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Westpac Institutional Bank

Quakes and balances

Q1 Current account deficit widens to 4.3%

- **The current account deficit widened to 4.3% in the March quarter.**
- **While reinsurance flows were shifted from the current account into the capital account the impact of the earthquake was still clearly evident in today's data.**
- **Abstracting from these one-off quake effects, subdued consumer demand and strong commodity export prices have contributed to reducing the external imbalances in the NZ economy.**

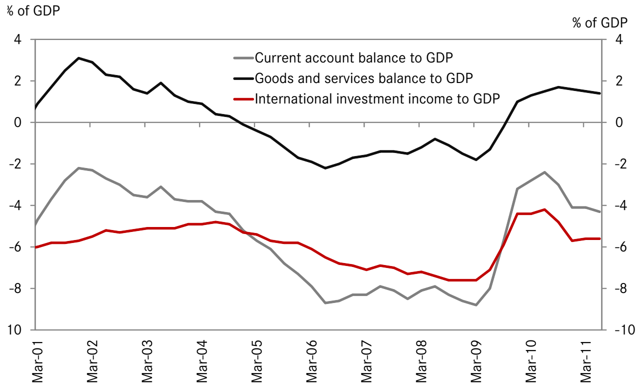
The current account deficit widened marginally from a revised -4.1% of GDP to -4.3% of GDP in the March quarter (with the ratio calculated from December 2010 GDP data – the March quarter GDP data has been delayed by the Canterbury earthquakes). Current account deficits at these levels are considered manageable – a far cry from the clearly unsustainable heights reached in 2008 when the current account deficit widened to 8.8% of GDP. Abstracting from one-off earthquake related effects, subdued consumer demand as well as a substantial improvement in export prices has helped improve New Zealand's external position and reduced the imbalances in the economy.

There were significant revisions included in today's data release as a result of Stats NZ's decision, announced a few days ago, to remove reinsurance flows related the Canterbury earthquakes from the current account. By reclassifying the earthquakes in Canterbury as "major" events rather than "normal" events, insurance and reinsurance flows associated with the earthquakes have been shifted from the current account to the capital account. This removed the possibility of a current account surplus and pushed earlier estimates of the current account further into more negative territory. These flows were measured at $7.6bn from the February Christchurch earthquake, on top of $3.56bn from the September quake. Estimates could be further revised as more information becomes available.

Yet while reinsurance flows have been removed from the transfers balance, the earthquake did directly impact on other parts of the current account. Foreigners' earnings from their investments in New Zealand fell sharply in the quarter (by over $1bn) – with a major driver of the fall the underwriting losses incurred by the insurance industry as a result of the Canterbury earthquakes. This saw a sharp improvement in the investment income balance in the quarter. Not quite as big in dollar terms, but certainly having a big human impact, was the $32m of foreign aid flowing into New Zealand in the March quarter (this figure includes both cash and aid 'in kind' – for example international rescue workers who arrived on masse to assist in the immediate aftermath of the quake).

In contrast, the goods balance was relatively unaffected by the unusual earthquake-related data flows – for now. The trade surplus widened to $824m (s.a.) in the March quarter – the 10th

Balance of Payments



Current Account Components ($million)

	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11
Goods Balance s.a.	894	1161	776	610	842
Services Balance s.a.	-43	-90	-172	-229	-185
Investment Inc Bal	-2,346	-2,885	-2,393	-3,213	-2,351
Transfers Balance	167	-121	-54	-23	-58
Current Account Bal s.a.	-1328	-1935	-1843	-2854	-1753
CAB Annual total	-4,458	-5,707	-7,748	-8,044	-8,300
Annual CAB, % of GDP	-2.4	-3	-4.1	-4.1	4.3

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consecutive quarterly trade surplus. Exports climbed as strong commodity export prices during the quarter boosted returns. Timing effects associated with the rather opaque "conceptual adjustment" of imports reversed as expected this quarter, but elsewhere the value of imports wasn't quite as strong as we had anticipated. Yet eventually even the goods balance will feel the effect of the earthquake as imports of equipment and materials required for the rebuilding of Christchurch are brought into the country, boosting imports over the coming years.

Despite the fall in visitor arrivals following the earthquake, the services deficit actually narrowed slightly (in seasonally adjusted terms) in the March quarter as growth in exports of services outpaced ongoing modest pickup in New Zealanders holidaying abroad.

Despite the removal of reinsurance flows from the current account, they have contributed to an improvement in New Zealand's net international investment position (NIIP) - the difference between New Zealand's external assets and liabilities. NIIP has fallen from a peak of around 90% of GDP to about 75% of GDP currently. And while the one-off nature of reinsurance flows exaggerates the extent of improvement in the country's imbalances (the reinsurance money will eventually be spent on reconstruction part of which will rely on imports – excluding the reinsurance flows current NIIP ratio is just over 5% higher), improved export returns and a more cautious consumer have led to a significant rebalancing in the New Zealand economy.

Market Implications

There had been a risk of a market reaction to the sizable revision in the current account level as a result of the reclassification of insurance flows. However this had been well signalled and there was little market reaction as the eventual outturn which was close to updated market expectations.

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