Better balance

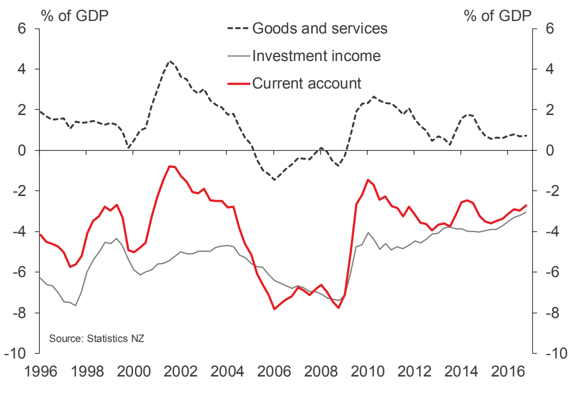
Q4 annual current account deficit narrows to 2.7% of GDP

15 March 2017

- The current account deficit narrowed to 2.7% of GDP in the year to December.
- The services surplus improved in the quarter as tourist export receipts bounced back, while a rise in goods imports drove a deterioration in the goods deficit.
- We expect the current account deficit to widen marginally over the coming year, with the improvement in export prices and continued strong services trade offset by deterioration in the primary income balance due to rising global interest rates and an increase in offshore borrowing.

Current account balance	Q4 2016	Q3 2016
Quarterly (s.a.) $m	-1,599	-2,019
Annual $m	-7,112	-7,617
Annual % of GDP	2.7%	3.0%

Annual current account balance



New Zealand's current account deficit narrowed to 2.7% of GDP in the year to the December quarter, from an upwardly revised 3.0% in September. This was the smallest deficit since Q3 2014, when the terms of trade had been at a multi-decade high (boosting the goods balance). December's outturn was in line with our own forecast and with market expectations, and had no impact on financial markets.

The narrowing of the deficit over the past year has been impressive against a backdrop of steady domestic demand and rapid growth in household borrowing, at a time when export receipts were held down by low prices. Although we expect some widening in the current account deficit this year, we expect it to remain benign relative to history. On the one hand, the rise in global interest rates in the past few months will increase interest payments on New Zealand's offshore debt, pressuring the deficit wider. But on the other hand, last year's recovery in dairy prices will support the goods balance this year, with the services balance expected to remain firmly in positive territory.

Details

One factor continuing to support the current account balance has been the strong run of services trade, with the annual balance remaining solid at 1.7% of GDP. Tourism exports have been an important driver of this, and on a seasonally adjusted basis receipts bounced back strongly in the December quarter after softening a bit in the previous six months. Spending per person recovered a bit after trending down over the previous year (likely weighed down by the strengthening NZ dollar), while growth in visitor arrivals accelerated. Looking ahead, increased momentum in the global economy and the recent depreciation of the NZ dollar should see services exports continue to push higher this year (with the Lions' tour providing a notable boost through the middle of the year), although capacity constraints in the sector, especially accommodation in tourist hotspots like Queenstown and Auckland, will likely hold back the pace of growth.

On the goods side of the ledger, the goods deficit widened in the quarter. Higher imports tipped the balance, with the solid domestic backdrop underpinning import demand, although subdued import prices continue to play a role keeping the import bill contained. At the same time, goods exports were broadly flat as an improvement in export prices (driven by the recovery in dairy prices) was offset by a fall in volumes. There is an element of timing at play here, with milk and meat production held back by wet spring conditions. A recovery in volumes and improved prices should see the goods balance improve in early 2017.

The third major component of the current account balance is the primary income balance (previously labelled investment income), which reflects New Zealand's large overseas liability position. The deficit narrowed on a quarterly basis, as earnings from New Zealand's direct investment abroad rose by more than earnings of offshore-owned firms based in New Zealand. A reduction in New Zealand's net liability position and low global interest rates in recent years have helped keep this balance low relative to history. But with global interest rates having turned higher over the past few months, this deficit is expected to widen a bit from here, which will pressure the current account deficit wider.

New Zealand's net liability position improved sharply in the quarter, from 64.8% to 59.9% of GDP. While a small part of this is a temporary improvement due to new insurance claims from the Kaikoura earthquake (which will be reversed when claims are settled and reconstruction occurs), most of the improvement has been driven by market price changes and financial flows. These can be volatile, and we wouldn't be surprised to see a sharp reversal next quarter. More broadly, New Zealand's international liability position had been deteriorating over the past year, as rapid gains in house prices saw growth in household borrowing outstrip growth in deposits, which in turn increased banks' need to borrow offshore. And despite a slower pace of house price inflation expected this year, the trend of rising offshore debt likely has a bit more to run.

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