Westpac
Institutional Bank

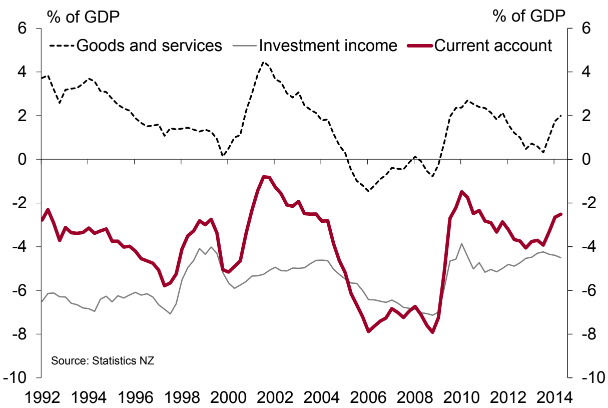
17 September 2014

The best of times

Q2 current account deficit narrows to 2.5% of GDP

- New Zealand's current account deficit narrowed from 2.7% to 2.5% of GDP in the year to June, in line with forecasts.
- The trade balance deteriorated over the June quarter as export prices and volumes fell. However, exports still fared better than this time a year ago, when volumes were hit by drought.
- New Zealand's net overseas liability position narrowed further to a 13-year low.
- The annual deficit will widen again by year-end as the sharp fall in world commodity prices this year is captured in the trade figures.

Annual current account balance



The June quarter balance of payments turned out much in line with both our expectations and market forecasts. Export earnings fell sharply over the quarter, as world commodity prices began to fall and volumes shrank. But that wasn't enough to fully unwind the record trade surpluses over the previous two quarters, with the result that the current account deficit improved further on an annual basis to 2.5% of GDP.

We suspect this will mark the low point in the current account deficit for the near future. The fall in commodity export prices will be incrementally captured over coming quarters, and we expect the annual deficit to peak at around 5% of GDP by June next year.

New Zealand's balance of payments was probably the least significant event in a risk-laden week for financial markets, and today's as-expected result produced no reaction. The implications for June quarter GDP (to be released tomorrow) have been well flagged, and we have no reason to budge from our forecast of 0.7% growth.

Details

On a seasonally adjusted basis, the goods trade surplus narrowed to $339m in the June quarter, following two quarters of record surpluses of over $1.6bn. The value of exports fell by around 8% over the quarter, as detailed in the terms of trade published earlier this month. Dairy exports have led the decline, and there is more to come. World prices for dairy products have been falling since February, and the impact will spill over into the September and December quarter trade figures.

As tough as things were over the June quarter, exports actually fared better than they did the same time last year, when the goods balance fell to a $106m deficit. In 2013, agricultural production was hit by a short but severe drought early in the year, which in turn affected export volumes over the June and September quarters. Since the current account balance is typically reported as an annual total, the fact that last year's particularly weak June quarter has dropped out of the calculation means that the annual balance actually improved this time. (For the same reason, we expect that the current account deficit will only widen slightly for the year to September, despite the plunge in dairy prices in this quarter.)

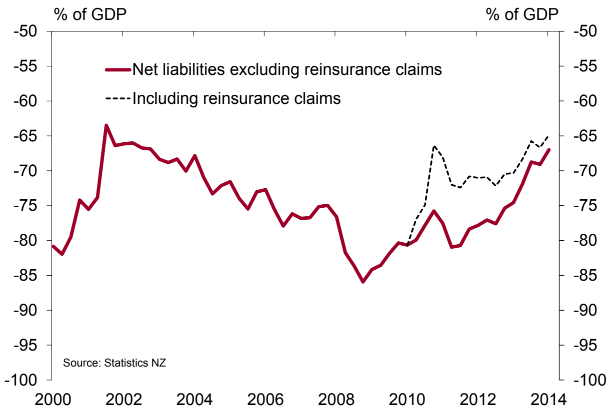
The services balance was little changed for the June quarter. Spending by overseas visitors edged back slightly after a steep rise in the March quarter, while spending by New Zealanders overseas also fell a little.

The investment income balance (now known as the primary income balance) moved further into deficit in the June quarter. Income outflows rose as foreign-owned businesses in New Zealand earned higher profits and paid larger dividends. This outflow is not a concern in itself, as higher profitability is a product of a stronger economy. The balance of transfers (now known as secondary income) also recorded a slightly larger deficit.

New Zealand's net international liabilities fell to 65.3% of GDP in June, compared to 66.9% of GDP in March. That balance includes a temporary 'asset' in the form of earthquake reinsurance claims yet to be settled, which have now been whittled down to $4.9bn out of an estimated total of $19.7bn. But even after adjusting for this item, the net liability position is still at its lowest since March 2003. While borrowing tended to grow faster than income prior to the Global Financial Crisis, that dynamic has largely been reversed in the last few years.

A shift to new reporting standards and a host of regular data revisions make it hard to judge whether there were any genuine surprises in the details of the report, though for the most part these changes don't affect the big picture. Today's release was the first to use the 6th version of the Balance of Payments Manual (BPM6), the latest version of the international reporting standards. These changes largely involved reclassifying or restating some items, with no net impact on the current account balance.

International investment position



Separately, there were also a number of tweaks to the historical data as a result of improved data coverage and new information from annual surveys. The most significant change was an upward revision to investment income earned overseas, based on income tax returns. This resulted in a narrowing of the current account deficit by 0.1 to 0.2% of GDP since 2013.

Michael Gordon
Senior Economist

Current Account components ($m)

	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14
Goods balance (s.a.)	-106	-397	1,601	1,624	339
Services balance (s.a.)	337	242	198	448	460
Balance on primary income	-2,164	-2,156	-2,630	-2,567	-2,618
Balance on secondary income	-175	-118	-20	-121	-164
Current account balance (s.a.)	-2,108	-2,428	-851	-617	-1,983
Annual current account balance	-7,894	-8,476	-7,350	-6,005	-5,798
Annual CAB, % of GDP	-3.7	-3.9	-3.3	-2.7	-2.5

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