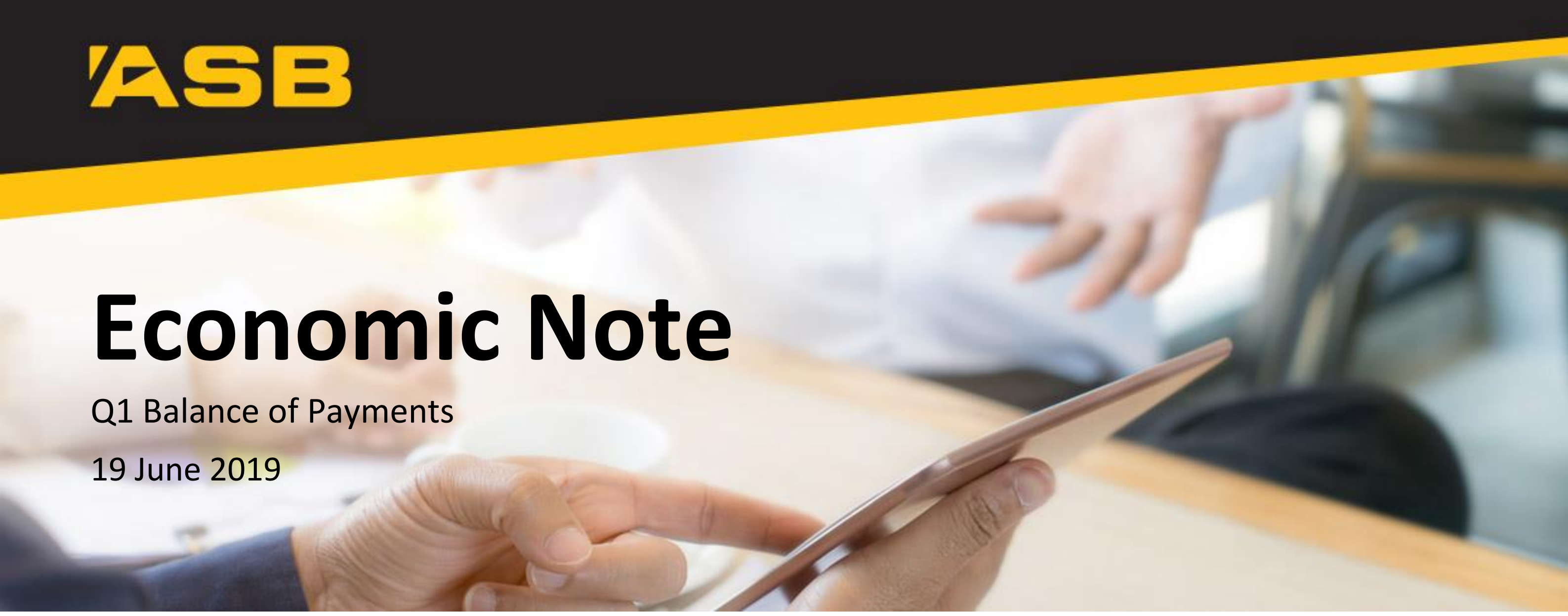


Economic Note

Q1 Balance of Payments

19 June 2019

Trim milk diet for deficit

- The annual current account deficit was slightly larger than market expectations, at 3.6% of GDP, in part on revisions that boosted the size of recent deficits.
- However, Q1 itself produced a stronger surplus than in Q1 last year, at $675mn.
- We expect the annual deficit to continue reducing over the next couple of years.

Summary

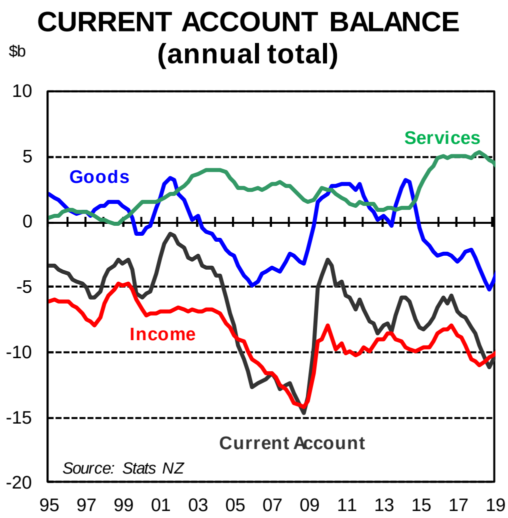
The Q1 annual current account deficit narrowed to 3.6% of GDP, from 3.8%. The annual deficit was marginally larger than the 3.5% that was widely anticipated, though that is not a significant surprise. Importantly, the start of an expected trend of narrower deficits still occurred. We see calendar 2018 as being the peak in the deficit for now, encompassing a period in which imports rose at a rapid pace.

Going forward we expect the current account deficit will continue to reduce and head below 3% of GDP. Further recovery in the goods balance will be the main driver of the narrower deficit.

Comments

In contrast to the market, we had expected a slightly stronger performance over Q1. From our point of view, **the Goods balance over the quarter did not get as much of a lift from exports as we had anticipated** based off previously-published trade figures that showed record dairy exports. Some of that shortfall was made up for by stronger Services earnings. Going forward, we expect export values will show more strength, the key driver of our expectation that the current account deficit will narrow more materially over time.

Meanwhile, the Investment Income deficit was slightly narrower than forecast – and smaller than in 2018Q1. The past year has seen NZ's earnings from investment abroad outgrow foreigners' returns from investing in NZ.



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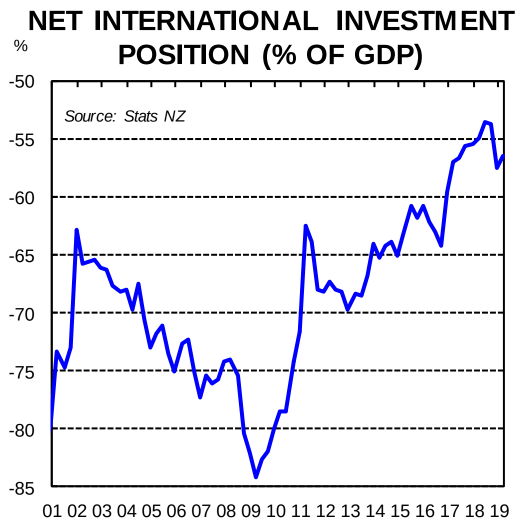
We should give the external accounts a tick for continuing to move in a direction that is making NZ more financially resilient bit-by-bit. We are still running current account deficits (spending more than what we earn as a nation). But those deficits are now smaller at 2.9% of GDP on average since 2010, down from 4.1% on average in the 20 years before that. That 2.9% of GDP annual shortfall is now being more noticeably outpaced by nominal GDP growth of 4.8% a year.

As a result, our net foreign liabilities have fallen from a peak of 84% of GDP in early 2009 to 53%-57% in recent years. Stronger tourism and foreign investment earnings, along with lower interest rates on external debt have helped shift the needle relative to before the Financial Crisis.



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