21 March 2012

Westpac Institutional Bank

Wave of milk

Q4 Current account deficit at -4.0%

- **New Zealand's current account balance narrowed modestly to -4% of GDP.**
- **The improvement was led by a high goods surplus on the back of record dairy exports.**
- **Estimates of the reinsurance costs of Canterbury earthquake have been revised higher to $15.3bn. $1.1bn of these claims have been settled to date.**

Implications

Today's current account balance provided few surprises for either markets or economists as it narrowed in line with expectation to -4% of GDP in the December quarter.

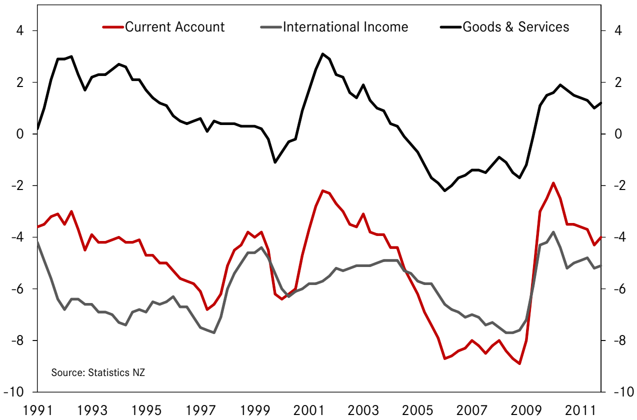
As expected, the improvement was driven by a stronger goods balance, with a smaller improvement in the services balance playing a supporting role as the as the effects hosting the Rugby World Cup in September and October last year filtered through the data for a second quarter. Offsetting this was a small fall in the investment income deficit as profits of offshore owned New Zealand corporates fell.

Over the next year we expect the current account deficit to widen as conditions become more challenging for New Zealand exporters, imports continue to recover and profitability of foreign owned firms improves on the back of stronger domestic activity. As the deficit widens it is likely to come under increased scrutiny as the sustainability of higher deficits comes into question. But this is a while away yet, and for now the market appears content to let the data slide by the wayside.

Detail

Dairy exports were once again the star performer in New Zealand's goods trade balance. Dairy farmers have enjoyed a bumper production season on the back of strong pasture growth and this has been reflected in record dairy export volumes. Combined with the weaker New Zealand dollar during the quarter, these stronger prices more than offset softer world dairy prices. There was a small increase in imports – led by stronger imports of capital equipment. In particular there was an increase in imports of transport equipment including military helicopters and other aircraft. We expect the goods surplus to moderate from these levels over the coming quarters as the more challenging external environment weighs on export commodity prices and imports continue to track higher as domestic economy accelerates.

NZ balance of payments



Current account components ($millions)

	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11
Goods balance (s.a.)	541	908	998	543	1,066
Services Balance (s.a.)	-244	-163	-405	-283	-199
Balance on investment income	-2,853	-2,134	-2,420	-2,956	-2,801
Balance on Current transfers	-33	-78	-145	-78	-62
Current Account balance (s.a.)	-2,617	-1,496	-1,997	-2,793	-2,033
Annual Current Account balance	-6,787	-7,196	-7,396	-8,827	-8,268
Annual CAB, % of GDP	-3.5	-3.6	-3.7	-4.3	-4

The services balance also improved further thanks in large part to Rugby World Cup visitors. Spending by overseas visitors rose in the quarter, although average length of stay of visitors at the sharp end of the tournament was shorter. Exports of services also received a boost from higher earning in movie production services. Also helping improve the services balance was reduced spending by New Zealanders who travelled abroad in the December quarter. Yet on balance, the services balance remains firmly in negative territory, a sign that the tourism sector continues to struggle to gain traction when faced with the high New Zealand dollar and cautious international consumers in key northern hemisphere markets.

The income deficit fell slightly in the December quarter as profits by offshore owned corporates declined. We expect the investment income deficit will tend to widen over the coming years as stronger growth in New Zealand's domestic economy is reflected in improved profitability of foreign owned firms.

Today's balance of payments data also provided a useful update of reinsurance claims following the Canterbury earthquakes. Stats NZ has revised up it estimates of reinsurance claims by $1.3bn to $15.3bn. It calculates that by the end of 2012, $2.6bn of claims had been settled with $12.7bn still outstanding. Like so many other aspects of Canterbury's recovery, this indicates that while work is underway, rebuilding is a mammoth task which has a very long way to go yet.

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