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Westpac Institutional Bank

A fonder look back

Q2 current account deficit narrows to 4.3% of GDP

- **The current account deficit narrowed to 4.3% of GDP in the year to June, from a downwardly revised 4.5% in March.**
- **The deficit was much lower than our forecast of 4.8%, in large part due to data improvements. Statistics NZ has found that the investment income balance has been stronger in recent years than previously thought.**
- **For the June 2013 quarter, the drought worsened the goods trade surplus as expected, while the outflow of profits from overseas-owned firms was surprisingly small.**

New Zealand notched up a current account deficit of 4.3% of GDP in the year to June, substantially smaller than the 4.8% of GDP that we and the rest of the market expected. About half of the surprise was due to data improvements that left the deficit narrower than previously thought over the last couple of years; the other half was due to a drop in investment income outflows that we suspect will prove to be temporary.

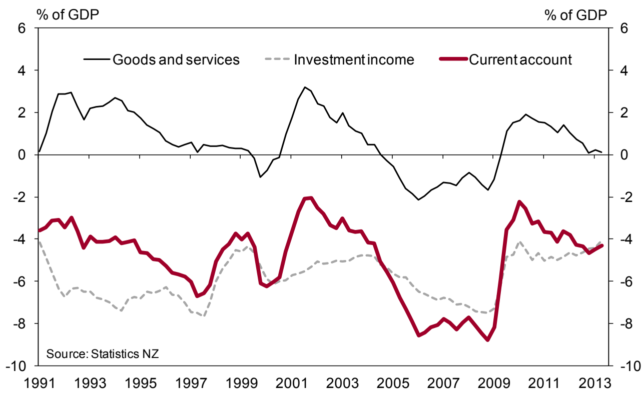
The current account deficit has narrowed over the first half of this year despite a short but severe drought taking a bite out of export income. With farm production starting to recover and dairy export prices remaining near record high levels, there is scope for the deficit to narrow further over the second half of this year. But from next year we expect the deficit to widen again, as the Canterbury rebuild generates demand for imports and profits of foreign-owned firms improve in line with stronger economic activity. Ongoing improvements to the quality of the data may soften the impact, but the end result is still likely to look unflattering by international standards.

Details

In seasonally adjusted terms, the goods trade balance narrowed to a $204m surplus for the June quarter, from a $583m surplus in March. Both exports and imports fell in dollar terms, with the former taking a substantial hit from the drought earlier in the year (much weaker export volumes were only partly offset by higher dairy prices). The services balance improved slightly to a $155m deficit, with a small drop in spending by overseas visitors but a jump in exports of business services.

As is often the case, the investment income flows were the main source of surprise, with the balance narrowing from $2.24bn in the March quarter to $1.96bn in the June quarter (this component is not seasonally adjusted). In particular, the outflow of profits from overseas-owned firms in New Zealand slowed to $1.8bn in the June quarter, a good $500m less than we had assumed. Lower domestically-generated profits are not in themselves something to celebrate; however, we suspect they will pick up again in coming quarters as the economy gathers momentum.

NZ annual current account balance



Current Account components ($m)

	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13
Goods balance (s.a.)	365	143	400	583	204
Services balance (s.a.)	-179	-283	-364	-182	-155
Balance on investment income	-2,635	-2,208	-2,242	-2,241	-1,962
Balance on current transfers	-111	-149	-92	-140	-205
Current Account balance (s.a.)	-2,618	-2,532	-2,332	-2,009	-2,157
Annual Current Account balance	-8,915	-9,082	-9,829	-9,512	-9,099
Ann CAB, % of GDP	-4.3	-4.3	-4.7	-4.5	-4.3

All together, the June quarter current account deficit widened to $2.16bn in seasonally adjusted terms, from $2.01bn in the March quarter. Even so, the annual deficit narrowed in June, thanks to a whopping $2.62bn deficit in the June 2012 quarter dropping out of the equation.

Revisions

The June 2013 quarter release included some major revisions to the historical current account data, a consequence of routine annual benchmarking by Statistics NZ. The most significant revision is that investment income earned overseas by New Zealanders has been substantially higher than previously thought. These revisions have had the net effect of narrowing the annual current account deficit by as much as 0.5% of GDP over the last two years.

We have long argued that New Zealand's current account deficit is overstated, particularly due to overseas income flows being under-reported. In recent years, Statistics NZ has worked hard to address this shortcoming in the data. Today's revisions take the official figures closer still to what we regard as the "truth" of New Zealand's balance of payments position.

And there is more to come. Last month Statistics NZ produced a paper detailing upcoming improvements to the national accounts, including updated estimates of spending by overseas visitors (adding as much as $2.3bn a year to the services balance) and of imports of small items that come under the GST threshold (which could add as much as $1.1bn a year to the import bill). If we take those numbers as indicative, the net impact could be a further narrowing of the historical current account deficit by as much as 0.6% of GDP.

We should point out that improvements in data quality won't always mean an improvement in the external accounts. For instance, today's revisions worsened the investment income balance over 2009, with the result that the current account deficit is now estimated to have narrowed to 2.2% of GDP in early 2010, compared to 1.8% previously. And in terms of New Zealand's external balance sheet, today's revisions uncovered a substantially higher overseas ownership of New Zealand's assets, with the result that net overseas liabilities in the March quarter are now estimated at 71.8% of GDP, compared to 69.3% previously.

Market implications

The implication of the data improvements is that the New Zealand economy is on slightly stronger macroeconomic ground than was previously thought. In theory, this should be positive for the New Zealand dollar, and negative for government bond yields – a better balance of payments position may make international investors more predisposed to lend to New Zealand entities. However, there was little market reaction to the release.

From 2014 onwards, the deficit is widely expected to widen for a couple of years, as the Canterbury rebuild generates demand for imports and profits of foreign-owned firms improve in line with stronger economic growth. Even with the potential for further favourable revisions to history, New Zealand's current account deficit will remain large by the standards of other developed economies.

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