Data Snapshot

Tuesday, 5 July 2016

Bank of Melbourne

Trade Balance

Is Bad News Good News?

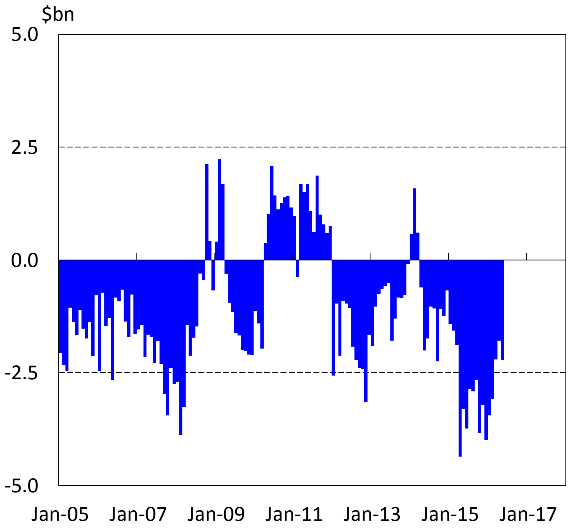
- **Australia's trade deficit widened $433mn to $2.2bn in May, breaking the four-month run of improvement. The good news however, was that the deterioration was largely as a result of a jump in imports of 2.2% in May, the largest monthly increase in eight months.**

- **A pickup in imports can be a sign that domestic demand is picking up although it is too early to gauge that a sustained improvement in demand is underway. Moreover, the downturn in mining investment has further to run.**

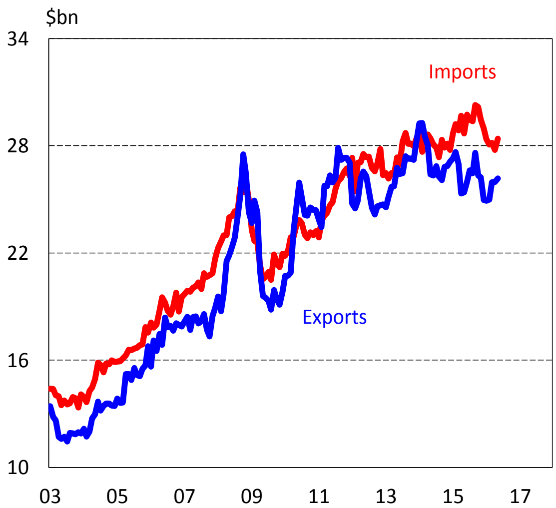
- **Exports continued to lift moderately, and rose 0.7% in May. The gain in exports was driven mostly by a lift in commodity exports. Service exports are also growing healthily. The low Australian dollar is providing support to both resource exports and non-mining exports, and production capacity is expected to increase further.**

- **We expect that the trend of improving exports will continue, and that export growth should outpace imports in the near-term. This would suggest that the trade deficit should narrow back to below $2bn in coming months.**

Australian Trade Balance



Exports and Imports



Australia's trade deficit widened $433mn to $2.2bn in May, breaking the four-month run of improvement. The good news however, was that the deterioration was largely as a result of a jump in imports of 2.2% in May, the largest monthly increase in eight months.

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- **Exports**

The gain in exports was driven mostly by a lift in commodity exports. Exports of metal ores & minerals (3.6%), coal, coke & briquettes (11.3%) and metals (excluding non-monetary gold) (6.1%) all rose in the month. Commodity prices weakened slightly in the month, but the fall in the Australian dollar would have supported values. Export volumes are also being supported by increasing production capacity.

Exports of rural goods declined 2.2% in May, which followed a 4.1% increase in the previous month.

However, service exports continued to rise steadily, gaining 0.5% in May. It was the fourth consecutive monthly increase. Annual growth was a healthy 7.2%, and continues to point to strength in the services sector. The steady growth in service exports continues to provide a sign that sectors outside of mining are continuing to improve.

Imports

A pickup in imports can be a sign that domestic demand is picking up, although some of the detail was less positive.

The jump partly reflected the rebound in oil prices – fuel & lubricant imports were up 8.9% in May.

In addition, consumption good imports fell 0.7% in May. This could signal further weakness in consumer spending and is in step with very modest growth in retail sales in recent months.

Encouragingly, imports of capital goods rose 3.8% in May. This could possibly reflect non-mining investment gaining some traction. The gain was driven by telecommunications (18.8%) and capital goods “not elsewhere specified” (14.7%). Meanwhile, machinery & industrial equipment imports declined 2.5%, which has tended to be driven by mining investment.

Implications and Outlook

There are mixed implications from today’s data. While the trade deficit was larger-than-expected, the surprise mostly came from a jump in imports. Strengthening imports could be a positive signal for domestic demand, although it is too early to gauge that a sustained improvement in demand is underway. Trade data can be extremely volatile. Moreover, the downturn in mining investment has further to run.

The trend of improving exports, however, should continue. The low Australian dollar is providing support to both resource exports and non-mining exports, and production capacity is expected to increase further.

On balance, we expect that export growth should outpace imports in the near-term. This would suggest that the trade deficit should narrow back to below $2bn in coming months.

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