

A growing deficit

Q1 Current account deficit at -4.8%

- New Zealand's current account deficit widened to 4.8% of GDP in the March quarter.
- The deterioration was led by a narrowing goods surplus, and larger services deficit.
- Stats NZ's estimate of the total cost of reinsurance claims related to the Canterbury earthquakes is now \$15.7bn. \$3.8bn of these claims have been settled, leaving \$11.9bn of claims outstanding.

Implications

New Zealand's current account deficit widened to 4.8% of GDP in the March quarter (from an upwardly revised 4.2% of GDP in the December quarter). While the headline measure was larger than our and market expectations, the detail in the data was broadly as expected.

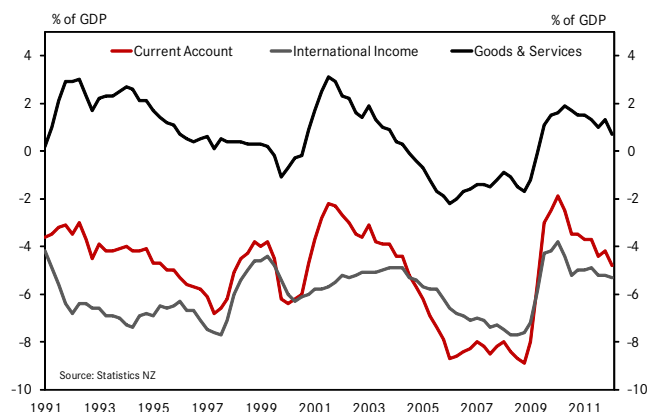
We expect the current account to sink further into deficit territory over the remainder of this year, with a further deterioration in the goods balance set to be the primary driver. Prices for commodity exports have fallen almost across the board over the last year, and while strong volume growth has provided an offset in some sectors, this is likely to be temporary with pastoral conditions expected to return to more normal levels in the year ahead. Services exports are also likely to remain under pressure, with the high New Zealand dollar and difficult domestic conditions in many traditional high-spending markets such as Europe weighing on arrivals from these regions.

Despite the sharply wider deficit, there was no market reaction to today's data. However, in a world still consumed by debt and wary of imbalances, we doubt this will remain the case forever. As New Zealand's current account deficit grows, it is likely to come under more intense scrutiny from markets and its sustainability will once more be called into question. However, for now, markets are content to leave these questions for another day.

Detail

Lower exports were the main factor behind the deterioration in the goods balance in the March quarter. Falling dairy prices in the quarter were a stand-out (though not unexpected) feature, but prices for a wide range of other commodities have also fallen in recent months. Imports were boosted by petroleum products, which can be very lumpy.

NZ balance of payments



Current account components (\$millions)

	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12
Goods Balance (s.a.)	963	993	544	1,016	117
Services Balance (s.a.)	-145	-405	-281	-214	-332
Balance on Investment Income	-2,134	-2,420	-2,956	-2,895	-2,362
Balance on Current Transfers	-78	-145	-78	-53	-184
Current Account Balance (s.a.)	-1,423	-2,002	-2,790	-2,184	-2,808
Annual Current Account Balance	-7,196	-7,396	-8,827	-8,338	-9,738
Annual CAB, % of GDP	-3.7	-3.7	-4.4	-4.2	-4.8

Spending by overseas visitors fell in the March quarter after being lifted in late 2011 by Rugby World Cup arrivals. The high New Zealand dollar is also weighing on the tourism sector, making New Zealand a relatively costly travel destination, while at the same time making overseas travel attractive for New Zealanders. Rising reinsurance costs in the wake of the Canterbury earthquakes are also being felt in the current account, boosting imports of services.

The investment income deficit shrank in the March quarter as earnings by overseas-owned entities declined. However, we expect this improvement will largely prove temporary. The investment income deficit is forecast to widen over the coming years as stronger growth in New Zealand's domestic economy is eventually reflected in improved profitability of foreign-owned firms.

The current account release also provides an update of reinsurance claims and settlements from the Canterbury earthquakes. This quarter Stats NZ's estimates of the reinsurance bill from the Canterbury earthquakes were revised \$350m higher to \$15.7bn. \$1.155bn of outstanding claims were settled in the March quarter (adding to the \$2.6bn in claims settled prior to this), but this still leaves \$11.9bn reinsurance claims outstanding – indicative of the huge rebuilding task that still lies ahead in Canterbury. These outstanding reinsurance claims count as an overseas asset, so they are temporarily flattering New Zealand's Net International Liability Position. This was 70.9% of GDP in the March quarter, but excluding reinsurance claims was 76.8% of GDP.

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