Westpac

Institutional Bank

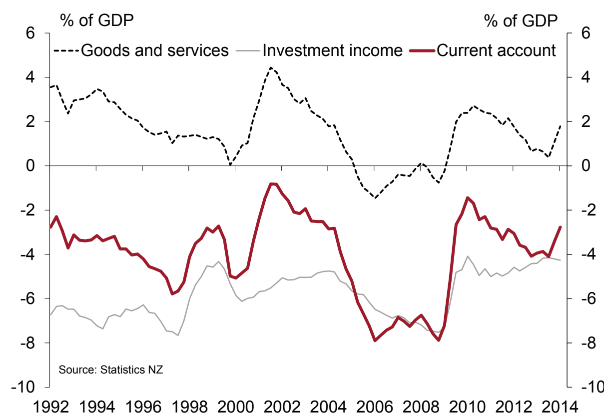
18 June 2014

Good news all around

Q1 current account deficit narrows to 2.8% of GDP

- New Zealand's current account deficit narrowed from 3.4% to 2.8% of GDP in the year to March, in line with market expectations.
- Strong export prices and volumes drove the seasonally adjusted trade balance to another record high.
- New Zealand's net overseas liability position has steadily improved over the last few years.
- While we expect some deterioration in the current account balance in the near term, we see it on a much more sustainable path compared to last decade.

Annual current account balance



There was a lot to like in today's balance of payments figures for the March quarter: another record trade surplus, a rebound in overseas visitor spending, strong profits for New Zealand-based firms, and a further improvement in our overseas liability position. While few of these details would have come as a surprise to the market, they help to reinforce the message that New Zealand's external finances are in a much better shape compared to last decade.

The current account deficit narrowed to 2.8% of GDP for the year to March, down from 3.4% in December and 4.1% in September. The speed of this turnaround reflects the changing fortunes of the farming sector over the last couple of seasons. A severe drought led to lower export volumes through the middle of last year; since then, not only have volumes fully recovered, but a substantial rise in commodity prices (particularly for dairy products) helped to push the goods trade balance to record highs (in seasonally adjusted terms) in each of the last two quarters.

The services balance also improved over the quarter, due to an 8% lift in spending by overseas visitors. We suspect that the increase in the latest quarter overstates the case, but there has been a noticeable improvement in visitor spending over the last year or so, after several years of decline since the Global Financial Crisis began.

The investment income deficit was a little larger than we expected, due to higher than expected profits for overseas-owned firms in New Zealand (which were also revised up for the previous quarter). While this is a negative for the current account in the short term, healthier profits for New Zealand-based firms are an encouraging barometer of the upturn in the domestic economy.

New Zealand's net overseas liability position continued its recent improvement, narrowing to 65.3% of GDP. That position has been flattered somewhat by an overseas 'asset' in the form of unsettled reinsurance claims for earthquake damage. But even that distortion is steadily disappearing; around three quarters of the estimated $19bn of reinsurance claims have

now been settled, and at the current pace they are likely to be complete by early next year.

If we strip out the reinsurance component, net liabilities to GDP are still at their lowest since 2003. That's the product of smaller current account deficits (requiring less financing), increases in the market value of assets held overseas, and strong growth in nominal GDP – that is, we've been 'outgrowing' our overseas debts in recent years.

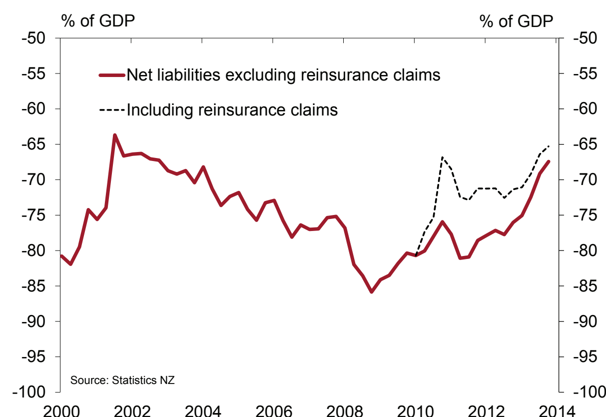
New Zealand's net external liabilities are still on the high side compared to other developed countries (though we have long suspected that under-reporting of assets is an issue when it comes to cross-country comparisons). But the steady improvement over the last few years will have come as a pleasant surprise to international investors and rating agencies; we can recall dire forecasts of net liabilities blowing out to 100% of GDP or more.

Implications

There was no market reaction on the release, with the current account balance falling right in line with market expectations, and with no obvious implications for the March quarter GDP figures published tomorrow. While the details of today's release point to some very healthy growth in nominal GDP, they don't reveal how much is due to rising prices versus stronger activity. Our forecast remains for a 1.2% increase in real GDP for the quarter.

On a quarterly basis, today's figures are likely to be as good as it gets for the current account balance, at least for the foreseeable future. (However the annual balance will narrow further, to around 2.3% of GDP in June, as last year's drought drops out of the calculation). Commodity export prices have come off their peaks, while import volumes should continue to rise in proportion to the economy's upswing.

International investment position



That said, we're expecting the deficit to settle in the range of 4% of GDP over the longer term – not that far from recent history, and a far cry from the deficits of up to 8% that were seen last decade. We believe there's been a step-change in New Zealand's export performance, due to greater engagement with the fast-growing Asian markets in the last few years. And we don't see scope for another debt-fuelled spending binge, given the already-high level of household debt.

Michael Gordon
Senior Economist

Current Account components ($m)

	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14
Goods balance (s.a.)	315	-138	-392	1,627	1,868
Services balance (s.a.)	311	379	283	189	364
Balance on investment income	-2,240	-2,205	-2,284	-2,661	-2,621
Balance on current transfers	-140	-205	-153	-23	-137
Current account balance (s.a.)	-1,784	-2,200	-2,564	-921	-585
Annual current account balance	-8,349	-8,244	-8,868	-7,623	-6,323
Annual CAB, % of GDP	-3.9	-3.9	-4.1	-3.4	-2.8

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