21 December 2011

Westpac Institutional Bank

Edging wider

Q3 Current account deficit at -4.3%

- **New Zealand's current account deficit widened further in the September quarter to -4.3% of GDP.**
- **The effects of the Rugby World Cup were clearly evident in the improvement in the services trade deficit in the September quarter. The remainder of the impact will come through in the December quarter.**
- **The total reinsurance cost of Canterbury earthquakes has been revised up to $14bn. Around $1.4bn in reinsurance claims have been settled to date.**

New Zealand's current account deficit widened further in the September quarter to -4.3% of GDP. This was a slightly wider deficit than either we (-4%) or the market (-3.9%) had expected.

Despite this, the underlying themes of today's release were very much in line with expectations. The goods surplus fell, reflecting softer prices for key commodity exports, while the effects of the Rugby World Cup were notable in the smaller services deficit for the quarter. Strong profits by foreign-owned firms (in particular banks) pushed the investment income deficit further into negative territory.

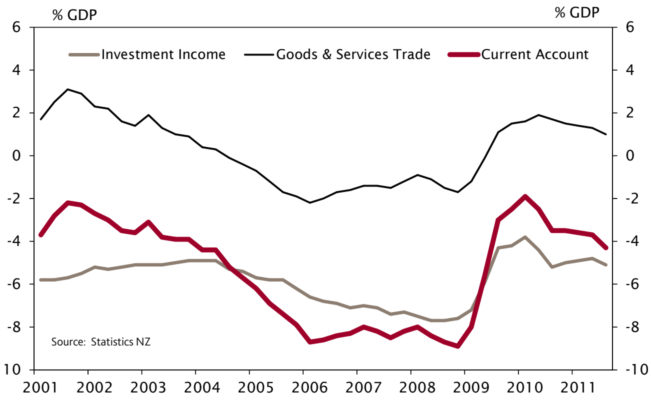
Yet even with the deficit exceeding expectations, there was no market reaction to today's release. Markets are content letting current account data fly under the radar, even as deficits in general have come under increasing scrutiny by investors and rating agencies. This is probably at least partly because at -4.3% of GDP the current account deficit is well below recent peaks and safely within what is broadly regarded as sustainable territory.

Markets may become less tolerant of renewed imbalances in the NZ economy. The current account deficit is forecast to widen next year on the back of falling exports, further import growth, improving returns to foreign owned firms and rising interest rates.

Detail

The goods trade balance deteriorated in the quarter as export prices for dairy, meat and log exports all fell. Yet while prices

NZ balance of payments



Current account components ($millions)

	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11
Goods Balance (s.a.)	785	606	894	995	480
Services Balance (s.a.)	-169	-240	-161	-401	-290
Balance on income and current transfers (s.a.)	-2,176	-2,914	-2,241	-2,590	-2,898
Current Account Balance (s.a.)	-1,559	-2,548	-1,509	-1,998	-2,708
Annual Current Acount balance	-6,620	-6,787	-7,196	-7,396	-8,675
Annual CAB, % of GDP	-3.5	-3.5	-3.6	-3.7	-4.3

for a number of primary product exports have fallen from their recent peaks they remain at historically high levels. We expect that export commodity prices will come under further pressure in the coming months as the pace of demand growth slows in key Asian economies including China (where we expect GDP growth to fall from 8.9% this year to 7.5% next year).

The tourism sector, which has struggled to emerge from the doldrums since the Global Financial Crisis, was a clear beneficiary of New Zealand's decision to host the 2011 Rugby World Cup – although the benefits weren't enough to propel the services balance into positive territory. There was a sharp jump in the number of overseas visitors entering New Zealand with arrivals

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peaking in September. The associated peak in departures was after the event concluded in October. Because of the way Stats NZ measures visitor expenditure (it surveys people as they are about to depart New Zealand and attributes that spending to the quarter in which they leave the country) we may well see an even bigger impact from the RWC on tourist spending in the December quarter Balance of Payments data.

Other flows associated with the Rugby World Cup that will also be spread across both the September and December quarters included a proportion of the hosting fees, licensing fees and merchandise fees for the tournament that were paid by New Zealand firms to offshore companies.

New Zealand's persistent investment income deficit has tended to widen since 2010, as a pickup in economic growth has improved foreign (and domestically) owned firms' profitability. We would expect it to widen further over the coming year as growth continues to improve. However, this quarter's out-sized move was driven largely by increased bank profits in the September quarter compared to June.

Like the aftershocks which have plagued Canterbury residents for months, the effects of the Canterbury earthquakes continue to reverberate through current account data releases. Statistics New Zealand has upgraded its estimates of the reinsurance cost of the earthquake to $14bn. Of this, around $1.4bn of reinsurance claims had been settled by the end of September.

Until the reinsurance claim has been settled, reinsurance payments accrued sit as an asset in New Zealand's Net International Investment Position (essentially what New Zealand owns overseas minus what it owes offshore) temporarily improving New Zealand's NIIP position. New Zealand's NIIP widened in the September quarter to 72.9% of GDP, but would be considerably larger – 79.1% of GDP – if outstanding claims on overseas reinsurers for the Canterbury earthquakes were excluded.

Aside from the temporary boost from reinsurance flows and recent had methodological revisions which have significantly reduced New Zealand's NIIP over history (and there are still gaps remaining) it's a reminder that New Zealand's persistently large and negative net international investment position is a vulnerability in today's global environment.

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