Monthly Economic Indicators

THE TREASURY
Kaitohutohu Kaupapa Rawa

July 2013

Executive Summary

- **Moderate GDP growth expected in the June quarter, with downside risks from drought**
- **Business optimism signals a pick-up in activity in the second half of the year**
- **Inflationary pressures set to increase**
- **Global markets stabilise**

Activity indicators are signalling only moderate GDP growth in the June quarter and it may be even weaker depending on the impact of the drought. This will likely be reflected in the negative contribution from net trade to GDP growth, although a partial offset is expected from stronger consumer spending.

Surveys showed that business confidence remains elevated and hiring and investment intentions were positive, providing a solid base for growth in the second half of 2013. Optimism is centred on the construction sector where the pipeline of residential building work is rising in response to regional housing pressures. There were also signs that the recovery will become more broad-based as the expected growth in building activity benefits local manufacturers and the agricultural sector bounces back from the drought. Likewise, elevated consumer confidence will support activity in the service and retail sectors.

Annual CPI inflation was subdued in the June quarter and has now been below the RBNZ's target band of 1-3% for four consecutive quarters, depressed by falling tradables prices. Beyond the June quarter, inflation is expected to pick up as the impact of the high NZD fades and non-tradables inflation begins to accelerate as the Canterbury rebuild gathers pace and competes for resources elsewhere in the economy. This is consistent with the marked increase in surveyed pricing intentions as capacity pressures firmed. The RBNZ acknowledged that GDP growth and inflation are likely to pick up, confirming that monetary stimulus will likely need to be removed in the future.

Global developments in July reinforced the rebalancing of global growth towards the developed economies while more dovish comments from the US Federal Reserve regarding the tapering of quantitative easing brought more stability to markets. The US economy continued to recover as June quarter GDP was stronger than expected. On the other hand, GDP growth slowed in China, although markets were relieved that the slowdown was not sharper.

One of this month's special topics examines the impact of a "hard landing" in China on the New Zealand economy. The slowing of growth in China reinforced the softer Australian outlook as the non-mining economy continues to be constrained by soft domestic demand. The softer outlook in Australia has been one factor behind fewer New Zealand residents departing to Australia which is covered in more depth in the other special topic this month on recent trends in external migration.

New Zealand Government

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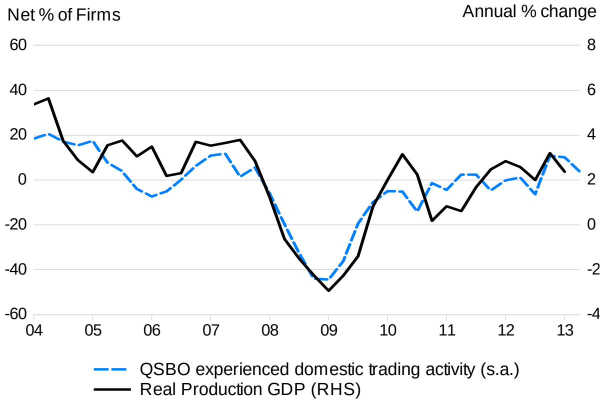
Analysis

Activity indicators are signalling moderate GDP growth over the June quarter, according to the NZIER Quarterly Survey of Business Opinion (QSBO). There is a risk that growth could be even weaker given the negative impact of the drought which is not picked up directly in the QSBO. The drought will likely lead to a negative contribution from net trade to GDP growth, although a partial offset is expected from stronger consumer spending. However, surveys show that optimism is still prevalent amongst businesses, which points to a solid base for growth in the second half of this year. Although optimism remains centred in the construction sector as the Canterbury rebuild gathers pace, growth is expected to become increasingly broad-based across sectors. The pick-up in activity in the second half of the year will see annual CPI inflation head back towards the middle of the Reserve Bank's target band.

Business confidence remains elevated…

The QSBO reported that business confidence remains at high levels, with a net 31% of firms expecting the general business situation to improve over the next six months, unchanged from the March quarter. This was in keeping with the positive tone of other business surveys such as the ANZ Business Outlook in which headline confidence lifted to its highest level since 1999. Elevated optimism amongst firms should provide a solid base for growth in the second half of 2013.

Figure 1 – Real GDP and QSBO Survey



Sources: NZIER, Statistics NZ

For the June quarter, domestic trading activity eased as only a net 4% of firms experienced an increase in trading activity, down from a net 10% in the March quarter. The relationship between firms' own activity and real GDP indicates moderate annual GDP growth for the June quarter (Figure 1).

Growth may be weaker than the QSBO suggests as it does not include the agricultural sector and therefore did not capture the direct impact of the drought.

The QSBO showed that the building industry remained the most optimistic sector over the June quarter as activity levels continue to be strong, although the pace of new orders and output did ease. Growing construction activity, particularly in Canterbury, contributed to an increase in actual output for manufacturers, while their export sales declined. This was consistent with an expansion in manufacturing activity reported by the BNZ-BusinessNZ Performance of Manufacturing Index (PMI) over the June quarter. The pace of activity was uneven across regions, with Canterbury growing strongly, followed by a moderate pick-up in Auckland while the drought weighed on activity in Waikato and the Bay of Plenty.

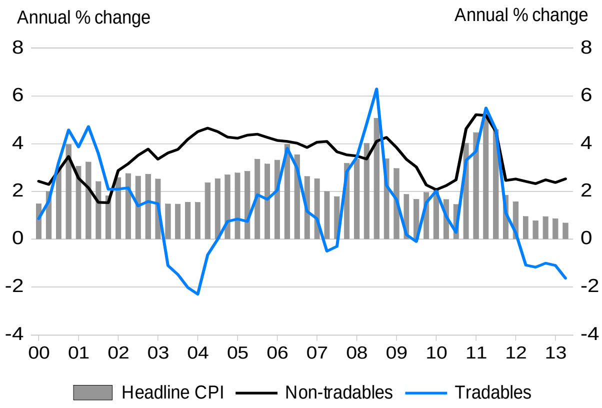
Beyond the near-term effects of the drought, the outlook for firms' own activity for the September quarter was higher, with a net 19% of firms expecting an expansion. While much of the expected growth is centred on the manufacturing and building sectors, sales for retail and service firms are also expected to increase, in line with robust levels of consumer confidence. This suggests that the recovery is expected to be more broad-based in coming quarters, particularly as the agricultural sector bounces back from the drought.

Healthy levels of business confidence translated into stronger hiring and investment intentions, both of which are currently above long-run averages. The labour market appears to be recovering, albeit gradually, with a net 9% of firms intending to employ more staff over the next quarter, up from a net 5% previously. Firms continue to report that skilled labour is difficult to find, much more so in Canterbury than elsewhere. This is consistent with an increase in the number of firms finding labour a constraint on output growth. This could place upward pressure on wages in the future as firms try to fill vacancies, particularly for skilled trades. Pricing intentions rose markedly in the June quarter from a net 13% of firms to a net 22% expecting to increase prices. This will partly reflect the depreciation of the NZD over the period.

...but annual inflation remains subdued…

The headline CPI rose 0.2% in the June quarter, following a 0.4% rise in the March quarter, leaving annual inflation subdued at 0.7%. Annual inflation has now been below the RBNZ's target band of 1-3% for the fourth consecutive quarter (Figure 2). The headline figure was depressed by tradables inflation, which was -1.6% for the year, as the pass-through of a high NZD persisted. However, annual non-tradables inflation remained broadly steady, at 2.5%.

Figure 2 – Annual CPI Inflation



Source: Statistics NZ

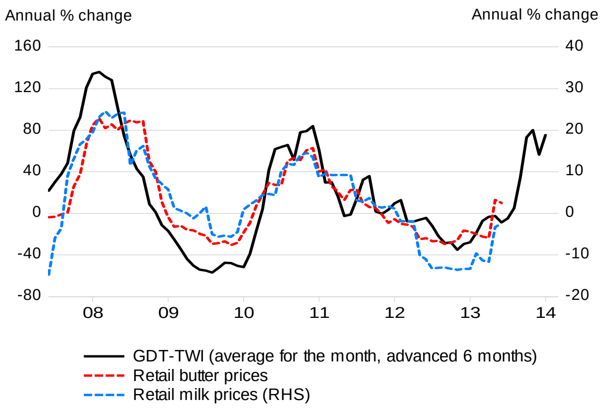
The housing and household utilities group provided the largest positive contribution to the quarterly growth in the headline CPI, adding 0.3% points. This was partially offset by a negative contribution from the transport group, which detracted 0.2% points as the price of fuel and imported cars fell, largely reflecting the ongoing pass-through of the elevated NZD. Within the housing and household utilities group, seasonally higher electricity prices as well as the price of newly-built houses were the main drivers. In Canterbury, the price of building a standard new house rose 2.9% in the quarter, stronger than the 1.7% rise nationally, but there are signs that price pressures are beginning to spread.

…although headline inflation is expected to pick up beyond the June quarter

On the whole, the CPI result for the June quarter showed limited price pressures across the wider economy, although it is expected to mark the low point for annual inflation. Recent falls in the NZD, if sustained, are expected to flow through to higher tradables inflation beyond the June quarter. This has already contributed to the recent increase in petrol prices while the pass-through for other tradable goods may take longer.

However, the outlook for the NZD remains uncertain with recent volatility being chiefly driven by international factors. Previous gains in commodity prices, particularly for dairy, could also contribute to higher food prices later in the year (Figure 3).

Figure 3 – Commodity and Retail Dairy Prices



Sources: GlobalDairyTrade, Statistics NZ.

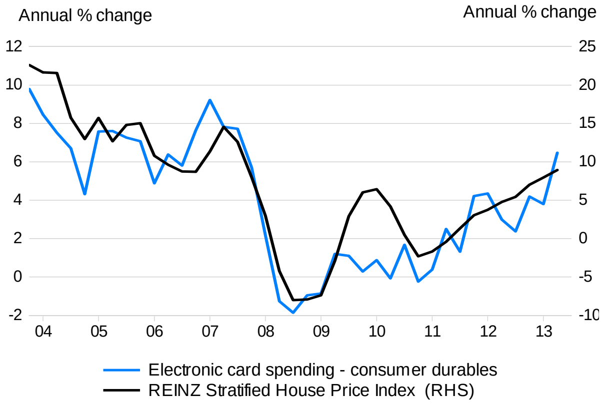
The medium-term outlook is for non-tradables inflation to begin to accelerate, as the Canterbury rebuild and housing shortages in Auckland reduce spare capacity in the wider economy. While the RBNZ kept the OCR unchanged in July, it confirmed that monetary stimulus will likely need to be removed in the future, acknowledging that growth is expected to pick up and become broad based across sectors. Most analysts now anticipate the first OCR hike to occur in the March 2014 quarter. Less certain is the pace of OCR hikes which may be influenced by the impact of macro-prudential measures, if enacted by the RBNZ.

Retail spending growth picks up…

Stronger-than-expected retail spending will provide a partial offset to the negative impact of the drought in the June quarter. Electronic card transactions data reported a 1.6% rise in the value of core retail sales (retail sales excluding auto) for the June quarter, to be up 4.1% in the year. Within this group, electronic card spending on consumer durables gathered further momentum, in line with the ongoing increase in housing market activity (Figure 4). The result, combined with the weaker-than-expected CPI outturn, points to solid volume growth in retail spending for the quarter.

Beyond the June quarter, robust consumer confidence, along with wealth effects associated with rising house prices, will continue to underpin retail spending growth. The ANZ-Roy Morgan Consumer Confidence Index eased slightly in July to 119.8 from 123.9, with petrol price increases contributing to the fall. However, the positive trend in the index remained intact, in keeping with the optimism expressed by services firms in the QSBO and BNZ-BusinessNZ Performance of Services Index.

Figure 4 – Electronic Cards and House Prices

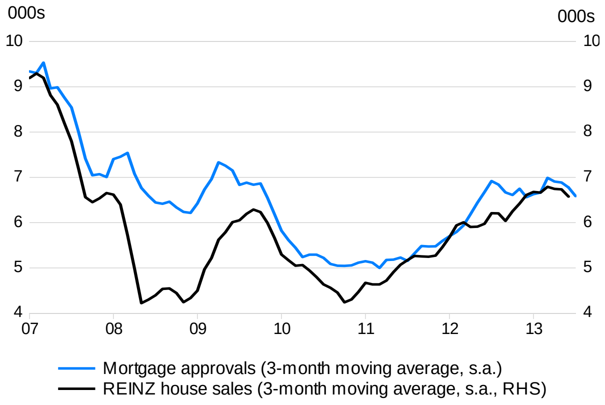


Sources: REINZ, Statistics NZ

...and pressure on housing market remains …

According to REINZ, there were 6,135 houses sold in June, a 7.0% drop from May after adjusting for seasonal variations and equal to the number sold in June 2012. The growth in house sales has flattened out since the start of 2013, with a similar trend seen in the number and value of mortgage approvals (Figure 5). However, indicators of demand appear robust with the number of days to sell (33) well below the historical average (39), suggesting that sales are partly constrained by low listings. While the growth of mortgage approvals has also slowed, the annual growth in housing credit, as measured by the RBNZ, gathered further momentum, rising 5.4%.

Figure 5 – House Sales and Mortgage Approvals



Sources: RBNZ, Statistics NZ.

The REINZ Median Housing Price Index lifted 0.3% in June on a seasonally-adjusted basis, with annual growth falling to 8.4% from 8.7% in May. In contrast, house price growth in Auckland increased further, rising 19.8% annually. In recent months, the annual net inflow of permanent and long-term migrants has risen significantly, currently standing at 7,900 for June. Most migrants are moving to Auckland but Canterbury has seen the strongest growth in net migration over the past year (see Special Topic: Recent trends in external migration). On the whole, the ongoing shortage of listings in parts of the country and the rapid turnaround in net migration is expected to maintain house price inflation in the near term.

…but supply is responding

The supply of new housing is increasing as dwelling approvals excluding apartments (which can be volatile) rose 8.4% in the June quarter, following a 4.7% increase in March, to be up 30% in the year. The growth in the quarter was led by Auckland, which recorded a 28% lift on a seasonally-adjusted basis, to be up 54% annually, although the level of consents is currently 20% below historical averages. The large-scale supply response required in both Auckland and Canterbury will continue to underpin the positive trend in consent issuance.

Export volumes decline owing to drought...

The merchandise trade balance posted a $414m surplus in the June month, contributing to the annual trade deficit narrowing further to $777m from $902m in May. For the June quarter, the NZD value of goods exports fell 4.7% as the effects of the drought flowed through, while the corresponding value of imports rose 1.0%. This result reinforces the Budget Forecast of a sizeable negative contribution from net trade to quarterly real GDP growth in the June quarter. It is also consistent with an expected narrowing of the annual goods trade surplus as measured in the current account.[1]

[1] Note that the monthly overseas merchandise trade data (OMT) reports the value of imports on a cif basis (ie, including the cost of insurance and freight). However, it is the value for duty series, which *excludes* the insurance and freight components, which is used for the Balance of Payments (BoP). This explains the current discrepancy between the annual trade deficit in the OMT data and the annual trade *surplus* in the current account of the BoP.

The decline in export values in the June quarter was driven by a 6.8% fall in dairy exports, with the volume of dairy exports down 18.2% following the drought. Meat exports were also down a sharp 11.6% in the quarter following the drought-induced early slaughter of stock.

...but outlook for coming season upbeat

Looking to next season, the dairy industry is expected to bounce back as pasture growth has recovered faster than anticipated and elevated dairy prices saw Fonterra upgrade its initial forecast payout by 50 cents to $7.50 per kg of milk solids. Average dairy prices at the GlobalDairyTrade auction rose 4.7% over July, following decreases in May and June, to be 75% above year-earlier levels. The lift in prices is partly a result of constrained supply in Australia, while the demand for inventory, particularly out of Asia, remained firm. Prices are likely to be maintained before the seasonal increase in production later in the year.

Global markets stabilise as growth rebalances towards the developed world

Developments in July reinforced the rebalancing of global growth towards developed economies. At the same time, comments from the US Federal Reserve (Fed) on the tapering of quantitative easing (QE) took a more dovish turn, leading to more stability in the market.

IMF revises down world growth forecast, driven by cut to emerging market growth...

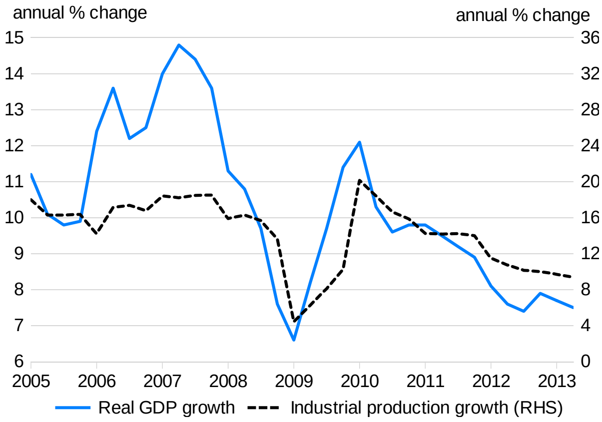
The IMF cut its world growth forecast for 2013 and 2014 by 0.2% points to 3.1% and 3.8% respectively, driven largely by the softer growth outlook for emerging economies. The IMF pointed to some common factors that underpinned the slowdown, including capacity constraints after previous strong growth and soft external demand growth from developed economies. In addition, tight monetary policies in emerging economies have led to currency appreciation against the USD, reducing competitiveness.

Consensus forecasts for most emerging Asian economies were also lowered throughout May to July, leading to a fall in NZ's trading partner growth of 0.1% points in both 2013 and 2014, to 3.3% and 3.7% respectively. These latest forecasts are 0.1% points lower than our Budget 2013 forecasts for both 2013 and 2014.

...as growth slows in China...

China's annual GDP growth in the 2013 June quarter was relatively soft at 7.5%, continuing its gradual decline (Figure 6) and owing in part to weak export growth in the June quarter. However, the market was relieved that the slowdown was not sharper. Annual industrial production (IP) growth eased to 8.9% in June, a post-GFC low, in line with subdued external demand.

Figure 6: China's quarterly GDP and IP growth



Source: Haver

Earlier comments from policymakers raised concerns that the government is less committed to maintaining growth, but Premier Li's confirmation later in July that 7.5% remains the growth target calmed markets. The government also initiated a small-scale stimulus package, including tax cuts for firms and infrastructure investment. One of the special topics explores the impact on New Zealand if a sharp slowdown in China's growth were to occur.

...reinforcing the softer Australian outlook

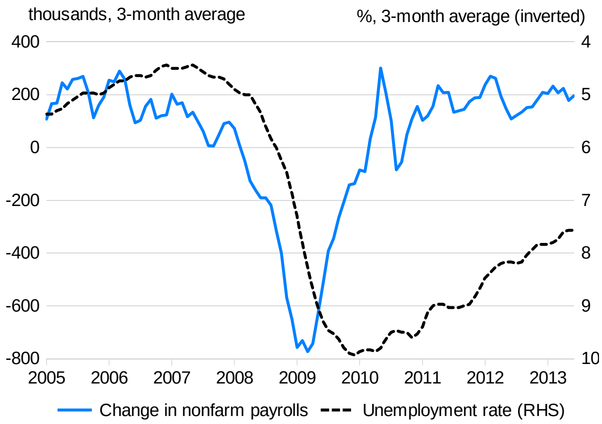
Australia's non-mining economy continues to be constrained by soft domestic demand. Retail sales growth was weak in March, April and May. Both the PSI and the PMI were subdued in June, which brought the June quarter averages to 43.4 and 42.0, respectively. Softness in the non-mining sectors led to low employment growth, and the unemployment rate ticked up 0.1% points to a 4-year high of 5.7% in June, which led the market to price in a high probability of a 25 bps rate cut by the RBA on 6 August. Expectations of a rate cut were reinforced by comments by Governor Stevens that the higher-than-expected June quarter inflation does not reduce the scope for easing. Positively, the interest rate-sensitive housing market appears to be responding to earlier rate cuts, with housing finance up 15.5% on a year ago in May.

US economic recovery continues...

US GDP expanded by 0.4% in the June quarter, higher than market expectation and driven by a rebound in construction. While March quarter growth was revised down (by 0.1% points to 0.3%), this was more than offset by upward revisions to earlier years.

The labour and housing markets continued to recover. Non-farm payrolls grew 195,000 in June, while the prior two months' readings were revised up. Payrolls growth has regained its pre-GFC rates (Figure 7), although the unemployment rate remains historically high. There was a setback in housing data in June, with falling housing starts, new permits, and existing home sales, but these were attributed mainly to monthly volatility and growth on a year ago remained strong. The continued rise in house prices and solid growth in new home sales indicated that housing demand remains robust despite higher mortgage rates. Manufacturing recovered modestly from its post-sequester weakness: IP expanded 0.3% in June, while the Markit PMI and the ISM manufacturing index both rose.

Figure 7: US labour market



Source: Haver

...and followed to varying degrees by others...

Positive developments continued in Japan. Market sentiment was supported by June's manufacturing PMI (+0.8 to 52.3) and strong net exports in the June quarter. There was some weakness in other data for June.

Improvements also occurred in the euro area and the UK. The preliminary euro area manufacturing PMI and services PMI both rose in July, while the unemployment rate remained at 12.1% in June, as the number of unemployed eased for the first time since early 2011. However, credit conditions remained constrained in June. Positively, UK's GDP grew by 0.6% in the June quarter, supported by solid growth in retail spending, attributed partly to rising house prices.

...indicating a broader but uneven pick-up in the developed world

July's developments provided further evidence of a recovery in the developed world, but the extent of this pick-up varies significantly between regions. While the euro area and the UK showed some improvement, this is from a low baseline. The pick-up in Japan was led by fiscal and monetary stimulus, which must ultimately be unwound, and structural reforms are needed for sustainable growth. Japan's ruling coalition gained control of the upper house in a recent election, which will facilitate further reforms. For now, the US recovery remains the most salient and most strongly supported by underlying fundamentals.

While the Fed plans to taper QE stimulus...

Fed Chairman Bernanke's comments in July on the tapering of QE were significantly more dovish compared to June, with greater emphasis on tapering being dependent on data matching the Fed's economic projections. Still, the underlying message is unchanged: the Fed will taper so long as the economic recovery continues.

...central bank reassurance of supportive policies stabilises the market

Throughout the month, Fed board members stressed the need for accommodative policy in the recovery, and that the policy rate would not be hiked for some time after QE is removed. The Fed's July policy statement reaffirmed this view and voiced additional concerns about the current low inflation. The BoE made no change in policy at the beginning of August and the ECB reaffirmed that rates would remain at present or lower levels for an extended period of time.

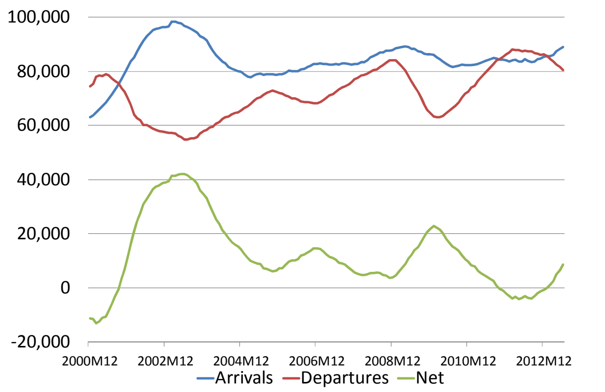
Reassurance of supportive monetary conditions led to greater stability in financial markets. US, European and Japanese equities regained much of their earlier losses. The appreciation of the USD has halted for now, as the market scaled back the expected pace of QE tapering, and there were fewer concerns about the impact of positive data on future Fed moves.

Special Topic 1: Recent trends in external migration

Net migration turns positive...

Permanent and long-term (PLT) migration has recently garnered more attention from economists and media, with the rapid turnaround to a net positive inflow over the first half of 2013. Annual net migration has turned from an outflow of 4,100 in August 2012 to an inflow of 7,900 in June 2013. If the recent pace of net inflow is maintained, the annual inflow of migrants could reach 20,000 by the start of 2014. This is well above Treasury's Budget 2013 forecasts, which assumed annual net migration would peak at 13,000 in mid-2014. The key driver for this turnaround has been a fall in departures to Australia, although total arrivals have been increasing as well. This will have important macro-economic and regional effects, particularly for Auckland and Canterbury.

Figure 1 – Annual PLT migration



Source: Statistics New Zealand

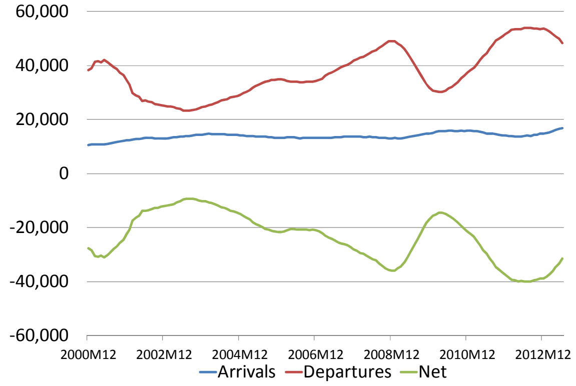
...as both departures fall and arrivals increase...

The turnaround in net migration has reflected both a recent pickup in arrivals, as well as a fall in departures. Arrivals have typically been much more stable than departures over history, in part owing to regulation (ie, visas etc), but nevertheless have ticked up recently (Figure 1). Departures from New Zealand have surged since the recession, peaking at 88,000 during 2012, but have declined recently.

...with migration to and from Australia the main driving factor

The main driving factor behind the cycles of net migration is departures to Australia, which generally account for more than half of total departures (Figure 2). The surge in migrants departing for Australia reflects the strong performance of the Australian economy since the GFC, as well as high wages, particularly in the mining sector. However, with the mining boom at or near its peak and the recent softening in the Australian economy, it has become less attractive. This is likely one of the main reasons behind the drop in departures over the past six months.

Figure 2 – Annual migration to and from Australia



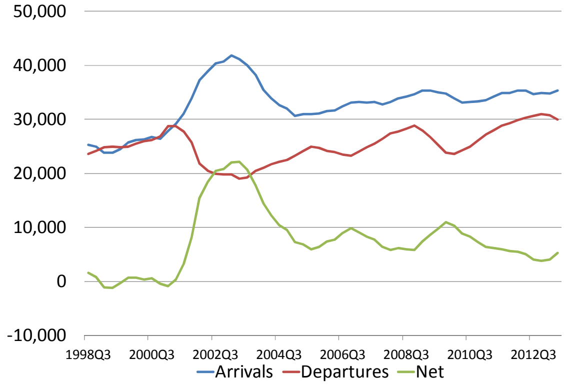
Source: Statistics New Zealand

The small pickup in total PLT arrivals of about 4,300 over the past year has also been mostly driven by migration from Australia, with the annual inflow from Australia up about 2,500 in the year to June compared to the previous year. The increase in arrivals from Australia has included both New Zealand and non-New Zealand citizens. Total arrivals have accelerated particularly over the past six months, with the rest of the increase in migrants coming mainly from European and Asian countries.

Immigrants moving mostly to Auckland and Canterbury

New migrants moving to New Zealand typically move to main centres, with Auckland region the most popular, with around 35,000 having arrived annually over the past few years (Figure 3). Departures from the region rose since 2009 to peak at 31,000 at the end of 2012, but have fallen slightly recently. The cycles in Auckland net migration have typically been driven by changes in departures rather than arrivals, although the cycles have become much more modest since the early 2000s. Annual net migration to the region sits at around 5,000 at present, in line with historical averages. It should be noted that this does not take into account any internal migration within New Zealand.

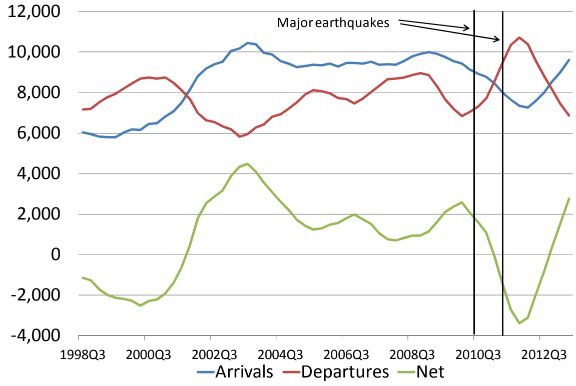
Figure 3 – Annual external migration - Auckland



Source: Statistics New Zealand

Given the earthquake rebuild, Canterbury is the other region that is of particular importance at present. The earthquakes have had a clear impact on net migration in the region, with arrivals falling and departures rising substantially following the earthquakes (Figure 4). Once again this does not include migration within New Zealand.

Figure 4 – Annual external migration - Canterbury



Source: Statistics New Zealand

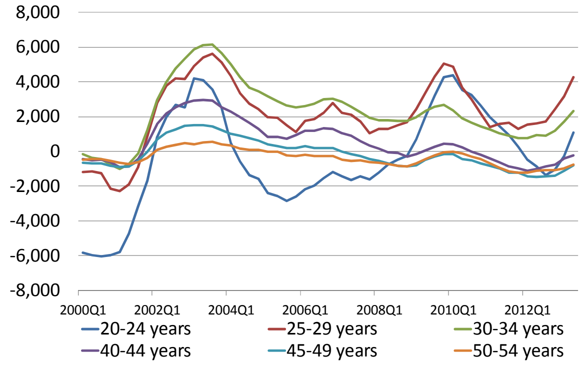
More recently, there has been a marked turnaround in net migration, driven both by a fall in departures and an increase in arrivals, returning annual migration figures closer to historical averages. However, with many workers being recruited from overseas to help with the rebuild, we expect net migration inflows to the Canterbury region to increase further. This will further strengthen aggregate demand in the region.

Young people more mobile

Young people are typically more mobile when it comes to travelling both within a country and overseas for work. They generally have fewer commitments, allowing them to move more easily. Young people also often leave to go on their "OE".

All of this is borne out in the data, with the numbers of younger people migrating much higher than for older people. The cycles are also much larger as well. Of interest here, however, is the recent turnaround in migration for some of these younger age groups (Figure 5).

Figure 5 – Annual net PLT migration by selected age group



Source: Statistics New Zealand

While net flows for several age groups have turned more positive very quickly, 20-24 year olds have seen the sharpest change. This has come through both a fall in departures and an increase in arrivals. In keeping with overall trends, a significant proportion of the increase is arrivals from Australia, with a high proportion of these arrivals NZ citizens (ie, returning Kiwis).

A similar pattern is evident for the 25-29 and 30-34 age groups, although their net flows have been positive for a while. The recent acceleration has also been caused by both a fall in departures and an increase in arrivals, including from Australia.

Recent trends expected to continue

Overall, there is little to suggest that recent trends in net migration will reverse soon. The New Zealand economy – despite the drought – is expected to expand solidly in coming years. The Canterbury rebuild will remain a key driver and attract more overseas workers to the region.

It is difficult to say when and at what level this cycle of net migration will peak, but at the current pace, the annual net inflow of migrants could reach 20,000 by the start of 2014. Stronger population growth implies stronger domestic demand and aggregate incomes, but also increases demand for government services

Special Topic 2: Impact on New Zealand of a sharp slowdown in China

The IMF has revised down its outlook for developing economies' growth and there has been increasing concern about a sharp slowdown or "hard landing" in China.[2] While we expect growth to slow in China, we consider it unlikely that it will fall dramatically. Nevertheless, this special topic looks at the impact on the New Zealand economy of such a development.

China's growth is slowing...

As detailed in the international section above (p.5), China's economic growth has been slowing recently. Like other emerging economies, China's growth has been affected by tighter domestic monetary conditions and by weaker growth in developed economies. The US Federal Reserve's announcement that it would begin tapering its asset purchases later this year led to higher US long-term interest rates and concerns that they might derail the economic recovery.

Concerns of a slowdown in China peaked in late June when the central bank initially refrained from increasing liquidity in the interbank market, pushing short-term interest rates higher and prompting fears about credit risk. The new leadership in China appears to be taking a firmer line on reducing debt levels and rebalancing the economy from export- and investment-led growth to more consumption, which would lead to slower but more sustainable growth. Efforts to cool the housing market may have also slowed consumption growth.

...but a sharp slowdown is unlikely...

While China has some risk factors, chiefly high house prices and elevated private and local government debt following the rapid expansion of credit following the global financial crisis, we do not consider that a hard landing is likely. Even if growth did slow sharply, the authorities have room to stimulate the economy by lowering interest rates and expanding credit, and through fiscal stimulus (central government debt is relatively low at around 23% of GDP). The leadership has recently reaffirmed its commitment to its 7.5% annual growth target for 2013 and a minor fiscal stimulus package was announced in July.

...however, forecasts have been revised down

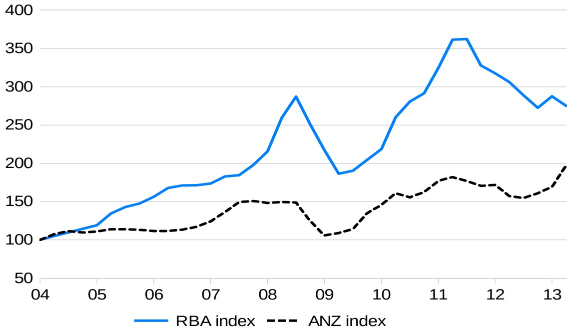
Most forecasters have revised down their outlook for China for this year and next. The OECD and IMF have reduced their forecasts for 2013 from 8.5% and 8.0% (respectively) to 7.8% (in both cases). The OECD expects a recovery to 8.4% in 2014, but the IMF sees growth of only 7.7% next year. Consensus forecasts (an average of international forecasters) have fallen from 8.2% growth in 2013 and 2014 earlier this year to 7.5% and 7.6% in July. Our BEFU forecasts were for growth of 8.0% and 7.6%, respectively.

Slower growth would impact Australia...

A sharp slowdown in China would have an impact on other economies, but the extent of the impact would depend on the specific causes of the slowdown (eg, whether it was a result of domestic or external factors) and the extent of any policy response in China and/or the rest of the world. In the case of a China-specific slowdown which affected investment, Australia would be likely to be adversely affected with around 30% of its goods exports destined for China and heavily concentrated in coal and iron ore. By contrast, China accounted for 17% of New Zealand's goods exports in the year to June 2013, spread across dairy, wood, meat, wool and seafood products.

The difference in the potential impact on Australia and New Zealand can be seen in recent movements in commodity price indices, with the Australian index falling 25% from its peak in mid 2011, while New Zealand's was 8% above its previous peak in the same period (Figure 1). Reduced dairy supply as a result of the 2013 drought has also contributed to the increase in New Zealand commodity prices.

Figure 1 – Australian and New Zealand commodity price indices



Sources: Reserve Bank of Australia, ANZ Bank

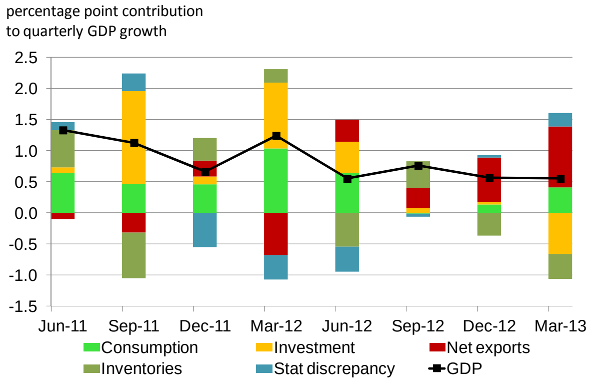
[2] For example, Barclays considers it increasingly likely that growth drops to 3% sometime in the next 3 years.

A similar impact can be seen in the two countries' currencies, with the Australian dollar down 12% from its recent peak against the US dollar, while the NZ dollar is down only 7%, resulting in an appreciation of 5% against the AUD. While the intended tapering of asset purchases in the US has been the major factor in the fall of the currencies, a weaker outlook for China has also been a factor and has affected the Australian dollar more and brought it into line with recent commodity price movements.

...but it may slow in any case

A sharp slowdown in China would have a significant impact on Australia, but there has been increasing concern about slower growth in Australia recently in any case as the peak in mining investment passes and is not yet replaced by other sources of demand. Investment's contribution to quarterly growth has been declining recently and the contribution of other components of expenditure GDP has been modest (Figure 2). Net exports are expected to increase their contribution to growth from 1% point in the March quarter 2013, but there may be a period of lower overall growth if they do not offset the fall in investment in the short term.

Figure 2 – Contributions to Australian GDP growth



Source: ABS, NZ Treasury calculations

Forecasts of economic growth in Australia have been revised down over the course of this year, but not to the same extent as for China. Growth in Australia will be supported by the fall in the currency, increasing the competitiveness of the tradables sector, and the reduction in the policy rate from 4.75% in October 2011 to 2.75% in May 2013, supporting parts of the domestic economy.

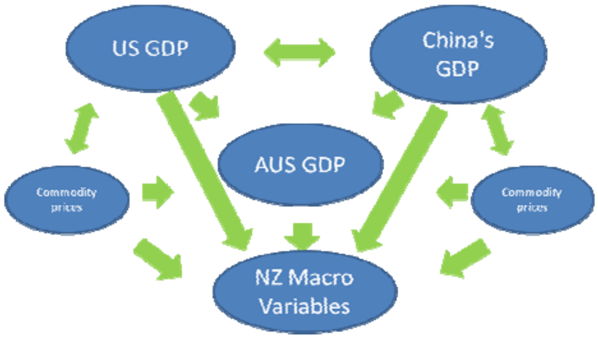
China's growth expected to slow gradually...

Recent Treasury research[3] concluded that China's rapid growth over the past decade has had a major impact on the New Zealand economy through increased demand for dairy and wood products, but that China's growth is likely to slow in the coming decade as it loses competitiveness, population growth slows, the economy rebalances and income levels converge with other economies. Nevertheless, per capita incomes will continue to grow and demand for western-style, high-protein food products will continue to grow, sustaining demand for New Zealand products.

...but a hard landing would have a significant impact on the New Zealand economy...

Further Treasury research[4] found that growth spillovers from China to New Zealand are important, with estimates of the accumulated impact on NZ GDP from a one percentage point change in China's growth being in the range of 0.2 to 0.4 percentage points. The transmission channel via commodity prices is important for the impact on nominal GDP, as well as second-round impacts on volumes via an income effect. Figure 3 illustrates the transmission channels from the world economy (represented by the US) and China to Australia and New Zealand.

Figure 3 – Transmission channels for global and China growth shocks to Australia and New Zealand



Source: Osborn and Vehbi (2013)

These results are supported by other international research. Roache (2012) finds that a 1% shock to China's industrial production growth has the largest effect on oil and copper prices, and that a decline in China's activity has a smaller impact than an equivalent shock to US activity, consistent with our findings. Previous IMF research also supports our conclusions.[5]

3 Bowman and Conway, (2013a and 2013b).
4 Osborn and Vehbi, (2013).
5 See Ahuja and Nabar (2012), Ahuja and Myrvoda (2012) and Sun (2011).

...similar to Budget 2012's downside scenario

The impact of a fall in China's growth to 3% and a consequent slowdown in Australia's growth would be likely to reduce New Zealand's trading partner growth by around 2 percentage points according to our estimates. This would be similar to the downside scenario in Budget 2012 in which lower growth in emerging Asia, especially China, led to real GDP growth in New Zealand being 2.1 percentage points lower over the forecast period, the terms of trade falling 9% in the first year, the current account deficit increasing by nearly 1.5% of GDP after two years and nominal GDP being around $25 billion lower over the 5-year forecast period as a whole (approximately 2.5%), with a commensurate impact on tax revenue. We do not expect such a scenario to occur, but if it did it would have a significant negative impact on the economy and the government's finances. Automatic macroeconomic stabilisers, coupled with room for further monetary and fiscal stimulus, could provide some offset to this.

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New Zealand Key Economic Data

2 August 2013

Quarterly Indicators

		2011Q4	2012Q1	2012Q2	2012Q3	2012Q4	2013Q1	2013Q2
Gross Domestic Product (GDP)								
Real production GDP	qtr % chg[1]	0.3	1.1	0.3	0.3	1.5	0.3	...
	ann ave % chg	1.4	1.9	2.4	2.5	2.7	2.5	...
Real private consumption	qtr % chg[1]	0.3	0.6	0.3	0.1	1.5	0.4	...
	ann ave % chg	2.0	2.5	2.7	2.4	2.3	2.2	...
Real public consumption	qtr % chg[1]	0.5	-0.9	1.0	0.3	-0.6	-0.2	...
	ann ave % chg	1.9	1.8	1.6	1.2	0.6	0.6	...
Real residential investment	qtr % chg[1]	5.1	0.7	7.4	5.2	2.2	9.6	...
	ann ave % chg	-11.2	-10.8	-2.2	6.6	12.1	19.2	...
Real non-residential investment	qtr % chg[1]	-0.2	3.4	3.3	-4.3	2.2	-2.2	...
	ann ave % chg	7.6	6.0	5.8	4.5	5.0	3.7	...
Export volumes	qtr % chg[1]	4.2	-2.7	-1.2	4.2	1.4	2.5	...
	ann ave % chg	2.7	2.6	2.4	3.0	2.0	3.4	...
Import volumes	qtr % chg[1]	-1.3	2.8	-2.9	2.1	-0.7	2.3	...
	ann ave % chg	6.5	6.1	3.7	1.5	1.9	0.5	...
Nominal GDP - expenditure basis	ann ave % chg	3.9	3.8	4.1	3.0	2.4	2.7	...
Real GDP per capita	ann ave % chg	0.4	1.0	1.6	1.7	2.0	1.9	...
Real Gross National Disposable Income	ann ave % chg	1.7	2.2	1.4	1.5	1.3	1.0	...
External Trade								
Current account balance (annual)	NZ$ millions	-8,268	-9,033	-10,087	-9,861	-10,486	-10,077	...
	% of GDP	-4.0	-4.4	-4.8	-4.7	-5.0	-4.8	...
Investment income balance (annual)	NZ$ millions	-10,750	-10,443	-10,899	-10,226	-9,824	-10,030	...
Merchandise terms of trade	qtr % chg	-1.5	-2.3	-2.5	-3.2	-1.2	4.2	...
	ann % chg	1.0	-2.1	-6.7	-9.2	-8.9	-2.9	...
Prices								
CPI inflation	qtr % chg	-0.3	0.5	0.3	0.3	-0.2	0.4	0.2
	ann % chg	1.8	1.6	1.0	0.8	0.9	0.9	0.7
Tradable inflation	ann % chg	1.1	0.3	-1.1	-1.2	-1.0	-1.1	-1.6
Non-tradable inflation	ann % chg	2.5	2.5	2.4	2.3	2.5	2.4	2.5
GDP deflator	ann % chg	0.4	-0.2	1.7	-1.5	-2.7	0.9	...
Consumption deflator	ann % chg	1.6	1.3	0.9	0.7	0.5	0.4	...
Labour Market								
Employment (HLFS)	qtr % chg[1]	0.5	0.0	0.0	-0.4	-0.9	1.7	...
	ann % chg[1]	1.6	0.9	0.6	0.0	-1.3	0.4	...
Unemployment rate	%[1]	6.3	6.7	6.8	7.3	6.8	6.2	...
Participation rate	%[1]	68.4	68.6	68.4	68.4	67.2	67.8	...
LCI salary & wage rates - total (adjusted)[5]	qtr % chg	0.6	0.4	0.5	0.5	0.5	0.4	...
	ann % chg	2.0	2.0	2.0	1.9	1.8	1.8	...
QES average hourly earnings - total[5]	qtr % chg	0.1	1.4	0.1	1.1	-0.1	0.8	...
	ann % chg	2.8	3.8	2.9	2.8	2.6	2.1	...
Labour productivity[6]	ann ave % chg	-0.1	0.7	1.7	2.8	3.4	2.6	...
Retail Sales								
Core retail sales volume	qtr % chg[1]	1.8	-0.3	0.7	0.1	1.2	0.6	...
	ann % chg	6.4	4.2	4.1	1.7	1.8	2.5	...
Total retail sales volume	qtr % chg[1]	1.4	0.2	1.2	-0.2	1.9	0.5	...
	ann % chg	5.7	4.2	4.7	2.2	3.2	3.5	...
Confidence Indicators/Surveys								
WMM - consumer confidence[3]	Index	101	102	100	103	111	111	117
QSBO - general business situation[4]	net %	0.1	13.0	-4.1	8.0	19.8	23.0	31.9
QSBO - own activity outlook[4]	net %	9.9	16.9	8.1	17.7	18.7	18.1	17.8

Monthly Indicators

		2013M01	2013M02	2013M03	2013M04	2013M05	2013M06	2013M07
External Sector								
Merchandise trade - exports	mth % chg[1]	1.6	3.1	-1.0	1.2	-0.8	-0.3	...
	ann % chg[1]	-10.2	7.6	4.8	1.9	-8.0	-3.9	...
Merchandise trade - imports	mth % chg[1]	-14.6	15.4	0.7	-8.8	-3.3	13.5	...
	ann % chg[1]	-6.3	1.6	-8.6	6.8	-3.3	-7.4	...
Merchandise trade balance (12 month total)	NZ$ million	-1288	-1066	-521	-686	-902	-777	...
Visitor arrivals	number[1]	214,270	224,410	227,220	231,210	229,650	226,290	...
Visitor departures	number[1]	217,800	220,630	229,910	234,330	232,060	238,720	...
Housing								
Dwelling consents - residential	mth % chg[1]	-0.6	5.2	-9.6	20.6	1.0	-4.0	...
	ann % chg[1]	19.5	28.1	-5.4	42.7	43.7	16.4	...
House sales - dwellings	mth % chg[1]	10.9	-4.0	-0.4	2.5	-2.5	-7.0	...
	ann % chg[1]	21.1	7.5	10.9	25.2	7.5	0.0	...
REINZ - house price index	mth % chg	-1.0	1.6	2.4	0.8	0.7	0.0	...
	ann % chg	7.2	8.1	8.6	9.8	8.7	8.4	...
Private Consumption								
Electronic card transactions - total retail	mth % chg[1]	0.3	0.7	-0.4	0.9	0.7	1.1	...
	ann % chg	5.8	2.5	4.2	5.2	5.4	5.1	...
New car registrations	mth % chg[1]	3.4	1.2	0.0	7.7	1.5	-0.2	...
	ann % chg	6.5	9.4	11.2	17.8	16.3	15.6	...
Migration								
Permanent & long-term arrivals	number[1]	7,070	7,200	7,740	7,830	7,850	8,330	...
Permanent & long-term departures	number[1]	6,660	6,420	6,430	6,200	6,060	6,010	...
Net PLT migration (12 month total)	number	12	1,195	2,542	4,776	6,242	7,907	...
Commodity Prices								
Brent oil price	US$/Barrel	113.02	116.19	108.49	102.53	102.52	102.92	104.61
WTI oil price	US$/Barrel	94.69	95.32	93.05	92.07	94.80	95.80	107.89
ANZ NZ commodity price index	mth % chg	-0.5	0.4	8.5	10.2	0.7	0.9	...
	ann % chg	-10.2	-5.9	2.2	17.4	17.3	22.5	...
ANZ world commodity price index	mth % chg	0.3	1.1	7.4	12.6	-1.6	-3.7	...
	ann % chg	-6.1	-4.9	3.9	22.5	26.1	24.5	...
Financial Markets								
NZD/USD	$[2]	0.8375	0.8389	0.8279	0.8473	0.8267	0.7908	0.7885
NZD/AUD	$[2]	0.797	0.8136	0.8013	0.8158	0.8325	0.838	0.8594
Trade weighted index (TWI)	June 1979 = 100[2]	75.27	76.26	76.15	78.05	77.31	74.00	74.78
Official cash rate (OCR)	%	2.50	2.50	2.50	2.50	2.50	2.50	2.50
90 day bank bill rate	%[2]	2.66	2.66	2.64	2.65	2.64	2.64	2.64
10 year govt bond rate	%[2]	3.56	3.81	3.72	3.34	3.37	3.84	4.23
Confidence Indicators/Surveys								
ANZ - business confidence	net %	...	39.4	34.6	32	41.8	50.1	52.8
ANZ - activity outlook	net %	...	37.6	32.4	30	34.3	45.0	43.7
ANZ-Roy Morgan - consumer confidence	net %	118.3	121.0	115.0	119.2	123.7	123.9	119.8
Performance of Manufacturing Index	Index	55.5	56.3	53.7	54.8	59.0	54.7	...
Performance of Services Index	Index	53.2	55.7	55.6	56.1	56.0	55.0	...

qtr % chg	quarterly percent change	1	Seasonally adjusted
mth % chg	monthly percent change	2	Average (11am)
ann % chg	annual percent change	3	Westpac McDermott Miller
ann ave % chg	annual average percent change	4	Quarterly Survey of Business Opinion
		5	Ordinary time
		6	Production GDP divided by HLFS hours worked

Sources: Statistics New Zealand, Reserve Bank of New Zealand, NZIER, ANZ, Haver, Westpac McDermott Miller, ANZ-Roy Morgan, REINZ, BNZ-Business NZ