19 September 2018

External Imbalance Widens Further

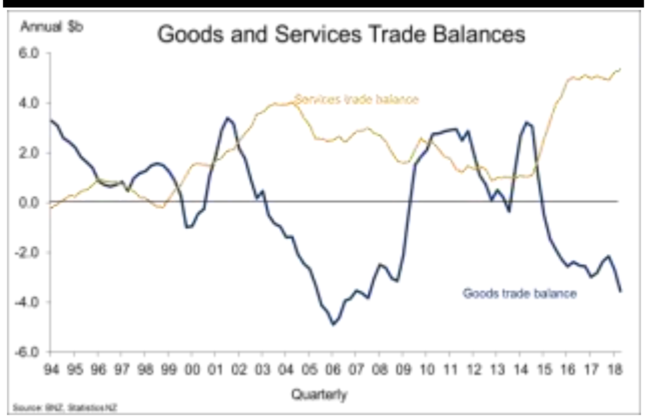
- **Current account deficit rises to 3.3% of GDP**
- **Deterioration in net export volumes to blame**
- **Terms of trade decline will add more pressure**
- **NZD negative at the margin**
- **Nothing in the data to dent our Q2 GDP forecast**

New Zealand's external accounts have continued their trend deterioration, which began in 2017. Back in December 2016 the current account deficit hit a low of 2.2% of GDP. That has now climbed to 3.3% of GDP and, by our expectation, will be through 4.0% by mid 2019.

Driving the balance further and further into red has been the weakness experienced in New Zealand export volumes. By our estimates, goods export volumes were just 0.3% higher in the June quarter 2018 than they were a year earlier. In stark contrast, import volumes soared 8.4%. In part the export weakness can be attributed to a weather-related dent in agriculture exports but, once this is behind us, we still don't see much of a resurgence in export activity.

Import growth reflects strong domestic demand in New Zealand. As domestic demand softens, we would also expect import growth to moderate but not so much so as to reverse the negative trend in the goods balance. Moreover, the goods balance has been supported by a soaring terms of trade. The terms of trade now appears to be falling as export prices start to come under downward pressure. This will further exacerbate the rise in the goods deficit.

Services To The Rescue

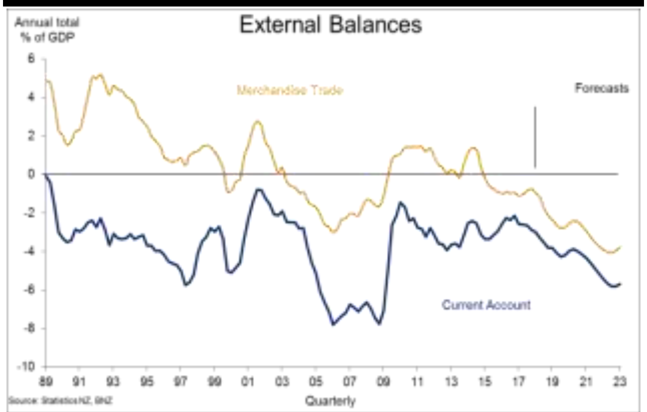


Dairy Prices Under Pressure

Symptomatic of this was this morning's dairy price auction in which the GDT Price Index fell a further 1.3% to be down 14.7% for the year. Moreover, we think the near term risk to dairy prices is more weighted to the downside than the up.

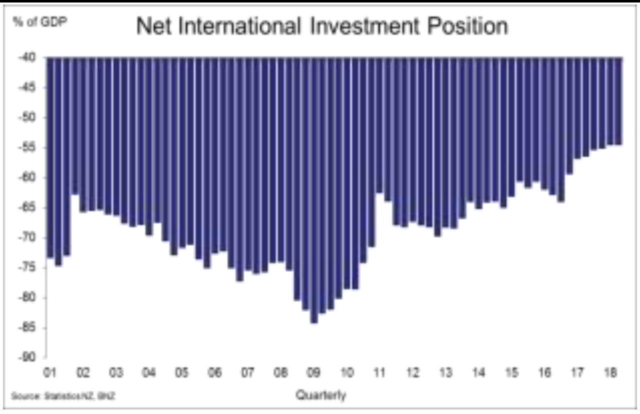
New Zealand's external accounts saviour remains its services balance and, in particular, the returns from tourism. The total services balance stands at a surplus of 1.8% of GDP. Without it, the total current account deficit would have climbed to 5.1% of GDP. The good news is that we expect the services balance to remain solidly in surplus for the foreseeable future. The bad news is that we do not see it growing significantly from here particularly as growth in inbound tourism is increasingly capacity constrained.

Deficit Getting Bigger



National Australia Bank

Debt Levels Okay



The state of the accounts was worse than we had anticipated. Statistics New Zealand had published revisions for services exports up to the year ended March 2017 which intimated that the current account deficit would be revised lower. Indeed, that's exactly what happened. Unfortunately, the data published today show revisions in the opposite direction for the period post March 2017 and that caught us off guard. Nonetheless, the "miss" did nothing to change our view of the world ahead.

The other aspect of our forecasts that today's data didn't change is our pick for the Q2 GDP outturn that will be released tomorrow. The current account data produced an implied export and import volume profile that is consistent with our view that production GDP through the June quarter rose 0.6%. However, at the margin there is some suggestion of upside risk to our projection with our current expenditure on GDP pick creeping up to 0.9%.

From a national indebtedness perspective, the deterioration in the current account balance is not yet sufficient to dent the trend improvement in New Zealand's net international investment position with net liabilities currently sitting at 54.6% of GDP, a far cry from the 82.6% peak reached back in March 2009. Even with the further increase in the current account deficit that we forecast, we do not think the external accounts will create any angst for the rating agencies.

From a market perspective, there wasn't a lot to get excited about in today's data. The higher than anticipated current account deficit has weighed modestly on the NZD but the reaction is hardly noticeable in the bigger picture. Moreover, those looking for confirmation of a weak GDP number tomorrow would not have found it so that would have ameliorated any downward pressure that resulted from the headline number. Going forward, we do believe the current account position will increasingly put downward pressure on the NZD but the impact of such is likely to pale beside the impact of the strength (or otherwise) of the New Zealand economy, movements in relative interest rate differentials and global risk.

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