

Research Economy Watch

17 December 2025

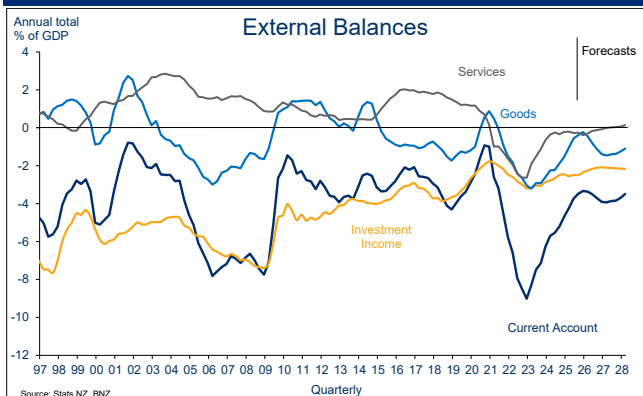
Deficit narrowing continues, for now

- **Annual current account deficit shrinks to 3.5% of GDP**
- **Led by primary exports and tourism**
- **Trend narrowing approaching its end**
- **Lower dairy prices to weigh on external accounts**
- **Q3 GDP pick stays at 0.9% q/q**

The current account deficit narrowed to 3.5% of GDP in the year to September 2025. It was a tick wider than our forecast of 3.4%, but smaller than the 3.7% annual deficit recorded in June and extends a material narrowing over the past three years.

New Zealand's annual current account deficit peaked at 9.0% in December 2022. Since then, there has been a steady tapering, in particular for the balance of goods trade (-3.0% to -0.4%) and the balance of services trade (-2.6% to -0.3%). This has been underpinned by strong primary sector export returns and the slow recovery in international tourism.

Running out of puff



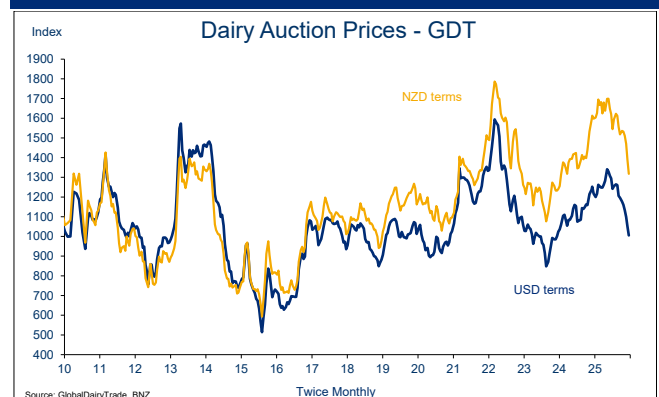
The external deficit as a share of the economy has returned to usual levels. It is important to note that a deficit itself is not necessarily a bad thing, it depends what the funds are being spent on and the rate of return achieved on any investment. Nonetheless, international rating agencies will have confidence that the current (low) level of economic growth is sustainable from an external accounts perspective.

Looking ahead, we expect the trend narrowing in the current account deficit is coming towards its end. Our forecasts show another quarter of annual deficit narrowing

before some widening takes place. Lower dairy prices and higher imports should start to weigh on the goods balance and external deficit through 2026.

Indeed, global dairy prices fell another 4.4% at the latest GDT auction overnight. It was the ninth consecutive decline and reflects significantly more milk from the US, NZ and EU. There is clear downside risk to Fonterra's 2025/26 midpoint milk price forecast of \$9.50 given current global prices and momentum. If current global prices were to remain around current levels for the remainder of the season, a milk price closer to \$9 could be expected. Of more concern is the outlook for the following 2026/27 season given global prices' current trajectory.

Free-fall



There is a long time before the end of this season let alone next. If current market conditions were to persist for the next 18 months the 2026/27 milk price would be at risk of falling below \$8. That is not our current forecast, but the risk must be taken seriously. Even a 2026/27 milk price in the mid-\$8s will bring tighter underlying financial conditions than recent seasons (although dividends and Fonterra's proposed capital return will be an important offset for those that get them).

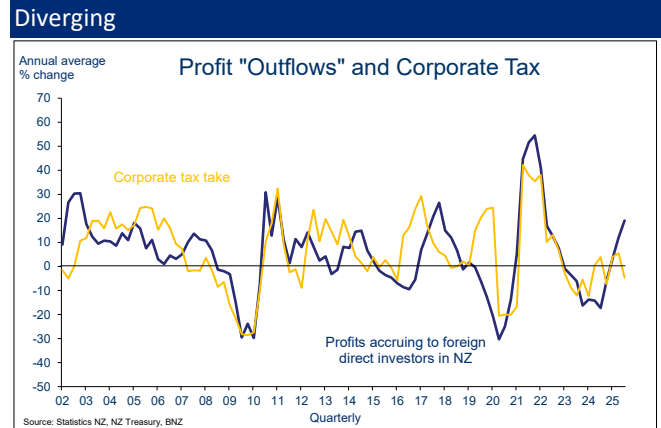
Lower dairy prices are expected to see a lower terms of trade in 2026. There are some helpful offsets to the softer near-term dairy outlook. Beef, lamb and horticulture prices are all holding up well and will dampen the expected easing in the terms of trade. Also, WTI oil prices fell to a four-year low of \$55 USD per barrel overnight and if they persist should put downward pressure on import prices.

On balance, we see downward pressure on the terms of trade that is already lower than what the Treasury published in yesterday's HYEFU. As GDP looks like surprising Treasury's HYEFU growth estimates tomorrow, a lower than projected terms of trade will be an offset regards nominal income expectations ahead.

The recovery in domestic demand in 2026 is likely to lead to higher imports. Today's Westpac consumer confidence data remained subdued. However, the future conditions index lifted to 103.4, its highest level in four years. This suggests households have growing optimism that the economy will improve over the coming year. It is consistent with our forecasts for improving growth in household consumption and imports in 2026.

In the mass of balance of payments data, we noticed that profits accruing to foreign direct investors in New Zealand for the year ended September 2025 increased 19.1%. This contrasts against downgrades to near-term corporate tax revenue forecasts in the HYEFU. We wouldn't make too

much of this divergence, as both series can be very volatile. However, the growth in profit outflows supports the idea that some economic growth is already underway. Overall, there was nothing in today's data to alter our pick for Q3 GDP tomorrow. Our final estimate sits at 0.9% q/q.



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