

# New Zealand's boom begins

## Rate hikes expected soon

**New Zealand's economy is booming. GDP increased strongly in Q3, rising by +3.5% y-o-y (market had 3.3%; HSBC had 3.5%). A bounce back from drought was a key driver in the quarter. More importantly, the broader economy has picked up over the past year. Post-earthquake reconstruction and rapidly rising housing and export prices have significantly boosted demand. These factors are expected to persist and timely indicators point to further solid growth in coming quarters. With the economy booming, we expect the RBNZ will need to raise rates from Q1 next year, to keep inflation in check.**

### Facts

- The production measure of GDP increased by +1.4% in Q3 (market had +1.1%; HSBC had +1.2%). Annual growth was +3.5% (market had +3.3%; HSBC had +3.5%).
- A bounce back in the rural sector was a key driver of growth in the quarter, with agricultural production rising by +17% q-o-q. Manufacturing activity also increased solidly, rising by +1.5% q-o-q, reflecting broad-based strength across the industry.
- The expenditure measure of GDP rose by +1.1% in Q3 and +3.1% y-o-y. Over the past year, post-earthquake reconstruction has been a key contributor to growth, with residential investment rising +18.7% y-o-y. Overall, domestic demand has increased strongly, rising +6.2% y-o-y.

### Implications

As we have been flagging for a while now, New Zealand economy looks to be at the beginning of a boom. This was confirmed in today's GDP figures. The economy registered strong growth in Q3.

While the strength partly reflects a bounce back in rural production from the impact of the drought seen earlier in the year, abstracting from the volatility caused by the drought, the rest of the New Zealand economy has grown strongly over the past year. Post-earthquake reconstruction in Canterbury has provided a significant boost, with residential investment rising by +18.7% over the past year.

The booming housing market has also supported a lift in economic activity. Rising asset prices, coupled with low interest rates and an improving labour market have driven a solid rise in consumer spending (+3.7% y-o-y). At the same time, high house prices have also begun to support an increase in construction activity outside of Canterbury.

Income growth has also been supported by a substantial rise in export prices, with the terms of trade hitting a 40-year high in Q3. This income boost likely supported growth in investment and spending in the quarter. Overall, these factors have seen domestic demand in New Zealand rise by a whopping +6.2% y-o-y.

Looking ahead, these key drivers are likely to persist and see the New Zealand economy continue to expand at a rapid pace. Recent business surveys have risen to multi-year highs and indicate further strong growth in Q4.

Today's figures are likely to have been an upside surprise for the RBNZ. In their official statement from last week, the RBNZ projected growth of +3.3% y-o-y in Q3. More importantly, the central bank expects the pace of growth to cool from here, but recent business surveys suggest there is upside risk to this assumption.

Overall, with the economy having grown strongly in Q3, and further solid performance expected, the RBNZ should start to raise interest rates soon, to keep medium-term inflation in check. We expect rate hikes will begin from Q1 2014. Focus will now shift to the Q4 CPI print, due on 21 January, with a higher than expected print likely to increase the chance that a cash rate rise could come as soon as late January. We have in mind that the cash rate will be 100 basis points higher by the end of 2014.

**Bottom line**

New Zealand's economy grew strongly in Q3, driven by a bounce back from drought and a solid underlying performance across a range of sectors

A strong housing market, rising commodity prices and post-earthquake reconstruction are providing a boost to demand, and these factors are likely to persist.

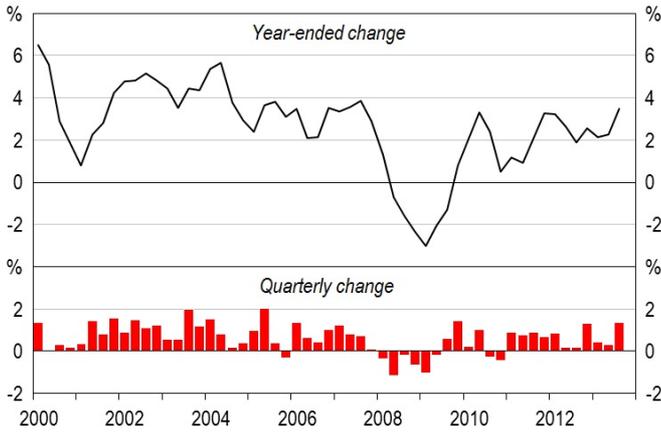
With the economy already at capacity and growing strongly, we expect the RBNZ to lift rates soon to keep a lid on inflation: we expect the first move to come in Q1.

Adam Richardson, Economist (Australia and New Zealand)

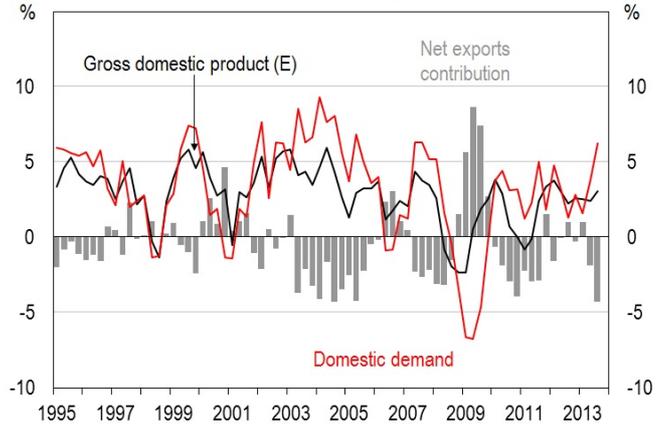
Paul Bloxham, Chief Economist (Australia and New Zealand)

**Summary charts**

**New Zealand GDP Growth**  
 Production measure



**New Zealand Economic Activity**  
 Year-ended change



Source: Statistics New Zealand

# Disclosure appendix

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