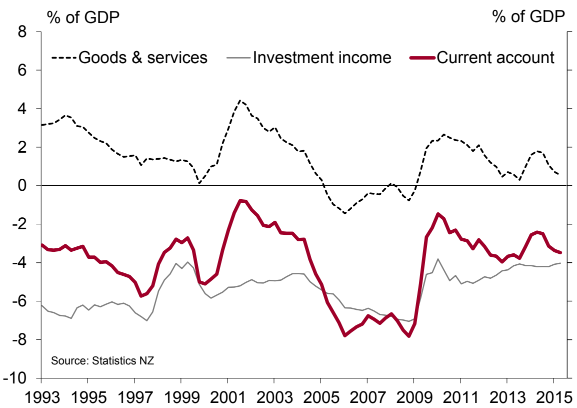
Westpac Institutional Bank

Better with hindsight

Q2 current account deficit widens to 3.5% of GDP

- The current account deficit widened to 3.5% of GDP in the year to June 2015, from a revised 3.4%.
- Weaker dairy export earnings were partly offset by stronger tourist spending and higher earnings on overseas investments.
- While New Zealand's finances have been on an improving trend in recent years, we expect to see a further cyclical deterioration over the next year.

Annual current account balance



New Zealand's current account deficit widened slightly to 3.5% of GDP in the year to June. The actual size of the deficit was smaller than we or the market anticipated, although the difference was mostly due to the annual round of data revisions, which had the effect of reducing the deficit slightly over the last couple of years.

The details of the release were largely as we expected. In seasonally adjusted terms, the balance of goods trade fell further into deficit in the June quarter, due to both lower exports and higher imports. While dairy export prices experienced a short-lived bounce over the quarter, this was more than offset by lower volumes.

In contrast, the services balance moved further into surplus, led by tourist spending. Both the number of visitors and the average spend per person have grown strongly over the last three quarters.

The main surprise relative to our forecast was a jump in New Zealanders' income from overseas investments – in fact the June quarter was the strongest on record. Earnings from foreign-owned assets in New Zealand also rose, in line with our expectations.

Today's report provided further evidence of the trend improvement in New Zealand's external position in recent years. Once again, the annual round of revisions resulted in a shrinking of the current account deficit over recent history. Meanwhile, net overseas liabilities narrowed further to 62.2% of GDP, the lowest on record going back to 2000. This comparison is only slightly flattered by the overseas 'asset' of unpaid earthquake insurance claims, which are now down to \$3.3bn out of an expected total of \$16.9bn.

That said, we expect to see some cyclical deterioration in these balances over the next year or so. Since the current account deficit is traditionally reported as an annual total, the impact of the plunge in dairy export prices will take some time to be fully captured. We expect the annual deficit to widen out to more than 5% of GDP over the next year, before gradually receding again.

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