14 March 2018

Starting To Widen

- **Current account deficit edges wider**
- **It is expected to widen further**
- **But remain contained by historical standards**
- **We stay with +0.7% for Q4 GDP tomorrow**

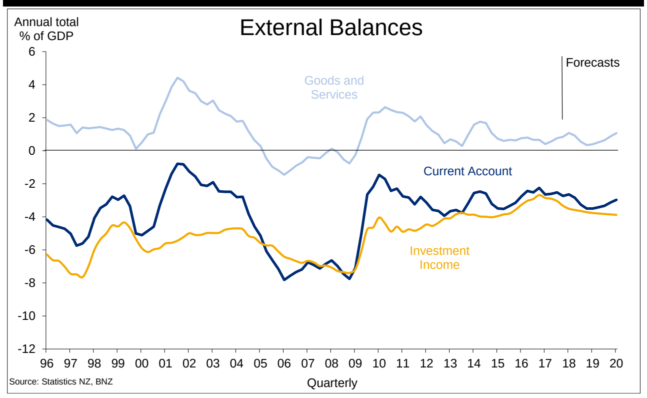
New Zealand's external accounts remain off the market's radar. One reason is a relatively small current account deficit. This morning's data showed the current account deficit for calendar year 2017 came in at 2.7% of GDP (from a downwardly revised 2.5% for the year ending September 2017).

Sure, this was a touch wider than the 2.6% of GDP deficit expected by the market (and us) but it remains small and is smaller than usual. Moreover, the bigger deficit included large aircraft imports in Q4 and so likely overstates any trend deterioration in the quarter. The average deficit over the past 10 years has been 3.5% of GDP.

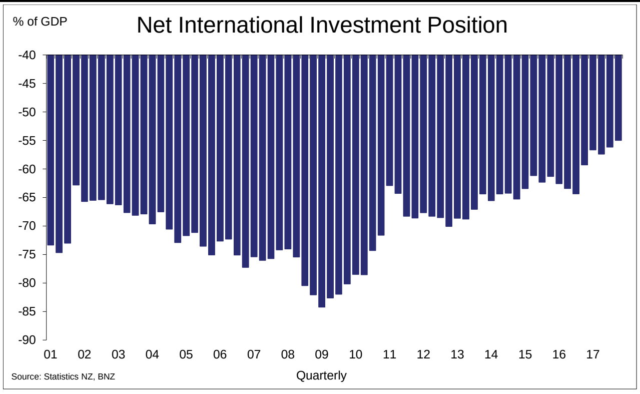
Another reason for limited market attention is because a relatively small current account deficit helps New Zealand's net international liability position continue to shrink as a share of the economy. It is still sizable at 54.8% of GDP as at the end of 2017, but it's a reasonable drop from 59.3% a year ago and a significant reduction from its peak at over 84% back in 2009. It represents a marked reduction in NZ's external vulnerabilities.

This sort of deficit and reduction in net liability ratio will not have the rating agencies losing any sleep.

Widening, But Benign



Getting Smaller

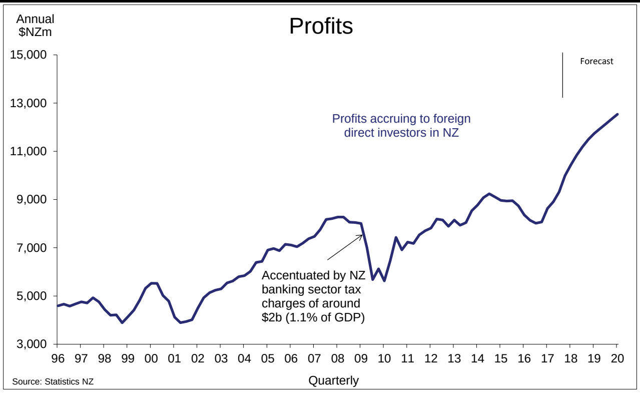


We think the annual current account deficit will widen a touch over the coming years, as domestic investment growth outpaces expansion in domestic saving. This has been our view for some time. Today's result may well be the beginning of that move (we think to around 3.5% of GDP by mid-2019).

The change in trajectory of the annual current account balance bears watching and may start to garner some attention, especially if it were to widen faster than we currently anticipate. In any case, aggregate deficits can only tell you so much – ultimately what matters is what the funds are used for. That said, the relatively small deficit by NZ standards is likely to keep the external accounts away from the market's attention for a while yet.

The investment income deficit was larger than we expected in the quarter. The implicit positive signal for profits across the economy (a signal reinforced by the buoyant equity market) offers encouragement for solid Q4 GDP growth in tomorrow's figures. Indeed, it is interesting that StatsNZ noted today that 'High levels of foreign direct investment income can indicate a strong New Zealand economy with higher profits for New Zealand-based companies.' However, it need not necessarily be the case with a dip in this balance of payments 'profit' measure through 2015-16 occurring despite strong economic growth at the time.

A Positive Growth Signal?



More directly, the goods and services detail in today's trade data offered mixed messages for our thoughts around tomorrow's Q4 GDP. But, on balance, they were more supportive than not.

The detail certainly confirmed our thoughts that import good volumes were up strongly in Q4, boosted by aircraft imports. As an aside, it is never absolutely clear whether aircraft imports in the monthly merchandise trade data will necessarily show up in the balance of payments (it depends on the particular financial arrangements for each one). But now we know they have been included they will almost surely show up in tomorrow's GDP figures too.

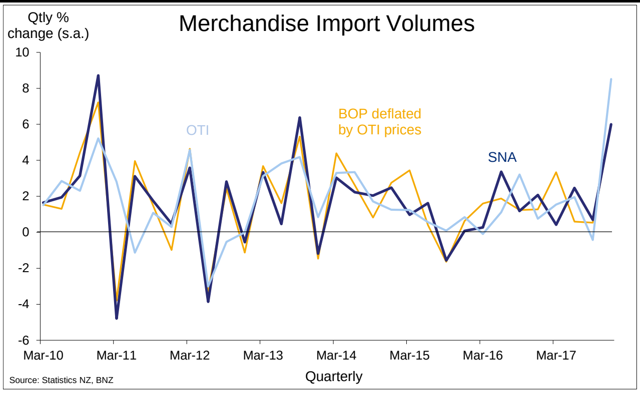
Of course, this applies to investment as much as imports. Indeed, strong investment is a feature of our robust expenditure GDP estimate. It may well be stronger than we think, given the potential boost from aircraft.

On the other side, today's numbers imply that export service volumes were weaker than we had been thinking, falling in Q4 in what looks like further unwind from a sports-event-related spike earlier in the year.

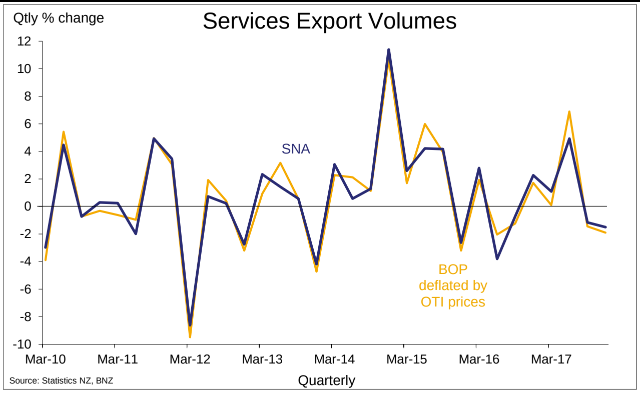
Meanwhile, it looks like goods export volumes were a bit stronger than anticipated and services import volumes weaker than we had factored in.

All this offers encouragement via a robust estimate for expenditure GDP growth. But that is not to give the impression that there is necessarily upside risk to our Q4 +0.7% pick for official production GDP. The many moving parts just add to the uncertainties around the quarter, including, as we have noted before, around manufacturing production. While precision is difficult, we've certainly seen enough to suggest that the economy performed at least reasonably well at the end of last year.

Big Imports Suggests Big Investment



Unwind From Spike



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