Better times

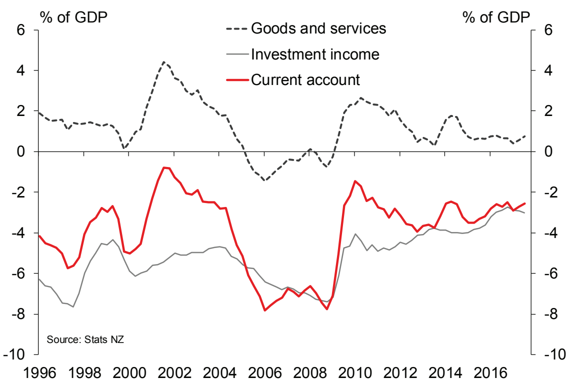
Q3 current account narrows to 2.6% of GDP

20 December 2017

- The current account deficit narrowed to 2.6% of GDP in the year to September.
- Export earnings are in a healthier position than they were a year ago. Dairy export prices and volumes have improved, and tourist numbers continue to trend higher.
- New Zealand's external imbalances are looking more sustainable.
- We expect the current account deficit to narrow further in the near term, although that view could be tested by a recent surge in imports of business equipment.

Current account balance	Q3 2017	Q2 2017
Quarterly (s.a.) $m	-1,309	-1,492
Annual $m	-7,100	-7,386
Annual % of GDP	2.6%	2.7%

Annual current account balance



New Zealand's current account deficit narrowed slightly to 2.6% of GDP in the year to September, reflecting an improvement in exports compared to a year ago. Upward revisions to nominal GDP also contributed to a narrowing of the deficit over the past few years. However, the deficit for the September quarter itself was larger than we expected.

In seasonally adjusted terms, the goods trade deficit narrowed to $26m, the smallest deficit in three years. Exports were steady in the September quarter, with lower prices offset by higher volumes. Imports were down, although not by as much as we expected.

The surplus on services trade narrowed to $1,186m in the September quarter. That was down from a $1,277m surplus in the June quarter, which was boosted by major sporting events such as the Lions rugby tour. However, services exports remained above pre-Lions levels, and more recent data suggest that tourism remains in a strong upward trend. Seasonally adjusted visitor arrivals rose to 323,000 people in November, not far from the Lions-related peak of 326,000 in June.

The investment income deficit widened to $2,384m in September. Earnings on New Zealanders' investments abroad fell, after a strong rise in the June quarter. Investment income outflows also fell slightly, with higher earnings for overseas-owned firms, but lower interest payments on overseas debt.

Net international liabilities continued to shrink as a share of the economy. The deficit narrowed to 56.3% of GDP in September, the smallest on record going back to 2000. The balance is flattered by earthquake reinsurance claims (an overseas asset), but only slightly – there are now just over $2bn of claims outstanding.

The New Zealand economy's external imbalances appear fairly benign at the moment. The net external debt position is still large by international standards, but no longer the outlier that it once was. And a current account deficit of less than 3% of GDP is broadly sustainable over the long term (that is, the economy is growing fast enough to generate the income needed to pay the deficit). However, that situation would change if world interest rates rose back to the levels seen before the Global Financial Crisis.

The balance of payments release has no major implications for our forecasts. We've been expecting the annual deficit to narrow further over the next couple of quarters, with dairy export prices and volumes both stronger than they were a year earlier, and visitor numbers on the rise. Meanwhile, we expect import growth to slow next year due to subdued domestic demand.

However, that view is being challenged somewhat by a recent surge in imports. Today's November trade figures showed that imports of plant and machinery reached another record high. Stronger imports of capital equipment bode well for the economy's growth potential over time, but in the short term they aggravate the country's trade deficit and overseas debt position.

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