20 June 2018

Not So Positive

- **External deficit as benign as expected**
- **But undercurrents point to a widening**
- **And BOP details stress vulnerabilities to Q1 GDP**
- **With net exports negating solid domestic demand**
- **Meanwhile consumer confidence failing to fire**

Current Account - Q1			
$NZ billions	**Actual**	Mkt Expected	Previous
Annual Balance (% GDP)	**-2.8**	-2.8	**-2.7**
Annual Balance	**-7.9**		**-7.7**
Unadjusted Qtly Balance	**+0.2**	+0.1	**-2.7**
R - revised			

This morning's Balance of Payments (BOP) headlines were about as non-threatening as they were anticipated to be. The year to March 2018 current account deficit printed at $7.9b, or 2.8% of GDP – exactly in line with market expectations (and ours). But the undercurrents suggest an expanding deficit is in train – the degree to which is worth keeping a tab on.

This might sound like a strange thing to say, given the March quarter alone managed a slight surplus, of $182m. But this was seasonally aided. Seasonally adjusted, the quarterly current account deficit was, in fact, the widest in nine years. Granted, this was probably overstated by timing issues in export production, and spiking oil import prices. Still, underneath it all, we judged the external deficit is turning higher.

There was certainly a rough patch in net exports in the March quarter. If nothing else, this solidifies our view of risk around tomorrow's Q1 GDP growth expectation (still 0.5%) – that is, to the downside.

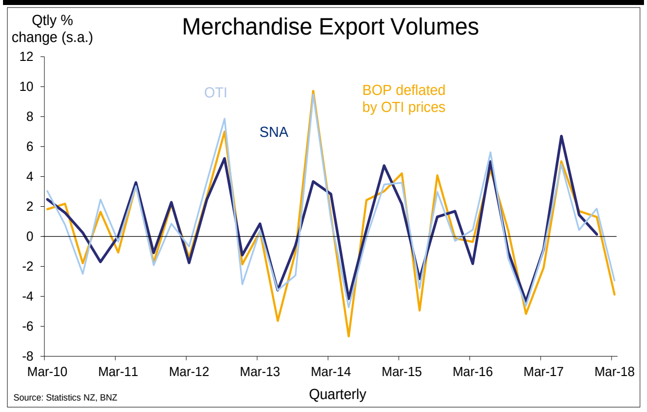
In this morning's BOP report, exports dropped as much as we thought in goods, and were about as flat with respect to services. However, its imports data were stronger than we anticipated, for goods and services. Of course, this could indicate faster domestic demand than we are figuring on for the quarter. However, we'll probably need this in order for expenditure GDP to not fall in Q1, presuming a concurrent big drag from net export volumes.

To be sure, there are timing issues at play in Q1's net exports negativity. Even so, we still see the annual current account deficit expanding, more broadly, to about 3.5% of GDP in calendar 2018 – so about its long-term average.

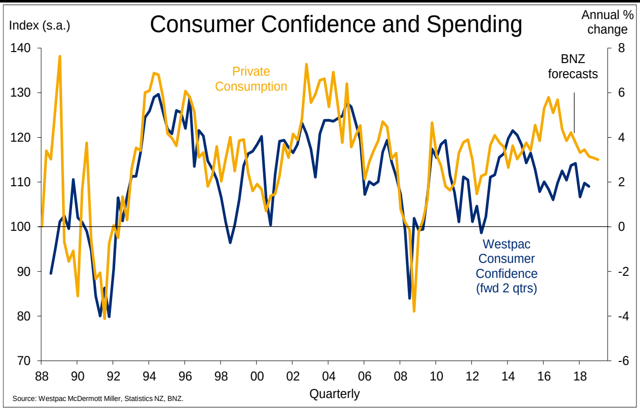
On the one hand, we might query how well exports will do over the coming year. On the other, we also have to wonder if domestic demand will remain so robust. As we've been emphasising, business investment is something to watch, lest it tracks business sentiment to the soft side. But private consumption is another thread to domestic demand that bears watching for any under-performance.

We mention this with morning's Westpac McDermott Miller consumer confidence report remaining about as so-so as it was three months ago. On the quiet, we were hoping for a little pick-up. In truth, its headline index slipped back to 108.6 in the June quarter, from the 111.2 it bumped up to in the March quarter. Some of this

A Big Dent for GDP



Uninspiring



movement was merely seasonality. But it left the level of consumer confidence barely average. It's OK, but just OK.

Most interestingly, it was the expected conditions index that limited confidence in Q2. It fell to 106.6, from 111.2. The present conditions index actually edged up to 111.7, from 111.2. We might have thought it would be the other way around, with consumers perhaps feeling the squeeze from the likes of the recent surge in petrol prices, but looking to the 1 July fiscal injection for relief.

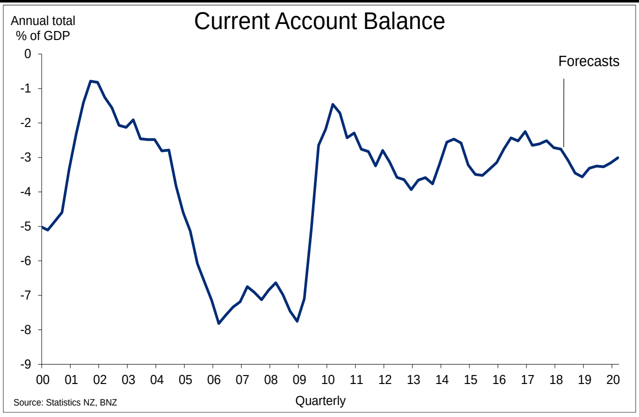
Given the impending fiscal injection, it will still pay to wait to see if this buoys the household sector's spirits. Then again, the "stimulus" is very much directed at low to middle income families, rather than the broader and bigger round of tax (threshold) relief that was promised by National, which has obviously met with the political kibosh.

As it stands, consumer confidence is not exactly pointing to the acceleration in consumption growth that we assume for the second half of 2018, as a key underpinning to our GDP forecasts.

Of course, any failure of GDP growth to strengthen later this year may or may not have implications for interest rates. It depends on what drives this – including the role of investment in the aggregate supply side of the equation. We also need to note the upside pressure already in prospect for CPI inflation, probably more than is generally appreciated.

All considered, however, the risks to the currency are arguably inclined to the south side. Our outlook for an increasing current account deficit is part of this, as support factors for NZD are prone to losing some of their relative shine.

Flagging



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