20 March 2013

Westpac Institutional Bank

Something to worry about

Q4 Current account deficit at 5.0% of GDP

- **The widening current account deficit is symptomatic of economic imbalances re-emerging.**
- **The current account deficit widened by 0.3 percentage points to 5.0% of GDP in the 2012 year, slightly more than market and our expectations.**
- **We expect the deficit to widen to over 6% of GDP over the next couple of years as the drought weighs on export volumes, imports rise as the Christchurch rebuild continues to ramp up, and foreign-owned firms become more profitable.**
- **A further $1.4bn of Canterbury earthquake insurance claims were settled over the quarter, taking the total of settlements to date to $8.0 billion. At the current pace, the $9.9billion of outstanding claims will be settled by the second half of 2014.**

After a temporary reprieve in the September quarter the current account deficit is widening once again. This is a worrying symptom of New Zealand's two-speed economy and re-emerging imbalances.

The economy is clearly improving – but the driver is domestic demand. The Canterbury rebuild is driving activity higher as are rising house prices, while household spending and business confidence are on the up.

Meanwhile, the export sector is struggling with the high exchange rate and now drought. All this adds up to an economy taking two steps forward and one step sideways.

Many businesses will enjoy the improvement in the domestic economy. And markets will continue to look favourably upon New Zealand compared to our international peers. But we worry-pants economists will fret about worsening economic imbalances such as the current account deficit, the household debt to income ratio (which is rising), overvalued house prices, and the overvalued exchange rate. Eventually, New Zealand's 'borrow and spend' ways may get it in trouble.

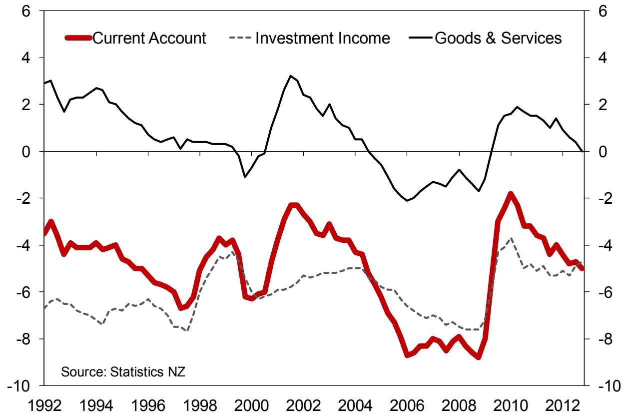
Detail

The current account deficit widened to $2.7bn in seasonally adjusted terms in the December quarter. This was slightly larger than we expected, with the goods and services balance not quite as strong as we had pegged. The remaining detail was broadly in line with our expectations, with a rise in profits by foreign-owned companies in New Zealand, after a temporary dip in September, driving much of the wider deficit.

As a proportion of GDP, the current account deficit widened to 5.0% in the December quarter from 4.7% in September. The deficit now stands around 3.2 percentage points higher than its recent low of 1.8% in March 2010.

The seasonally adjusted balance on goods improved to a surplus of $341m, up $210m from the September quarter as a fall in import values outweighed a fall in export values. The fall in import values was largely due to a fall in the volatile transport equipment category.

NZ balance of payments as a % of GDP



Current account components ($millions)

	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12
Goods Balance (s.a.)	994	166	352	131	341
Services Balance (s.a.)	-54	-226	-201	-280	-405
Balance on Investment Income	-2,897	-2,305	-2,811	-2,213	-2,462
Balance on Current Transfers	-21	-160	-106	-147	-84
Current Account Balance (s.a.)	-2,006	-2,553	-2,795	-2,528	-2,655
Annual Current Acount Balance	-8,268	-9,033	-10,087	-9,861	-10,509
Annual CAB, % of GDP	-4.0	-4.4	-4.8	-4.7	-5.0

On the services side, lower exports drove a wider deficit, despite an increase in tourist numbers over the quarter. Chinese tourist arrivals are increasing at a rapid pace. This market is still in a maturing phase with many groups adding New Zealand on to the end of a visit to Australia. We expect the numbers of arrivals to continue to rise, but at the same time we expect more visits to be directly to New Zealand, particularly as direct flights increase, and thus for the value of Chinese tourism market to increase.

Over 2013, we expect the Canterbury rebuild will generate further demand for imports. At the same time, exports will be held back by the drought. Overall, we expect the goods and services balance to remain in deficit, and, in fact, widen.

The deficit on investment income widened by $249m compared to the September quarter, as profits earned by foreign-owned New Zealand companies increased. However, the proportion of profits retained in New Zealand has doubled compared the previous quarter.

We expect the income deficit to also widen over 2013. With growth improving, profits of foreign-owned New Zealand firms should increase. Moreover, we expect interest rates to rise from late this year, increasing interest payments to overseas lenders.

Estimated earthquake reinsurance claims were revised up from $17.6bn to $17.9bn. Another $1.4bn of claims were settled in the December quarter, leaving $9.9bn outstanding claims. If the current pace of settlement continues, the $9.9billion of outstanding claims will be settled by the second half of 2014. Anticipation of these claims may be one factor keeping the NZD high.

Market implications

There was a very brief 10 pip fall in the NZD against the USD, which was quickly retraced.

There are no obvious implications for tomorrow's GDP release. Net exports probably made a slight positive contribution to growth, but much of the observed rebound in the Q4 data was in domestic activity.

Nathan Penny
Economist

Westpac Economics Team Contact Details

Dominick Stephens, Chief Economist Ph: (64-9) 336 5671 dominick_stephens@westpac.co.nz
Michael Gordon, Senior Economist Ph: (64-9) 336 5670 michael_gordon@westpac.co.nz
Felix Delbrück, Senior Economist Ph: (64-9) 336 5668 felix_delbruck@westpac.co.nz
Nathan Penny, Economist Ph: (64-9) 336 5669 nathan_penny@westpac.co.nz