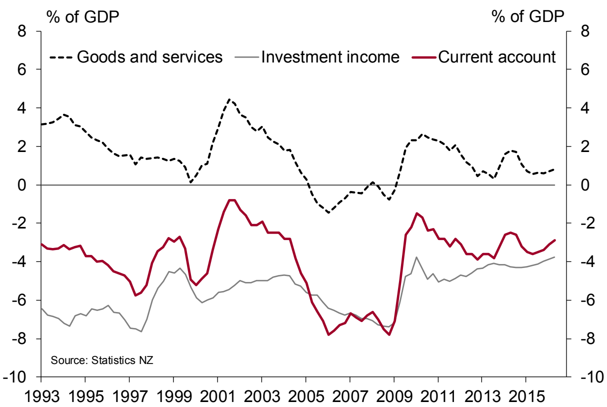
Easing wider

Q2 current account deficit narrows to 2.9% of GDP

- The current account deficit narrowed to 2.9% of GDP in the year to June.
- The goods trade deficit improved slightly in seasonally adjusted terms, due to a temporary surge in export volumes.
- The services surplus narrowed this quarter. While the tourism sector locally continues to go from strength to strength, New Zealanders are also spending more on trips overseas.
- We expect the current account deficit to hover broadly around its current level over the next few years. An improvement in New Zealand's key export prices and ongoing strength in tourist spending should at least partially offset a deteriorating investment income balance as New Zealanders' appetite for borrowing returns.

Annual current account balance



Current account details

	Q2 2016	Q1 2016
Quarterly (s.a.) $m	**-1,826**	**-1,639**
Annual $m	-7,383	-7,820
Annual % of GDP	-2.9%	-3.1%

New Zealand's current account deficit narrowed to 2.9% of GDP in the year to June, down from a revised 3.1% of GDP in the March quarter (previously 3%). This was a slightly larger deficit than we and the market had forecast. The surprise reflected both unanticipated historical revisions, particularly to the investment income balance, and a slightly weaker than anticipated goods trade balance in the June quarter.

These surprises have no real implications for either our forecast of tomorrow's GDP data, or for next week's OCR review. For the Reserve Bank, much of the information on activity in the New Zealand economy contained in today's data has already been foreshadowed by earlier data releases. Meanwhile, all eyes now turn to tomorrow's GDP release where we continue to forecast a solid 1% increase in the June quarter.

Details

In seasonally adjusted terms, the goods trade deficit narrowed a touch in the June quarter, as a very strong rise in agricultural export volumes more than offset weak prices. We don't expect this strength in volumes to be repeated anytime soon. Horticulture exports have been experiencing a bumper run, but the lift in meat and dairy exports in the June quarter is likely to be down to timing. High beef prices, in conjunction with very low dairy prices, have encourage increased slaughter of both dairy cows and beef cattle as farmers looked to cut costs and take advantage of high prices on offer. This pattern is unlikely, indeed unable, to be repeated in the second half of the year, especially if dairy prices maintain their recent improvement.

On the services side of the ledger, the strength in New Zealand's tourism sector remains a feature. However, while New Zealand remains a very attractive destination for foreign holidaymakers, low international airfares and the strong NZ dollar (and perhaps a dearth of accommodation locally) are also enticing Kiwis to holiday offshore. On balance, this saw the services surplus narrow in the June quarter on a seasonally adjusted basis. Looking ahead, the tourism sector is likely to struggle to maintain the impressive pace of growth we've seen of late, as capacity constraints in the sector continue to bite. What's more, data from the international visitor survey showed that tourist spending seems to be declining (from a high level) on a per-person basis, perhaps as the strong NZ dollar pushes up the cost of a New Zealand holiday for international visitors.

The third major component of the current account is the primary income balance, which reflects New Zealand's large overseas liability position. Annual revisions, reflecting new information from sources such as the IRD, have led to an increase in the size of the investment income deficit over history. This quarter, the primary income deficit widened as the outflow of profits from overseas-owned firms rose by more than NZ-owned firms' earnings offshore. Even so, the deficit remains smaller than it was a year ago.

Meanwhile, the overseas liability position increased to 64.9% of GDP in the June quarter. This is the second consecutive quarterly increase, and is the largest it has been as a proportion of GDP since the December 2014 quarter. The increase at least in part reflects a turning point for New Zealand's borrowing and savings position. In recent months, housing borrowing growth has begun to outstrip deposit growth for the first time since the GFC.

Anne Boniface
Senior Economist

Contact the Westpac economics team

Michael Gordon, Acting Chief Economist +64 9 336 5670
Satish Ranchhod, Senior Economist +64 9 336 5668
Anne Boniface, Senior Economist +64 9 336 5669
David Norman, Industry Economist +64 9 336 5656
Sarah Drought, Economist +64 9 336 5696
Any questions email: economics@westpac.co.nz

Disclaimer

Disclaimer continued

or (b) high net worth entities, and other persons to whom it may otherwise lawfully be communicated, falling within Article 49(2)(a) to (d) of the Order (all such persons together being referred to as "relevant persons"). Any person who is not a relevant person should not act or rely on this communication or any of its contents. The investments to which this communication relates are only available to and any invitation, offer or agreement to subscribe, purchase or otherwise acquire such investments will be engaged in only with, relevant persons. Any person who is not a relevant person should not act or rely upon this communication or any of its contents. In the same way, the information contained in this communication is intended for "eligible counterparties" and "professional clients" as defined by the rules of the Financial Conduct Authority and is not intended for "retail clients". With this in mind, Westpac expressly prohibits you from passing on the information in this communication to any third party. In particular this communication and, in each case, any copies thereof may not be taken, transmitted or distributed, directly or indirectly into any restricted jurisdiction. This communication is made in compliance with the Market Abuse Regulation (Regulation(EU) 596/2014).

Investment Recommendations Disclosure

The material may contain investment recommendations, including information recommending an investment strategy. Reasonable steps have been taken to ensure that the material is presented in a clear, accurate and objective manner. Investment Recommendations for Financial Instruments covered by MAR are made in compliance with Article 20 MAR. Westpac does not apply MAR Investment Recommendation requirements to Spot Foreign Exchange which is out of scope for MAR.

Unless otherwise indicated, there are no planned updates to this Investment Recommendation at the time of publication. Westpac has no obligation to update, modify or amend this Investment Recommendation or to notify the recipients of this Investment Recommendation should any information, including opinion, forecast or estimate set out in this Investment Recommendation change or subsequently become inaccurate.

Westpac will from time to time dispose of and acquire financial instruments of companies covered in this Investment Recommendation as principal and act as a market maker or liquidity provider in such financial instruments.

Westpac does not have any proprietary positions in equity shares of issuers that are the subject of an investment recommendation.

Westpac may have provided investment banking services to the issuer in the course of the past 12 months.

Westpac does not permit any issuer to see or comment on any investment recommendation prior to its completion and distribution.

Individuals who produce investment recommendations are not permitted to undertake any transactions in any financial instruments or derivatives in relation to the issuers covered by the investment recommendations they produce.

Westpac has implemented policies and procedures, which are designed to ensure conflicts of interests are managed consistently and appropriately, and to treat clients fairly.

The following arrangements have been adopted for the avoidance and prevention of conflicts in interests associated with the provision of investment recommendations.

(i) Chinese Wall/Cell arrangements;

(ii) physical separation of various Business/Support Units;

(iii) and well defined wall/cell crossing procedures;

(iv) a "need to know" policy;

(v) documented and well defined procedures for dealing with conflicts of interest;

(vi) steps by Compliance to ensure that the Chinese Wall/Cell arrangements remain effective and that such arrangements are adequately monitored.

U.S.: Westpac operates in the United States of America as a federally licensed branch, regulated by the Office of the Comptroller of the Currency. Westpac is also registered with the US Commodity Futures Trading Commission ("CFTC") as a Swap Dealer, but is neither registered as, or affiliated with, a Futures Commission Merchant registered with the US CFTC. Westpac Capital Markets, LLC ('WCM'), a wholly-owned subsidiary of Westpac, is a broker-dealer registered under the U.S. Securities Exchange Act of 1934 ('the Exchange Act') and member of the Financial Industry Regulatory Authority ('FINRA'). This communication is provided for distribution to U.S. institutional investors in reliance on the exemption from registration provided by Rule 15a-6 under the Exchange Act and is not subject to all of the independence and disclosure standards applicable to debt research reports prepared for retail investors in the United States. WCM is the U.S. distributor of this communication and accepts responsibility for the contents of this communication. All disclaimers set out with respect to Westpac apply equally to WCM. If you would like to speak to someone regarding any security mentioned herein, please contact WCM on +1 212 389 1269. All disclaimers set out with respect to Westpac apply equally to WCM.

Investing in any non-U.S. securities or related financial instruments mentioned in this communication may present certain risks. The securities of non-U.S. issuers may not be registered with, or be subject to the regulations of, the SEC in the United States. Information on such non-U.S. securities or related financial instruments may be limited. Non-U.S. companies may not subject to audit and reporting standards and regulatory requirements comparable to those in effect in the United States. The value of any investment or income from any securities or related derivative instruments denominated in a currency other than U.S. dollars is subject to exchange rate fluctuations that may have a positive or adverse effect on the value of or income from such securities or related derivative instruments.

The author of this communication is employed by Westpac and is not registered or qualified as a research analyst, representative, or associated person under the rules of FINRA, any other U.S. self-regulatory organisation, or the laws, rules or regulations of any State. Unless otherwise specifically stated, the views expressed herein are solely those of the author and may differ from the information, views or analysis expressed by Westpac and/or its affiliates.