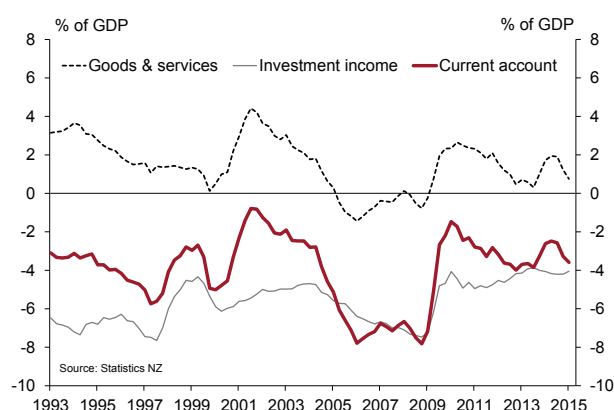


Mixed fortunes

Q1 current account deficit widens to 3.6% of GDP

- The current account deficit widened to 3.6% of GDP in the year to March 2015, as we expected.
- The fall in dairy export prices over the past year drove the increase in the deficit, and will continue to do so over the course of this year.
- Cheaper oil imports and strong growth in tourist spending helped to soften the blow.

Annual current account balance



New Zealand's annual current account deficit widened from 3.3% to 3.6% of GDP in the March quarter. The deficit was smaller than the market expected, but was right in line with our forecast.

Since the current account balance is typically reported as a four-quarter total, it tends to reflect developments in trade with a substantial lag. In this instance, the record-high dairy export earnings over the first half of 2014 are now giving way to the steep fall in world dairy prices over the past year. This lag means that today's low dairy prices won't be fully reflected in the current account balance for another year at least.

The deficit for the March quarter itself was an improvement on the December quarter, narrowing from \$2.53bn to \$1.78bn in seasonally adjusted terms. There were three factors behind this. First, the fall in dairy export prices was more than offset by a sharp drop in the price of oil, which makes up about one-sixth of New Zealand's imports.

Second, there was another strong lift in spending by overseas visitors, to be up 17% on the same time last year. We note that this has no implications for tomorrow's March quarter GDP release; it simply means that the strong growth in retail sales over the quarter will be attributed to both foreigners (exports) and locals (consumption).

Finally, the investment income deficit narrowed, due to lower returns on foreign-owned assets in New Zealand. This is not entirely a positive sign, as the returns on assets within New Zealand can be a bellwether for the health of the domestic economy.

We expect the annual current account deficit to widen further over the next year. However, we're sceptical that it will go as far as the Reserve Bank projected in its latest *Monetary Policy Statement*, which forecast a deficit of almost 7% of GDP by March 2017. Neither the fall in dairy export prices to date, nor the recent lift in oil import prices, could produce such a result in our view. Such a blowout would require the kind of rampant debt-fuelled spending growth that we saw in the mid-2000s – and it's very hard to see that being repeated, with the RBNZ increasingly clamping down on mortgage lending growth.

Michael Gordon
Senior Economist

Westpac economics team contact details

Dominick Stephens, Chief Economist
+64 9 336 5671

Michael Gordon, Senior Economist
+64 9 336 5670

Felix Delbrück, Senior Economist
+64 9 336 5668

Satish Ranchhod, Senior Economist
+64 9 336 5669

Any questions email:
economics@westpac.co.nz

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