Mind the gap

Q2 current account deficit widens to 3.3% of GDP

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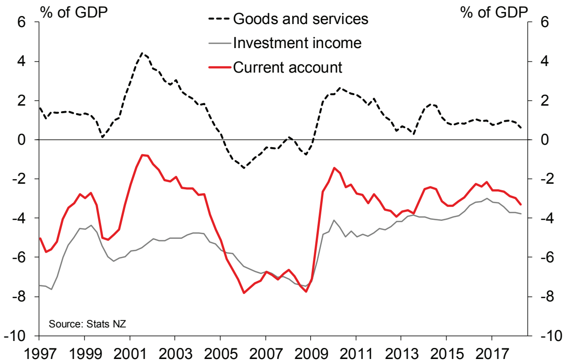
- The current account deficit widened from 3.0% to 3.3% of GDP in the year to June. While this was larger than expected, the difference was due to data revisions.
- The balance of trade in goods and services improved in the June quarter, though it was softer than the same time last year.
- The current account deficit remains low relative to history, and New Zealand's external imbalances were steady in the June quarter.

Current account balance	Q2 2018	Q1 2018
Quarterly (s.a.) $m	-2,666	-3,160
Annual $m	-9,536	-8,541
Annual % of GDP	3.3%	3.0%

Annual current account balance



New Zealand's annual current account deficit increased to 3.3% of GDP in June, compared to an average market forecast of 2.9%. While this was the largest deficit in three years, it is still low relative to history, and remains within the range of what we would consider to be sustainable.

The current account is rarely market-moving, and despite the substantially larger than expected deficit there was little impact on the New Zealand dollar. The surprises in the details of today's release don't affect our forecast of tomorrow's GDP figures, where we expect a 0.9% gain for the June quarter.

In seasonally adjusted terms, the current account deficit narrowed to $2.67bn in the June quarter, with improved results in goods, services and investment income compared to the March quarter. However, the balance was still about a billion dollars weaker than the same quarter last year, which led to the widening of the deficit on an annual basis.

Goods exports benefited from a pickup in both prices and volumes in the June quarter. Spending on imports rose by a lesser degree, largely due to an increase in oil prices.

Similarly, exports of services rose by more than imports in the June quarter, led by solid growth in tourist spending. As we detailed in our latest quarterly *Economic Overview*, services exports have been a quiet achiever in recent years, with strong growth in earnings across a range of industries. Discussions of 'the trade deficit' often focus on physical goods and overlook services; taking them together, New Zealand's trade balance is actually in surplus and has been for some time.

The investment income deficit narrowed a little in the June quarter. Earnings from foreign-owned firms in New Zealand rose in the June quarter, as we expected. However, there was a surprisingly large lift in New Zealanders' earnings from their overseas investments.

So why was the current account deficit larger than expected? Part of the reason is a change in the starting point. The June quarter release includes annual revisions to the historic data, where the net impact can go in either direction. This year there were two notable changes. The first was an upward revision to services exports, due to improved estimates of earnings from education and film and TV production. These revisions go back several years

– in fact, the deficit between 2014 and 2016 is now smaller than previously reported.

But the bigger change was a significant worsening of the investment income deficit over the past year. The revisions are based on annual tax returns, and until this data is available Stats NZ uses assumptions about the rates of return on investments. In this case, the returns to New Zealand investors were lower, and returns to foreign investors were higher, relative to what was assumed. Together, these revisions widened the deficit over the last year by 0.3% of GDP.

Revisions to current account

Year to March 2018	Previous	Revised	Impact
Goods balance $m	-2,671	-2,695	-24
Services balance $m	4,965	5,226	+261
Primary income inflows $m	8,750	8,380	-370
Primary income outflows $m	18,275	18,724	-449
Current account % of GDP	**-2.8%**	**-3.0%**	**-0.2%**

The other reason was an error in previously reported figures for tourist spending in the June quarter. The correction added another 0.2 percentage points to the deficit relative to our forecast.

Despite the widening in the current account deficit, New Zealand's international position remains on a sustainable path. Net international liabilities were steady at 54.6% of GDP, which is the lowest reading for this series dating back to June 2000. Relatively small current account deficits in recent years, and hence a smaller borrowing requirement, have meant that New Zealand has effectively been able to outgrow its debts.

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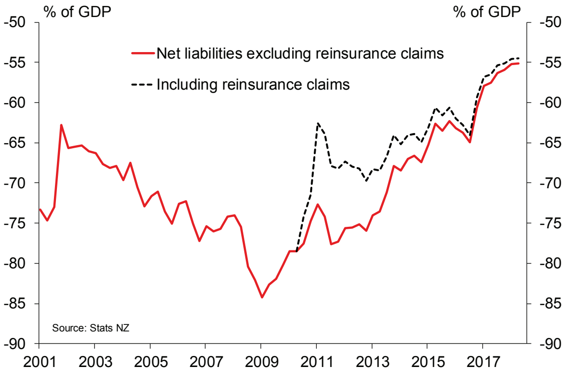
International investment position



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