 1.2% after surging 5.1% in 4Q, as investment slowed in non-residential buildings and in intangibles. Business confidence remains weak, as do firms' activity expectations as corporate profitability continues to suffer amid record high interest rates and tighter credit conditions.

Private consumption also fell, slipping 0.4%q/q; this is the first quarter since June 2004 that private consumption has contracted. 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 also have dampened consumer sentiment and spending, and local banks recently have been passing on higher funding costs resulting from credit market tightening, even though the official cash rate has remained steady since July.

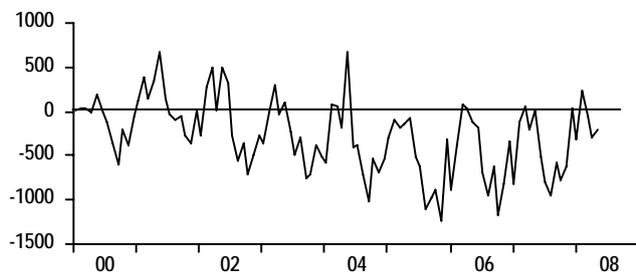
Net exports also subtracted from growth. Export volumes slumped 1.8%q/q owing to the drought, with exports of dairy and other food, beverages and tobacco products falling. Imports slowed, growing a mere 1.2%q/q, as domestic demand continued to weaken. The 12.2%q/q slump in imports of

motor vehicles, in particular, reflects the recent weakness in private consumption.

Government spending was the only expenditure-based measure to rise in 1Q, up 1.1%q/q. The government is running a large budget surplus, and government spending will probably remain elevated for the time being as the government embarks on what it hopes will be a vote-winning spending spree in the run-up to the election to be held later this year.

Other data today showed that New Zealand's trade balance remained in deficit in May for the third straight month. A deficit of NZ\$196 million was recorded, bucking expectations for a surplus (JPMorgan NZ\$50 million, consensus NZ\$150 million).

New Zealand: trade balance
NZ\$ million, nsa



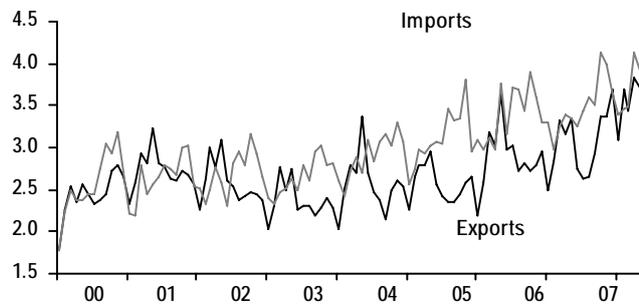
In the 12 months to May, the deficit widened to NZ\$4.81 billion from NZ\$4.61 billion in April. From a year ago, exports increased 11.2%, the highest ever for a May month, owing to increases in shipments of crude oil, meat and edible offal. Imports were up a solid 17.3% oya, mainly owing to a spike in intermediate goods (+21.6%). In commodity imports, a large increase in imports of petroleum and products (+NZ\$235 million) was recorded, led by imports of crude oil.

Looking ahead, imports will likely moderate significantly in coming months, reflecting weakening domestic demand. Elevated crude oil prices will keep upside pressure on headline imports, however, and the expected interest rate cuts later this year should help support domestic demand. We expect that the RBNZ will start easing monetary policy in September. The nation's export

competitiveness should benefit from the anticipated depreciation of the Kiwi dollar, but drought conditions will continue to weigh on agricultural production; this remains a key downside risk to the export outlook, as does a sharper than expected slowdown in global demand.

New Zealand: exports and imports

NZ\$ billion, nsa



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Economic **Research**
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