Monthly Economic Indicators

THE TREASURY
Kaitohutohu Kaupapa Rawa

September 2013

Executive Summary

- **As expected, last summer's drought weighed on growth in the June quarter...**
- **...but the economy showed signs of underlying momentum and the near-term outlook remains positive.**
- **US Fed delays expected start of tapering quantitative easing, leading to a stronger NZD.**

The negative impact of last summer's drought was the main factor behind the slowdown in the pace of quarterly growth to 0.2% in the June quarter. Drought impacts aside, other parts of the economy showed clear signs of momentum – particularly the services sector. Eight of the 11 service industries recorded an increase in activity and the sector as a whole contributed around 1 percentage point to quarterly growth.

The turnaround in the terms of trade since the end of 2012, including a 4.9% rise in the June quarter, underpinned another strong quarterly rise in nominal GDP (1.7%, following a 2.6% increase in the March quarter). The level of nominal GDP was close to that expected in the Budget and year-end tax revenues are expected to be close to forecast. (Financial Statements of the Government for the year ended 30 June 2013 will be released on Monday 7 October.)

The rebound in the terms of trade has also driven an acceleration in growth of real gross national disposable income (RGNDI) – a purchasing power-adjusted measure of national income – with RGNDI up by 1.6% in the quarter. In a reflection of the recent divergence in the performance and outlook for the New Zealand and Australian economies, annual RGNDI growth in the June quarter accelerated ahead of that in Australia.

The current account deficit narrowed to 4.3% of GDP in the June quarter, driven by a narrower income deficit and following a range of revisions to historical data. The narrowing in the annual income deficit mainly reflected lower profits being recorded by foreign-owned companies in both the corporate and banking sectors. This result appears at odds with indicators such as corporate taxes and profitability readings from business surveys, and we expect income outflows to pick up over the second half of the year as momentum in the economy continues to build.

Looking ahead, the near-term outlook for GDP remains positive, with the economy carrying a sizeable degree of momentum into the second half of the year. The outlook is supported by a range of factors, including the ongoing Canterbury rebuild, the turnaround in net migration, and an expected bounceback in the agricultural sector from the drought. All told, the Treasury expects quarterly real GDP growth to accelerate to around 1% in each of the two remaining quarters of 2013.

The US Federal Reserve voted against initiating the widely-expected tapering of quantitative easing in September, which triggered a sharp rise in the New Zealand dollar against the greenback. While recent data outturns in the US have been weaker than expected, this month's special topic looks at the wider rebalancing of global growth from emerging market to developed economies that has occurred in recent months, and assesses its implications for New Zealand.

New Zealand Government

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Analysis

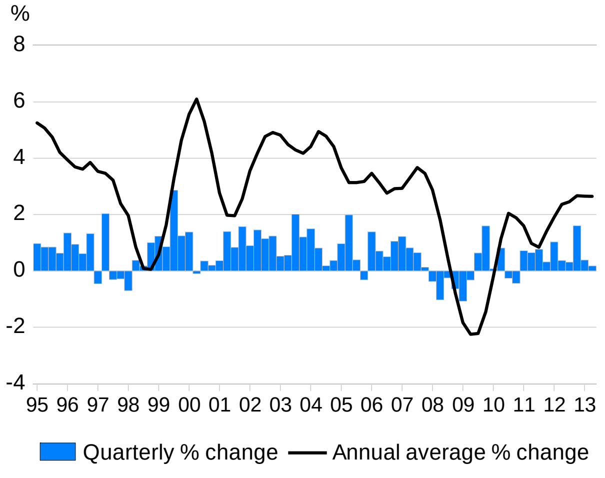
As expected, the impact of last summer's drought weighed on growth in the June quarter. However, drought aside, the rest of the economy showed clear signs of momentum – particularly the services sector. Looking ahead, the outlook for the rest of the year remains positive, with robust domestic conditions and an expected bounceback from the drought. All told, the Treasury and other commentators expect quarterly real GDP growth to accelerate to around 1% in each of the two remaining quarters of 2013.

The annual current account deficit narrowed to 4.3% of GDP in the June quarter, driven by lower-than-expected income outflows, and a range of revisions to the historical data. While the current account deficit is still expected to widen over the course of our five-year forecast horizon – principally as the Canterbury rebuild gathers pace – a range of forthcoming revisions are expected to result in a further narrowing of the current account deficit in the near term.

Drought detracts from real GDP growth…

The 0.2% gain in real production GDP in the June quarter was largely as anticipated by the market, although some expected a weaker result, and was the same as Treasury's 2013 Budget Economic and Fiscal (BEFU) forecast, (Figure 1).

Figure 1 – Real GDP (production measure)



Source: Statistics NZ

The negative impact of last summer's drought was the main factor behind the slowdown in the pace of quarterly growth. Agricultural production and related food processing industries both experienced large falls in the June quarter, in keeping with the drop-off in milk production seen at the end of last season and the inevitable decline in meat slaughter. Drought impacts aside, other parts of the economy showed clear signs of momentum in the June quarter – particularly the services sector. Eight of the 11 service industries recorded an increase in activity and the sector as a whole contributed around 1 percentage point to quarterly growth. The retail trade and accommodation industry grew for the third consecutive quarter, up 2.1%, reflecting higher sales of durable goods and a rise in international tourist arrivals. Construction activity also picked up, largely owing to increased heavy and civil engineering work. This more than offset a fall in residential building work.

On the expenditure side, real quarterly GDP growth slowed to 0.1% in the June quarter, down from 0.3% in the previous period. As indicated by the prior release of the Overseas Trade Indices (OTI) for the June quarter, net trade was a sizeable drag on quarterly growth. Total exports dropped by 5.9%, driven by declines in dairy and meat volumes of 16.8% and 6.9% respectively. Residential investment also fell slightly, consistent with other signs of a 'pause' in growth in construction activity in the middle of the year.

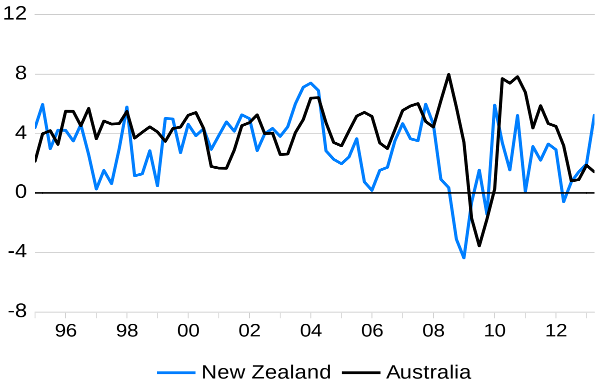
These negative factors were offset by another strong showing from private consumption (+1.5% qpc), driven by a 4% quarterly rise in durable goods sales. The latter was the third largest quarterly increase on record and is likely to reflect the effect of rising housing wealth on consumption.

...but nominal GDP posts another strong rise

Following a 2.6% increase in the March quarter, nominal GDP posted another strong quarterly rise (1.7%) in the June quarter. This was underpinned by the continued rebound in the terms of trade, with the headline OTI measure up 4.9% in the quarter. The level of nominal GDP was close to that expected in the BEFU and year-end tax revenues are expected to be close to forecast. (The Financial Statements of the Government of New Zealand for the year ended 30 June 2013 are scheduled to be released on Monday 7 October.)

The turnaround in the terms of trade since the end of 2012 has also driven an acceleration in growth of real gross national disposable income (RGNDI) – a broader indicator than GDP that measures the real purchasing power of national disposable income. RGNDI grew by 1.6% from the March quarter, and 5.2% from June 2012. In a reflection of the recent divergence in the performance and outlook for the New Zealand and Australian economies, annual growth in New Zealand's RGNDI in the June quarter accelerated ahead of that in Australia (Figure 2). The slower growth outlook for the Australian economy, and its implications for New Zealand, was the subject of a special topic in last month's Monthly Economic Indicators.

Figure 2 – Real Gross National Disposable Income[1]



Sources: ABS, Statistics NZ, the Treasury

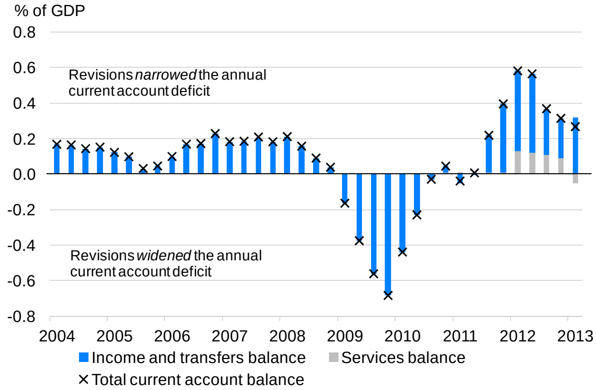
Sizeable revisions to the current account

The other headline macroeconomic release from the past month – the June quarter Balance of Payments – was dominated by a range of revisions to the historical data.

On a positive note, the current account deficit over recent history was revised to be *narrower* than previously estimated, mainly on the back of higher estimates of the returns that New Zealanders have earned on overseas investments. The annual deficit in the March 2013 quarter is now estimated to have been 4.5% of GDP compared to 4.8% previously. A separate set of revisions to reinvested earnings by foreign direct investors in New Zealand *widened* the deficit during the time of the global financial crisis (Figure 3).

However, while the current account was revised narrower for the recent period, revisions to the balance sheet of the international accounts increased previous estimates of the amount of foreign investment in New Zealand. As a result, New Zealand's net international debtor position was revised 2.5 percentage points of GDP higher than was previously estimated (ie, 71.8% of GDP at the end of the March quarter compared to 69.3% before).

Figure 3 – Revisions to the annual current account balance since the March 2013 release



Sources: Statistics NZ, the Treasury

Further changes to the Balance of Payments and wider macroeconomic accounts are in the pipeline to be incorporated in late-2013. These will reflect improved measurement of spending by international visitors and students in New Zealand, as well as a new estimate of households' goods imports for items valued under $1,000 (a known area of undercoverage encompassing items bought online from overseas). These changes will increase previous estimates of both exports of services and imports of goods, with the net impact expected to result in a further narrowing in the measured current account deficit.

By attributing some expenditure that is currently counted as household consumption to spending by international visitors and students, the revisions will also have implications for household and national saving. Based on guideline figures issued by Statistics NZ, household consumption could be revised around $1.2 billion a year lower than previously measured. Notwithstanding any potential revisions to household disposable income, this would be consistent with increasing the household saving to disposable income rate from around zero in 2012 to closer to +1%. The changes are a positive step but will not materially change New Zealand's position relative to other advanced economies.

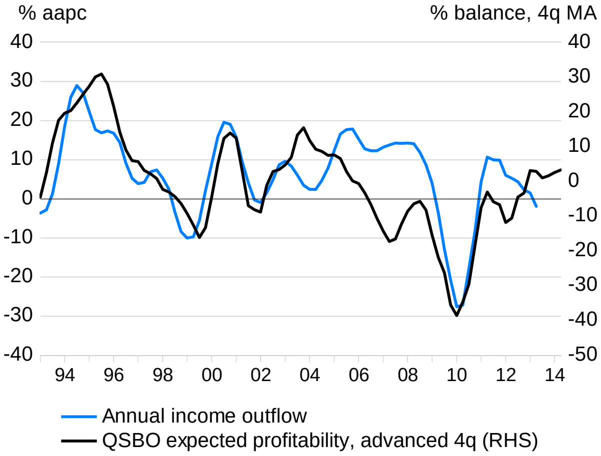
[1] The Australian Bureau of Statistics does not produce a directly comparable series to New Zealand's RGNDI, but rather a real *net* measure of national disposable income. The RGNDI series for Australia used in Figure 2 has been calculated by the New Zealand Treasury to ensure comparability between the series. Note that the difference between the gross and net measures reflects consumption of fixed capital.

Lower-than-expected income outflows in the current account...

Looking past the historical revisions, the annual current account deficit narrowed to 4.3% of GDP in the June quarter, driven by a narrower income deficit. This mainly reflected lower profits being recorded by foreign-owned companies in both the corporate and banking sectors.

On the face of it, lower income outflows appear in keeping with the drought-affected GDP outturn in the June quarter. However, the weakness in income outflows has been a feature of the past four quarters and appears at odds with indicators such as corporate taxes and profitability readings from business surveys. Indeed, while the relationship is far from perfect, the trend in growth in income outflows has gone in the opposite direction from that suggested by the QSBO (Figure 4). It is unclear exactly what the drivers of the fall are, but given the underlying momentum apparent in the economy, we expect income outflows to pick up over second half of year.

Figure 4 – Income outflows in the current account and QSBO profitability measure



Sources: NZIER, Statistics NZ, the Treasury

...more than offset the negative impact of the drought

Following last summer's drought, the annual goods surplus narrowed in the June quarter. Goods exports were $468 million (3.7%) lower than in the March 2012 quarter, although this was offset in part by a corresponding $275 million (2.5%) fall in goods imports. The annual goods surplus is expected to increase over the coming quarters, on the back of good growing conditions and high dairy prices (see later on).

The annual deficit on services remained unchanged at $1 billion (0.5% of GDP) from the March quarter. Exports of services increased slightly from the June 2012 quarter, but this was broadly offset by a similarly-sized increase in imports.

A sizeable net errors and omissions item has opened up in the Balance of Payments over the past year or so, with the annual total climbing to $6.9 billion (3.3% of GDP) in the June quarter. The nature of the net errors balance suggests that there have been inflows of capital into New Zealand that have funded the current account deficit and have not been measured by the reporting framework. To the extent that this is the case, New Zealand's stock of international liabilities will also be underreported. It will be interesting to see what happens to the balance over the coming quarter, particularly in light of the forthcoming round of revisions.

Near-term outlook for GDP remains positive...

Looking ahead, the near-term outlook for GDP remains positive, with the economy appearing to have carried a sizeable degree of momentum into the second half of the year. This is owing in large part to the strength of domestic conditions including private consumption.

Admittedly, consumer confidence has eased for three consecutive months after reaching a three-year high in June. This may in part reflect the prospect of higher mortgage rates following the rise in long-term bond yields since earlier this year. However, with a tightening labour market and wealth effects from the housing market, conditions remain strong. All told, while the pace of quarterly growth in private consumption is expected to moderate in the September quarter from the strong 1.5% rise seen in June, annual growth is likely to remain supported in the region of 4% – around its fastest pace in six years.

It is a similar picture for the business sector. The BNZ/Business NZ Performance of Services Index (PSI) dropped sharply in August, driven by falls in the new orders and current activity components. However, the indicator is volatile and the fall in August came after the indicator reached a five-year high in July. The bigger picture is that the PSI and its counterpart from the manufacturing sector both point to robust, ongoing growth in the business sector.

...with support from turnaround in migration

The ongoing, strong turnaround in net migration is also expected to continue to support demand in the domestic economy over the near term. There was a seasonally-adjusted net inflow of 2,100 migrants in August, bringing the annual total to 12,800 – the highest level since September 2010. The acceleration in net migration over the past year or so has been faster than we had anticipated at BEFU, and we now expect the annual net inflow of migrants to peak at a similar level to that seen in 2010.

In keeping with trends in recent months, the bulk of the turnaround in annual net migration over the year to August was driven by a slowdown in net migrant outflows to Australia, mainly reflecting fewer departures from New Zealand. This ties in with the recent divergence in the outlook for the two economies mentioned earlier.

Drawing a line under the drought...

The external and agricultural sectors are also expected to bounce back strongly from the drought in the second half of the year, and lend additional impetus to growth. Milk production this season to date is tracking well ahead of last year, and milk output over the season as a whole is expected to increase by around 4-5% from 2012/13. This would take dairy production to a record season-high.

Meanwhile, although lambing rates over the spring will be affected by the drought's impact on ewe condition and feed availability, the total impact also looks likely to be less negative than we previously expected. Beef and Lamb NZ forecast a 7.7% reduction in the lamb crop this season compared to the Treasury's estimate made at the time of BEFU of a 10% decline.

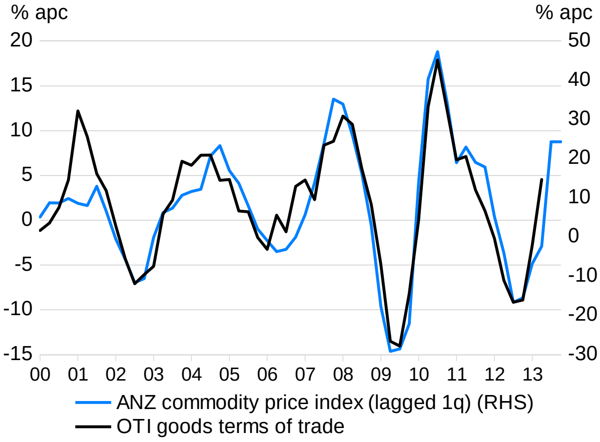
Based on developments since last summer, the Treasury is confident that the impact of the drought on real GDP will be broadly in line with the estimate outlined at BEFU of a net 0.7% hit in the 2013 calendar year. While the recovery currently looks on track to be faster than we expected, a full assessment of the drought's impact will have to wait until the set of annual national accounts for the year ended March 2014 are released late next year. These will include more complete information about the extent of intermediate consumption throughout the drought (eg, imported feed/fertiliser) and will therefore determine its overall impact on value-added GDP.

...with an ongoing bounce in the terms of trade

That said, the one area where our estimates of the impact of the drought look to have been too negative is nominal GDP. Estimating the impact of the drought on nominal GDP was always more difficult than estimating the direct impact on production, as it involved taking a view on a range of highly uncertain price impacts. On balance, we assessed the nominal impact to be similar to the real impact (ie, around 0.7% of nominal GDP).

However, tighter-than-expected global supply conditions have supported dairy prices at a higher level than we assumed and have provided a significant offset to farm incomes. Fonterra recently revised up its forecast payout for the 2013/14 season by 50c to a record $8.30 per kilogram of milk solids. Dairy prices are expected to fall back from their current levels as and when global supply conditions recover. However, any sharp correction looks unlikely to occur until early next year, with higher prices remaining a feature throughout the peak-production window. Indeed, indicators point to continued strong annual growth in the goods terms of trade over the rest of the year (Figure 5), with the index set to surpass its 2011 peak in the September quarter.

Figure 5 – Goods terms of trade and ANZ commodity prices



Sources: ANZ, Statistics NZ, the Treasury

This will directly support growth in nominal GDP, and the additional income will have positive second-round effects in the real economy too. All told, the outlook for the second half of 2013 remains positive with the Treasury anticipating quarterly real GDP growth of around 1% in each of the two remaining quarters of 2013.

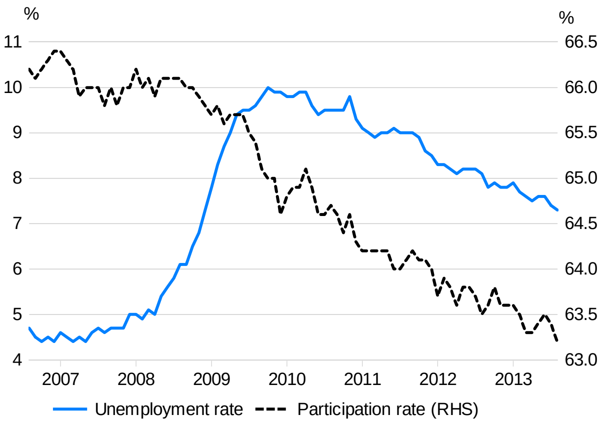
Developed world monetary stimulus left intact owing to softer economic developments

Softer developments in advanced economies led major central banks to maintain supportive policies, including the US Federal Reserve (Fed), which chose not to initiate the widely-expected September tapering of quantitative easing (QE). Activity and financial markets in emerging Asia were more stable. This month's special topic looks at the rebalancing of global growth from emerging market economies to developed economies and its implications for New Zealand.

US employment growth on the weaker side...

Weaker US developments raised uncertainty over the sustainability of the economic recovery. Non-farm payrolls grew by a weaker-than-expected 169,000 in August, while growth in June and July was revised down. This brought the average rate of growth over the past six months to 160,000 – below the Fed's benchmark for labour market improvement (200,000). Figure 6 shows that the decline in the unemployment rate has been partly due to falling participation rates, as discouraged job-seekers have left the labour force and baby-boomers are starting to retire. Retail sales growth was soft in August, and consumer confidence dipped in September, possibly owing to weaker jobs growth and rising mortgage rates. Positively, both the manufacturing and the non-manufacturing ISM indices were strong in August, indicating expansion in activity.

Figure 6: The US labour market



Source: Haver

The US government is expected to reach its debt ceiling in late October. To continue funding the government, a bill raising the debt ceiling must be passed through Congress, including through the Republican-controlled House. Analysts expect an eleventh-hour deal to be struck without major policy changes to avert a government shutdown, but risks are present and are likely to lead to financial volatility. The Congress must also agree on funding for the new fiscal year beginning 1 October.

...convincing the Fed to delay tapering QE...

The Fed maintained its asset purchases at US$85 billion per month, surprising the market, which had expected a $15 billion reduction. The Fed cited the elevated unemployment rate, rising mortgage rates, fiscal risks and low annual inflation (1.5% in August) as reasons to delay tapering QE. The market reacted sharply, with equities and bonds rising and the USD weaker. However, the market still expects a tapering in QE to start in the next few months, and QE to end by mid 2014.

...which supported emerging Asian markets

Emerging Asian financial markets stabilised during the month, with equity prices rebounding, and long-term yields declining from their peaks in late August, helped by the Fed delaying the reduction of asset purchases. However, central banks in some of the emerging market economies have increased policy rates to help stabilise their currencies, which may dampen activity growth.

Australian demand subdued despite reasonable June quarter growth...

The Australian economy grew by a solid 0.6% in the June quarter, but final domestic demand remains soft, growing just 0.3%. Net exports have made a historically large contribution to growth so far this year, and soft retail sales reflected the weakness of domestic demand.

The unemployment rate ticked up 0.1% points to 5.8%, owing to a fall in employment over the past six months. Positively, the housing market recovery continued, with rising housing finance and house approvals. The RBA meeting minutes in September presented a reduced easing bias, but the market has priced in an above 50% chance of a rate cut by May 2014.

The NZD is likely to remain strong against the AUD, as the outlook for hard and soft commodity prices and domestic policy rates diverges.

...but may be helped by stabilisation in China

Chinese developments were in line with the stabilisation in activity in recent months. Industrial production expanded 10.4% on a year ago in August – the strongest growth in 17 months – while retail sales were also above market expectations. Positive manufacturing PMI outturns also indicate at-trend growth in industrial activity.

Still-tentative euro area recovery prompts dovish ECB guidance

The near-term recovery in the euro area remains far from certain, leading the ECB to reiterate its dovish stance and consider further supportive measures. Euro area industrial production fell 1.5% in July, to be down 2.7% on a year ago, reversing the recent trend of slower annual contractions. Positively, the flash manufacturing and services PMIs (at 51.1 and 52.1, respectively) indicate positive growth in activity in September. The ECB left its policy rate unchanged at 0.5% in September and restated its commitment to keep rates low for an "extended period". ECB President Draghi said that he is willing to use more long-term refinancing operations if needed to ensure liquidity for banks. Low inflation in August (1.3%) offers room for further ECB action to support lending.

However, Japan and the UK appear positive

Japan's GDP growth in the June quarter was revised up by 0.3% points to 0.9%, on higher investment and inventories. Strong industrial production growth in July, as well as a solid PMI reading and a smaller trade deficit in August, reinforced analyst expectations of reasonable growth in the second half of 2013.

Positive developments also occurred in the UK, where the manufacturing and services PMIs reached historical highs in August. Housing demand continued to pick up, reflected by rising house prices and mortgage approvals.

Special Topic: Rebalancing of growth in the global economy

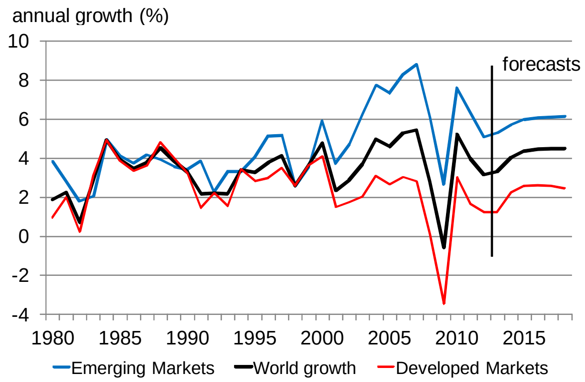
Emerging market (EM) economies have been the main drivers of world growth in the period since the global financial crisis (GFC), as developed market (DM) economies recovered only slowly. Now the tables are turning, with EM economies' growth and outlook weakening recently and DM economies recovering more strongly. This topic explores the reasons for this development and its implications for the New Zealand economy.

EM economies recovered quickly from GFC...

The GFC, while partly caused by global imbalances, originated in the DM economies but spread to EM economies through trade, financial and confidence channels. A slump in demand in DM economies, combined with a fall in the provision of trade finance and a run-down in inventories, led to a sharp fall in growth in EM economies (Figure 1).

However, EM economies recovered quickly from the effects of the GFC as they benefitted from the various fiscal and monetary stimulus measures introduced in DM economies, enabling them to resume their position of leading growth in the world economy which they held prior to the GFC. EM growth rates were similar to DM rates until the 2000s when they diverged and lifted world growth (Figure 1). EM growth remained positive in 2009, while DM growth was negative during the GFC.

Figure 7 – EM and DM growth rates



Source: International Monetary Fund, WEO April 2013

The recovery from the GFC was boosted by a large fiscal stimulus and credit expansion in China. In late 2008 China announced a fiscal stimulus package estimated to be equivalent to 6% of GDP, spread over 2 years; much of the stimulus was delivered via infrastructure investment and credit growth in 2009 and 2010 reached 30% per annum, far in excess of growth in nominal GDP. Growth fell from 9.6% in 2008 only to 9.2% in 2009, supporting demand for commodities and boosting output in other EM economies and in Australia and New Zealand.

...but DMs struggled to recover until recently...

Meanwhile, the major DM economies recorded falls in output in 2009, before growth recovered in 2010 (Figure 1). However, since that rebound and until recently, growth has languished in those economies, with the euro area and the United Kingdom (UK) falling back into recession in late 2011, growth remaining sluggish in Japan, and the United States (US) economy struggling to achieve self-sustaining growth. Continuing high household, corporate and government debt constrained demand in these economies.

Recently, however, DM economies have started to show more sustainable growth. The housing and labour markets in the US are beginning to recover, leading to increased household demand and business investment; the euro area recorded positive growth in the June quarter after six quarters of contraction; Japan's economy grew by 1.9% in the first half of 2013, boosted by monetary and fiscal stimulus, and output grew 1.0% in the UK in the first half of 2013.

This pick-up in growth in the major DM economies is chiefly owing to the large fiscal and monetary stimulus delivered in each of them and steps taken to stabilise financial markets and banking systems. For example, the US increased general government gross debt from 66% prior to the GFC to more than 100% in 2012 as a result of fiscal stimulus; at the same time, the Federal Reserve (Fed) expanded its balance sheet from 6% to 22% of GDP currently as a result of quantitative easing, and it has held its policy rate at 0-0.25%.

...but their stimulus benefited EM economies

The large stimulus in the DM economies also benefited EM economies through increased demand for their goods and services, and by holding down long-term interest rates and redirecting funds from DM bonds into riskier assets such as EM equities and commodities. While some EM leaders voiced concern about the potentially destabilising impact of financial inflows, these conditions supported EM economic growth and brought a marked shift in the shares of output in the global economy. EM economies will have nearly doubled their share of global output from 20% in 2002 to 38% in 2012. Adjusting for differences in the cost of living, EM economies will account for more than half of world output this year, according to the IMF, giving them a greater impact on the world economy than before.

Pick-up in DM growth prompts tapering...

The pick-up in activity in DM economies in the first half of 2013 led to the first steps towards reducing monetary stimulus. (Governments had generally started to reverse fiscal stimulus earlier.) The Fed announced in May that it would begin to reduce its asset purchases later in the year and complete its purchases by mid-2014. Although the Fed was widely expected to begin tapering its purchases in September, it has decided not to start yet.

The announcement in May brought a fall in US bond prices (and increase in rates) as markets anticipated reduced demand for bonds from the central bank, increases in equities as funds flowed into riskier assets in anticipation of more self-sustaining growth, and a rise in the US dollar as USD assets will offer better returns and growth in the supply of US dollars will be reduced. These changes had an impact on financial markets around the world: long-term interest rates moved up and the US dollar strengthened against most other currencies, including the NZ dollar which fell from 85 to 80 US cents over the course of May.

...leading to reversals in EM financial markets

The Fed's announcement in May also led to a reversal in EM financial markets, as the signalled tapering indicated reduced availability of global liquidity at low interest rates which had contributed to robust investment growth in EM economies since the GFC. Bond rates increased and equity prices fell as money flowed out of these economies and their currencies weakened.

EM economies' growth had already started to slow in the second half of 2012 as their own stimulus and the indirect stimulus from the DM economies led to resource pressures and rapidly rising asset prices (eg, property values). Tighter monetary conditions were evident in the appreciation of EM currencies and – in some cases – higher short-term interest rates. EM economies continued to slow in early 2013 as slower growth in DM economies in 2012 had a lagged impact on them.

Parallels drawn with Asian financial crisis...

The Fed's foreshadowing of its tapering of asset purchases in May was a symptom of the rebalancing in growth between DM and EM economies that was already under way and not a cause of it. However, the Fed's announcement brought considerable volatility in EM financial markets, particularly in Asia and some commentators compared the situation to the lead-up to the Asian financial crisis (AFC) in 1997/98.

The similarities with the AFC are that Asian EM economies have been experiencing high growth rates (driven largely by rapid investment growth), rising asset values (equities and property) and exchange rate appreciation. In the late 1990s a tightening in DM monetary conditions and a resulting growth slowdown led to large capital outflows from Asian EM economies and falls in their exchange rates, the erosion of their foreign exchange reserves, lower growth and large fiscal deficits. Many already had large current account deficits.

...but a repeat looks unlikely...

However, there are significant differences from the late 1990s. The chief of these is that most Asian economies have floating exchange rates which have adjusted gradually to changing conditions; in addition, most of the those economies have larger foreign exchange reserves than previously, their current account positions are stronger, they have less foreign-currency external debt and what external debt they do have is financed by private capital flows rather than official borrowings. In addition, investment currently accounts for a smaller share of GDP in these economies than it did prior to the AFC.

...although growth likely to slow

While a repeat of the AFC looks unlikely, growth in Asian EM economies is still expected to slow as they adjust to tighter monetary conditions in the form of higher long-term interest rates. The low-income economies in New Zealand's trading partner basket (India, Indonesia, Malaysia, Philippines and Thailand) are likely to be more affected than the newly industrialised economies (South Korea, Taiwan, Hong Kong and Singapore) because the latter group is in a stronger position on the macroeconomic indicators mentioned above and they are not as dependent on commodity exports to other DM economies, in particular China.

China less affected by these developments...

China is likely to be less affected by these developments than other low-income Asian EM economies for a couple of reasons. Its financial markets are largely insulated from the rest of the world with a closed capital account (ie, capital cannot move freely in and out of China) and a managed-float exchange rate (although there are moves to open the capital account to some degree). In addition, China has a current account surplus of 2.3% of GDP and foreign exchange reserves equivalent to nearly 40% of GDP.

Nevertheless, there was some volatility in China's financial markets in late July when the central bank initially refrained from easing a liquidity crunch in the inter-bank market, causing overnight interest rates to spike up. It subsequently injected liquidity but only after indicating that it wanted to curtail lending growth. Growth is expected to slow in China chiefly for its own reasons, namely tighter domestic monetary conditions, a rebalancing of growth from investment and exports to private consumption, slowing productivity growth as returns to investment decline, slower population growth and eroded competitiveness as wage costs escalate.

...but New Zealand affected by slowdown...

The rebalancing of global growth from EM to DM economies will have an impact on New Zealand. In the recovery from the GFC, New Zealand's dependence on fast-growing Asian EM economies was an advantage with 36% of goods exports destined for Asia ex-Japan; the inclusion of Australia, which is even more dependent on Asia, increases the region's share of NZ's goods exports to 57%. With the Australian economy slowing as the mining boom winds down (see the August 2013 special topic), our dependence on emerging Asia and Australia becomes a negative for the outlook.

...although there are some positives

However, not all the global developments are negative for New Zealand. In the medium term, stronger growth in DM economies will be positive for Asian EM economies as their major export markets are the DM economies. The transition in

China from investment- and export-led growth to greater emphasis on private consumption can only be positive for our exports of food products. In addition, as we suggested last month, the rebalancing of the Australian economy from mining investment to household consumption and residential investment will be positive for New Zealand exports to that market.

The rebalancing of global growth from EMs to DMs, as flagged by the Fed's tapering, will have other impacts on the NZ economy as well. The initial announcement from the Fed brought a fall in the NZ dollar, as noted above, which will assist the competitiveness of the export sector, particularly for manufactured products and services, and promote the rebalancing of the economy towards tradable activity.

Although the NZD has crept back up towards its pre-taper announcement level against the USD, the USD is expected to resume its appreciating trend once tapering commences. However, an offset has been the appreciation of the NZD against the AUD which has fallen further against the USD than the NZD has. This may be a brake on demand from our major export market.

The outlook is positive, but risks remain

Despite lower growth in EM economies, they will continue to drive growth in the global economy given their larger share of world output and higher growth rates. In addition, stronger DM growth will be positive for EMs and the world economy in the long run.

However, many risks remain for DMs, in particular the debt crisis, banking and fiscal union, and the lack of competiveness in peripheral economies in the euro area; the impact of Japan's efforts to boost its economy through monetary and fiscal stimulus; and the longer-term issues facing the US of fiscal sustainability, reversing asset purchases and normalising monetary policy.

Monthly Economic Indicators is a regular report prepared by the Modelling and Forecasting team of the Treasury.

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New Zealand Key Economic Data

27 September 2013

Quarterly Indicators

		2012Q1	2012Q2	2012Q3	2012Q4	2013Q1	2013Q2	2013Q3
Gross Domestic Product (GDP)								
Real production GDP	qtr % chg[1]	1.0	0.4	0.3	1.6	0.4	0.2	...
	ann ave % chg	1.9	2.4	2.5	2.7	2.7	2.7	...
Real private consumption	qtr % chg[1]	0.7	0.2	0.2	1.6	0.6	1.5	...
	ann ave % chg	2.5	2.7	2.4	2.4	2.3	2.6	...
Real public consumption	qtr % chg[1]	-0.8	0.9	0.4	-0.8	-0.2	0.5	...
	ann ave % chg	1.8	1.6	1.2	0.5	0.4	0.1	...
Real residential investment	qtr % chg[1]	0.1	8.4	4.6	2.4	8.1	-1.6	...
	ann ave % chg	-10.8	-2.2	6.6	12.1	18.9	18.5	...
Real non-residential investment	qtr % chg[1]	3.6	2.6	-3.6	2.1	0.3	5.7	...
	ann ave % chg	6.0	5.8	4.5	5.0	4.2	3.1	...
Export volumes	qtr % chg[1]	-0.8	-1.1	3.1	0.4	2.5	-5.9	...
	ann ave % chg	3.0	2.9	3.6	2.6	3.0	2.7	...
Import volumes	qtr % chg[1]	3.0	-2.9	2.1	-0.6	2.2	1.3	...
	ann ave % chg	6.1	3.8	1.7	2.1	0.7	1.9	...
Nominal GDP - expenditure basis	ann ave % chg	3.8	4.0	3.0	2.3	2.4	2.1	...
Real GDP per capita	ann ave % chg	1.0	1.5	1.7	2.0	2.0	2.0	...
Real Gross National Disposable Income	ann ave % chg	2.9	2.0	1.6	1.1	0.9	2.3	...
External Trade								
Current account balance (annual)	NZ$ millions	-7,833	-8,915	-9,082	-9,829	-9,512	-9,099	...
	% of GDP	-3.8	-4.3	-4.3	-4.7	-4.5	-4.3	...
Investment income balance (annual)	NZ$ millions	-9,502	-9,957	-9,645	-9,300	-9,327	-8,653	...
Merchandise terms of trade	qtr % chg	-2.3	-2.5	-3.2	-1.2	4.2	4.9	...
	ann % chg	-2.1	-6.7	-9.2	-8.9	-2.8	4.5	...
Prices								
CPI inflation	qtr % chg	0.5	0.3	0.3	-0.2	0.4	0.2	...
	ann % chg	1.6	1.0	0.8	0.9	0.9	0.7	...
Tradable inflation	ann % chg	0.3	-1.1	-1.2	-1.0	-1.1	-1.6	...
Non-tradable inflation	ann % chg	2.5	2.4	2.3	2.5	2.4	2.5	...
GDP deflator	ann % chg	-0.3	1.4	-1.5	-2.8	0.8	1.0	...
Consumption deflator	ann % chg	1.3	0.9	0.7	0.6	0.4	-0.1	...
Labour Market								
Employment (HLFS)	qtr % chg[1]	0.0	0.0	-0.4	-0.9	1.7	0.4	...
	ann % chg[1]	0.9	0.6	0.0	-1.3	0.3	0.7	...
Unemployment rate	%[1]	6.8	6.8	7.3	6.8	6.2	6.4	...
Participation rate	%[1]	68.7	68.4	68.4	67.3	67.9	68.0	...
LCI salary & wage rates - total (adjusted)[5]	qtr % chg	0.4	0.5	0.5	0.5	0.4	0.4	...
	ann % chg	2.0	2.0	1.9	1.8	1.8	1.7	...
QES average hourly earnings - total[5]	qtr % chg	1.4	0.1	1.1	-0.1	0.8	0.2	...
	ann % chg	3.8	2.9	2.8	2.6	2.1	2.1	...
Labour productivity[6]	ann ave % chg	0.7	1.6	2.8	3.5	2.7	2.1	...
Retail Sales								
Core retail sales volume	qtr % chg[1]	-0.3	0.6	0.0	1.1	1.0	2.3	...
	ann % chg	4.2	4.1	1.7	1.8	2.5	4.5	...
Total retail sales volume	qtr % chg[1]	0.3	1.1	-0.2	1.8	0.9	1.7	...
	ann % chg	4.2	4.7	2.2	3.2	3.5	4.2	...
Confidence Indicators/Surveys								
WMM - consumer confidence[3]	Index	102	100	103	111	111	117	115
QSBO - general business situation[4]	net %	13.0	-4.1	8.0	19.8	23.0	31.9	...
QSBO - own activity outlook[4]	net %	16.9	8.1	17.7	18.7	18.1	17.8	...

Monthly Indicators

		2013M03	2013M04	2013M05	2013M06	2013M07	2013M08	2013M09
External Sector								
Merchandise trade - exports	mth % chg[1]	-1.0	1.3	-0.6	0.6	12.7	-2.5	...
	ann % chg[1]	4.8	1.9	-8.0	-4.1	-4.9	0.6	...
Merchandise trade - imports	mth % chg[1]	0.5	-8.9	-3.2	12.9	-5.8	2.1	...
	ann % chg[1]	-8.6	6.8	-3.4	-6.6	17.0	9.7	...
Merchandise trade balance (12 month total)	NZ$ million	-521	-687	-901	-816	-1684	-2063	...
Visitor arrivals	number[1]	227,520	231,090	229,400	225,400	228,160	228,150	...
Visitor departures	number[1]	230,440	234,230	231,070	235,470	230,490	229,160	...
Housing								
Dwelling consents - residential	mth % chg[1]	-9.6	20.5	0.7	-4.3	-0.8	...	...
	ann % chg[1]	-5.4	42.7	43.7	16.4	28.1	...	...
House sales - dwellings	mth % chg[1]	-0.2	3.5	-2.7	-6.9	12.0	...	...
	ann % chg[1]	10.9	25.2	7.5	0.0	14.7	...	...
REINZ - house price index	mth % chg	2.4	0.8	0.7	0.0	-0.5	2.1	...
	ann % chg	8.6	9.8	8.7	8.4	8.6	9.5	...
Private Consumption								
Electronic card transactions - total retail	mth % chg[1]	-0.4	0.9	0.6	1.2	0.5	0.8	...
	ann % chg	4.2	5.2	5.4	5.1	7.7	6.4	...
New car registrations	mth % chg[1]	0.1	7.9	1.8	0.1	8.5	-2.1	...
	ann % chg	11.2	17.8	16.3	15.6	27.6	23.0	...
Migration								
Permanent & long-term arrivals	number[1]	7,750	7,820	7,810	8,220	7,730	7,910	...
Permanent & long-term departures	number[1]	6,430	6,200	6,060	6,000	5,760	5,810	...
Net PLT migration (12 month total)	number	2,542	4,776	6,242	7,907	10,569	12,848	...
Commodity Prices								
Brent oil price	US$/Barrel	108.49	102.53	102.52	102.92	107.89	111.34	*112.12*
WTI oil price	US$/Barrel	93.05	92.07	94.80	95.80	104.61	106.57	*106.91*
ANZ NZ commodity price index	mth % chg	8.5	10.2	0.7	0.8	0.6	0.7	...
	ann % chg	2.2	17.4	17.3	22.5	26.9	28.8	...
ANZ world commodity price index	mth % chg	7.4	12.6	-1.6	-3.7	0.6	0.7	...
	ann % chg	3.9	22.5	26.1	24.4	25.7	26.0	...
Financial Markets								
NZD/USD	$[2]	0.8279	0.8473	0.8267	0.7908	0.7885	0.7923	*0.8109*
NZD/AUD	$[2]	0.8013	0.8158	0.8325	0.838	0.8594	0.877	*0.8748*
Trade weighted index (TWI)	June 1979 = 100[2]	76.15	78.05	77.31	74.00	74.78	74.75	*76.12*
Official cash rate (OCR)	%	2.50	2.50	2.50	2.50	2.50	2.50	2.50
90 day bank bill rate	%[2]	2.64	2.65	2.64	2.64	2.64	2.64	*2.64*
10 year govt bond rate	%[2]	3.72	3.34	3.37	3.84	4.23	4.47	*4.71*
Confidence Indicators/Surveys								
ANZ - business confidence	net %	34.6	32.3	41.8	50	52.8	48.1	...
ANZ - activity outlook	net %	32.4	30.3	34.3	45	43.7	43.3	...
ANZ-Roy Morgan - consumer confidence	net %	115.0	119.2	123.7	123.9	119.8	123.0	118.8
Performance of Manufacturing Index	Index	53.6	54.9	59.0	55	59.5	57.5	...
Performance of Services Index	Index	55.7	56.1	56.0	55	58.2	53.2	...

qtr % chg	quarterly percent change
mth % chg	monthly percent change
ann % chg	annual percent change
ann ave % chg	annual average percent change

1 Seasonally adjusted
2 Average (11am)
3 Westpac McDermott Miller
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