16 March 2016

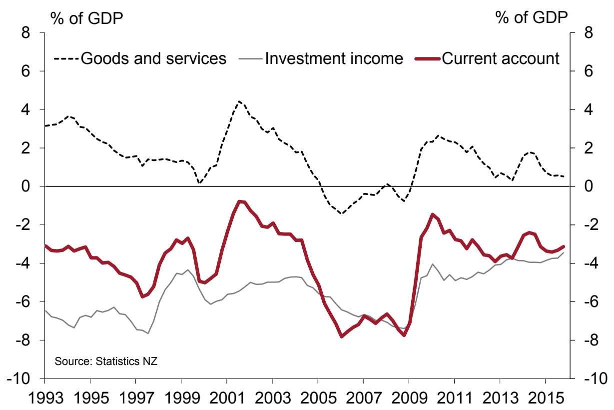
Westpac Institutional Bank

No cause to celebrate

Q4 current account deficit narrows to 3.1% of GDP

- The current account deficit narrowed to 3.1% of GDP in the year to December, the lowest in a year.
- Lower dairy export earnings outweighed the fall in fuel import prices, and tourist spending fell despite record visitor numbers.
- The narrowing in the deficit was due to lower outflows of corporate profits, which does not reflect well on the strength of the domestic economy.

Annual current account balance



New Zealand's current account deficit remains remarkably well contained, relative to its long-term history. The deficit narrowed to 3.1% of GDP in the year to December 2015, against market expectations that it would hold steady at 3.3%.

However, the details don't offer much cause for celebration. The narrowing in the overall deficit came despite a worsening in both the goods and services trade balances. Instead, the headline result was driven by a sharp drop in the outflow of profits from overseas-owned firms in New Zealand. While this might be a positive for the current account deficit, it doesn't reflect well on the strength of the domestic economy.

The details of today's release have no implications for our forecast of December quarter GDP, which will be published tomorrow. We expect a 0.7% increase for the quarter, following a 0.9% gain in the September quarter.

Details

In seasonally adjusted terms, the current account deficit widened from $1.73bn in the September quarter to $1.95bn in the December quarter. This was, however, a smaller deficit than in the same quarter a year ago, resulting in a narrower annual deficit.

The goods trade deficit widened to $810m, the worst quarterly result since 2008. In recent times, the goods trade balance has been a tug of war between falling dairy export prices and falling fuel import prices; in this case, the first effect was greater.

The surplus on services fell slightly to $977m, the first decline in two years. The main factor was a drop in travel exports (i.e. tourist spending), which had previously been signalled by the visitor spending survey.

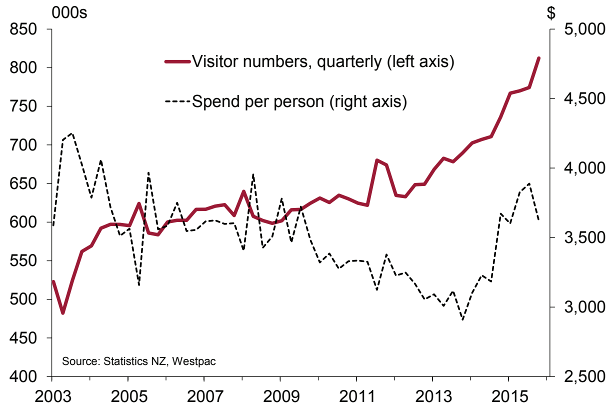
The latest figures reinforce our sense of caution about the strength of the tourism boom. There's no doubt about the surge in visitor numbers, which topped 3m people for the first time last year. But the figures also show a sudden jump in the average spend per person in the December 2014 quarter, the same time that there was a technical change to the spending survey. With the passage of time, it's looking increasingly like the reported step-up in spending was a one-off, rather than a change in the trend (and, we suspect, a sign that tourist spending was previously being under-reported).

The balance on primary income narrowed to a deficit of $1.975m. In particular, there was a sharp drop in the outflow of direct investment income, a category that includes profits earned by overseas-owned firms in New Zealand. While this fall led to a narrower current account deficit, it shouldn't necessarily be taken as a positive sign – we would expect company profits to be rising if the domestic economy were in a strong position.

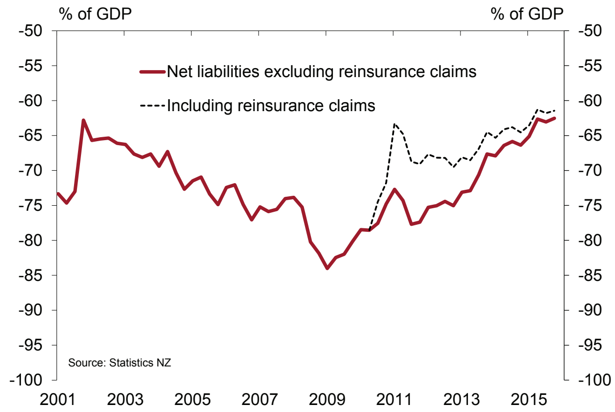
The continued run of modest current account deficits means that New Zealand's overseas liability position has continued to improve, narrowing to 61.4% of GDP. It's important to note that this balance is no longer being flattered to any meaningful extent by pending earthquake reinsurance claims – the balance of unsettled claims has shrunk to $2.7bn from a total of more than $20bn.

Michael Gordon
Senior Economist

Overseas visitor spending



International investment position



Westpac economics team contact details

Dominick Stephens, Chief Economist
+64 9 336 5671

Michael Gordon, Senior 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

Any questions email:
economics@westpac.co.nz

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