

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.

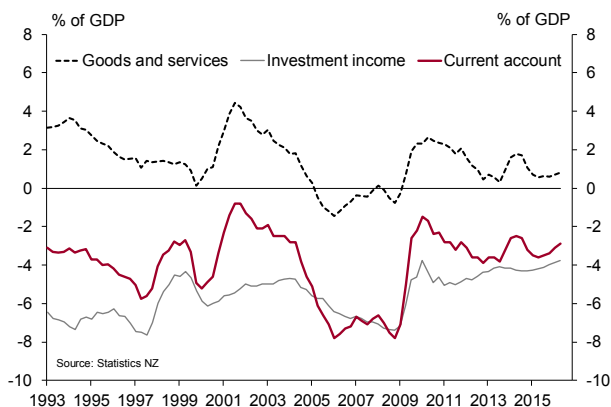
Current account details

	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.

Annual current account balance



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.

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