21 September 2011

Westpac Institutional Bank

Retrospective rethink

Q2 Current account deficit at 3.7%

- **New Zealand's current deficit account was 3.7% of GDP in the June quarter.**
- **While the quarterly deficit was broadly in line with expectations, there were substantial revisions to history. It turns out New Zealand's current account deficits have not been quite as hefty as previously thought.**
- **At the same time, new and improved data sources have also led to a significant improvement in New Zealand's Net International Investment Position.**
- **Today's data sheds new light on the debate around New Zealand's imbalances relative to other countries.**

New Zealand's current account deficit was -3.7% of GDP in the year to June. This was a smaller deficit than forecast but a slight increase from a revised 3.6% deficit recorded in March. While significant revisions reduced the historic level of the current account deficit (as IRD data on the receipt and payment of overseas income was incorporated) developments in the June quarter were largely as expected.

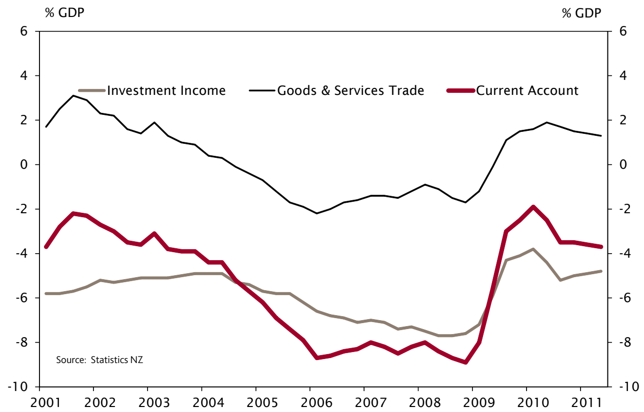
Despite the better than expected tone to today's release, there was no market reaction. Current account data has tended to fly under the market's radar lately as the headline ratio prints well below recent peaks and well within sustainable territory. However there have always been long term concerns over the level of New Zealand's indebtedness. In today's data it turns out that the situation is not quite as bad as we thought.

Detail

High commodity prices were reflected in a solid goods trade surplus in the quarter. The value of exports increased on the back of strong prices for dairy and meat exports in particular (though we think we've probably seen the peak in the terms of trade for now with dairy prices in particular well off their highs).

The services balance remained in deficit territory as the tourism sector struggles to emerge from the doldrums. The sector was impacted by ash cloud disruptions to flights in the quarter as well as the negative impact of the Canterbury earthquake. The current Rugby World Cup will be providing a welcome fill-up for

NZ balance of payments



Current account components ($millions)

	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11
Goods Balance (s.a.)	1,148	766	596	878	1,059
Services Balance (s.a.)	-21	-160	-236	-171	-401
Balance on income	-2,614	-2,125	-2,881	-2,162	-2,533
Balance on Current transfers	-120	-50	-33	-78	-165
Current Account Balance (s.a.)	-4,697	-6,620	-6,787	-7,196	-7,474
Annual CAB, % of GDP	-2.5	-3.5	-3.5	-3.6	-3.7

this sector and provide a boost to service exports in the second half of the year – we've already seen a sharp increase in visitor arrivals in the third quarter.

Also broadly in line with expectations was the widening in the investment income balance. We saw a sharp reduction in this balance in the March quarter as foreigners' earnings from their investments in New Zealand fell as underwriting losses were incurred by insurers in February's earthquake. These earnings rebounded in the June quarter.

We'd also like to take the opportunity to draw readers' attention to the significant revisions to New Zealand's Net International Investment Position (NIIP). New Zealand's NIIP is basically the stock of New Zealand owned assets held offshore minus the stock of liabilities owed to offshore by New Zealanders. Today's

For further information, questions or comments contact Dominick Stephens, telephone (09) 336 5671, email dominick_stephens@westpac.co.nz

data shows that New Zealanders now owe more than they own to the tune of 70% of GDP. While this may seem a staggering ratio at first glance, it is a significant improvement from a revised peak of almost 85% in 2009 (with the previously published peak just over 90%).

In the past, New Zealand's assets held abroad were underreported, meaning we looked more indebted than we really were. This situation has been partially corrected with the inclusion of new data sources (including assets held abroad by fund managers, improved coverage of New Zealand's portfolio equity investment in Australian listed companies and estimates of outstanding student loans debts of people now based offshore) has led to a significant increase in the measured level of New Zealand's investments abroad and a consequent reduction in the net liabilities position – giving us a more accurate read on New Zealand's true net debt position (though Stats NZ notes that there remain gaps yet to be filled).This in turn provides good ammunition against ratings agencies in the increasingly debt-conscious world we now live in. As a nation, our debt levels don't look all that difference from Australia's (though we're probably still a little too close for comfort to some of the headline grabbing Eurozone economies).

While this improvement is essentially structural (it was always there, we're just recording it now) another driver of the improvement in the NIIP is temporary. Overseas reinsurance money associated with the Canterbury Earthquakes is recorded as an increase in New Zealand's international assets, with these assets reducing as settlements with reinsurers are reached and claims are paid out. Statistics New Zealand's survey of the insurance industry shows reinsurance claims have been made totalling $12.5bn have been made for September, February and June quakes, with less than $100m in claims settled in the March quarter, and $514m of claims settled in the June quarter.

Dominick Stephens, Chief Economist, Ph: (64–9) 336 5671
Anne Boniface, Senior Economist, Ph: (64-9) 3365669