20 September 2017

NZ Less Vulnerable

- **Current account deficit smaller than expected**
- **Part of a trend reduction in external vulnerabilities**
- **Indicating NZD not overvalued**
- **We expect current account deficit to shrink further**
- **Nothing here to change our +0.8% view for tomorrow's Q2 GDP.**

Current Account - Q2			
$NZ billions	**Actual**	Mkt Expected	Previous
Annual Balance (% GDP)	**-2.8**	-3.1	**-2.9R**
Annual Balance	**-7.5**		**-7.7R**
Unadjusted Qtly Balance	**-0.6**	-0.9	**+0.2R**
R - revised			

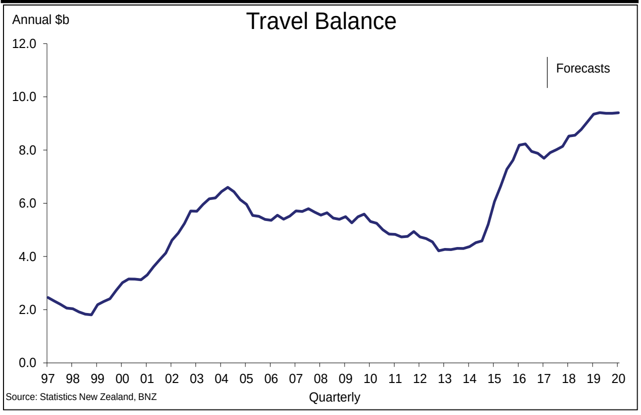
New Zealand's external accounts are looking more and more benign by the day. Sure, the annual current account balance remains in deficit, as it has since 1973, but at the equivalent of 2.8% of GDP in the year to June 2017 it is smaller than its historical average. This result was a smaller deficit than the market consensus of 3.1% of GDP and even a touch smaller than our 2.9% forecast (helped by some revisions).

More spending by overseas travellers, boosted by the World Masters Games and the Lions Rugby tour, lifted services exports to a record level on a quarterly seasonally adjusted basis. But this was by no more than we expected. In fact, most of the major sub components came in close to our expectations so nothing to derail our thinking that the annual current account deficit continues to shrink from here down towards 2% of GDP over the coming few quarters.

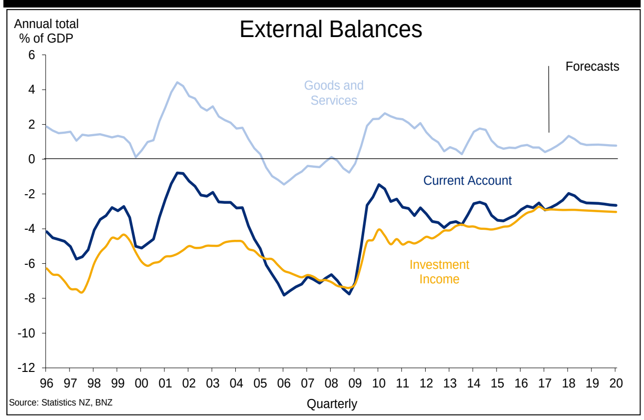
The goods and services trade balance has remained firmly in surplus over recent years, as strong tourism receipts helped offset weakness in dairy exports. The travel component of the services balance in the year to June 2017 was in surplus to the tune of $7.9b. But with dairy exports now improving on the back of better international prices, and with healthy prices for many other primary products, the goods deficit is expected to shrink such that it will help drive a bigger surplus in the overall goods and services balance. This has already begun with the value of goods exports in Q2 9.3% higher than a year ago, while goods imports were up 8.5%.

The latest dairy auction overnight supports this view, with the GDT Price Index rising 0.9% to be 17.8% higher than a year ago. Higher anticipated dairy export receipts tie in with Fonterra's current $6.75 milk price forecast for the 2017/18 season that is higher than last season's $6.15 (expected to be finalised next Monday with Fonterra's annual results) and miles above the $3.90 in the season before that. As the new season's milk is made and sold at better prices, it will support export receipts ahead.

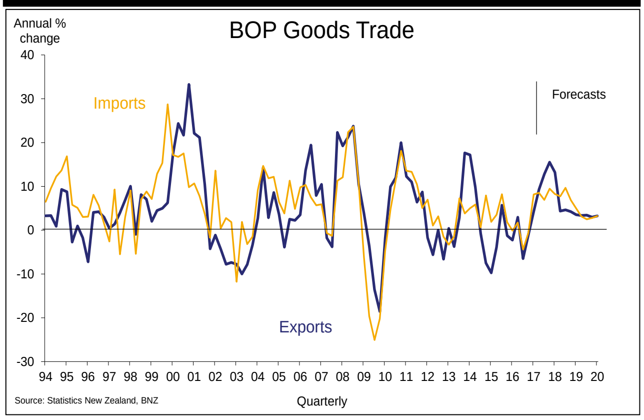
Hotspot



Calm



Goods Exports Improving



A relatively low current deficit has helped the nation's external debt and net international investment position (NIIP) to both continue to shrink as a share of GDP. The NIIP sat at 57.5% of GDP as at the end of June, continuing the trend improvement from a peak of around 84% in early 2009. This is a significant improvement and represents a reduction in New Zealand's external risks. A relatively small current account deficit and a trend decline in the NIIP as a share of the economy support our view that the NZ dollar is not overvalued. And with the TWI tracking lower than the RBNZ's most recent forecasts, we don't expect any additional jawboning from the central bank at next week's OCR review. The external accounts remain off the radar from a foreign exchange market or rating agency point of view, with a lot more focus on the outlook for relative growth, inflation, interest rates and with Saturday's election in mind, fiscal policy.

Speaking of growth, today's trade details do not change our thinking around tomorrow's Q2 GDP figures. Our estimate remains at 0.8% in the quarter, which would keep annual growth at 2.5% (assuming no revisions). We see the risks around this estimate for official production GDP as reasonably balanced. But we note that our expenditure measure of GDP is showing stronger growth for the quarter, reinforced by today's strong tourism spending figures. However, any outperformance on expenditure GDP for Q2 may simply be catch up following it's slow Q1, rather than a guide to upside risk around our +0.8% estimate for official GDP this quarter. Tomorrow's data will tell all.

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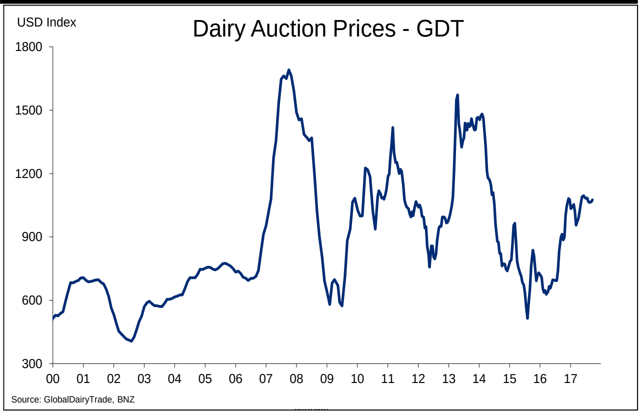
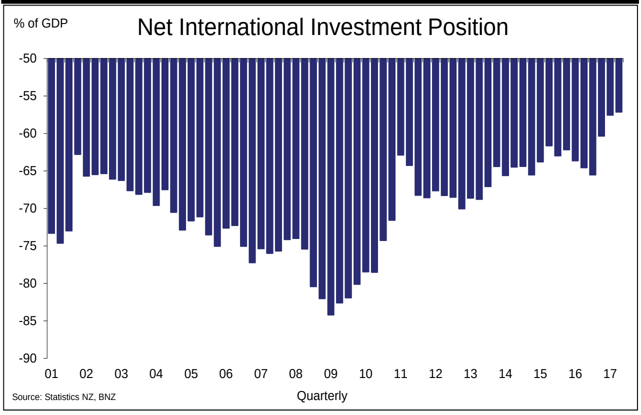
Dairy Prices Stable At Healthy Level



Vulnerability Reducing



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