Westpac

Institutional Bank

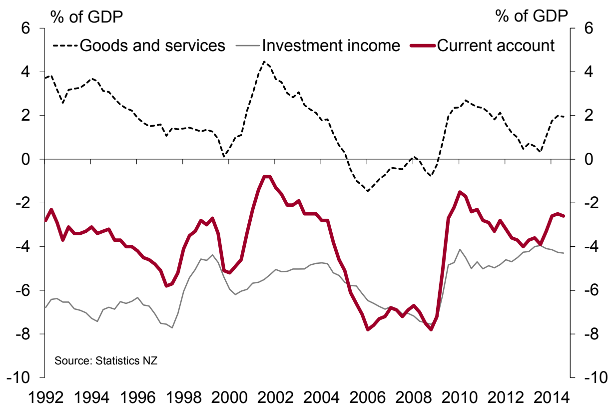
17 December 2014

Brief reprieve

Q3 current account deficit widens to 2.6% of GDP

- New Zealand's current account deficit widened by less than expected in the September quarter. The annual deficit rose from 2.5% to 2.6% of GDP.
- The smaller than expected deficit reflects the treatment of large plane imports and lower profits for overseas-owned firms. Both of these are likely to be transitory.
- Today's result doesn't change the outlook for a significant widening of the deficit over the next year, as the steep fall in dairy export prices is captured in the official data.

Annual current account balance



The September quarter marks the first stage of a significant deterioration in New Zealand's current account deficit, as the steep fall in dairy prices this year is gradually captured in the trade statistics. That may not be obvious from the headlines of today's release, with the annual deficit widening only slightly from 2.5% to 2.6% of GDP. But on a quarterly basis, the balance has clearly taken a turn for the worse, and the positive surprises we saw in the latest quarter are unlikely to persist.

The quarterly goods trade balance fell to a $405m deficit in seasonally adjusted terms, from a $300m surplus in the June quarter and surpluses of $1.58bn in each of the two prior quarters. Export receipts fell by 3%, largely due to the 11% drop in dairy prices. Prices at the twice-monthly GlobalDairyTrade auction suggest we'll see similar-sized falls in each of the next two quarters. Interestingly, goods exports were only around $100m lower than in the same quarter last year, when volumes of dairy exports were hammered by drought. This is the main reason why the annual deficit widened only slightly.

Meanwhile, goods imports rose strongly in the quarter, though about $200m less than we expected. The difference appears to be due to the treatment of the large aircraft that were imported in the September – some, but not all, were treated as operational leases rather than changes of ownership, and were removed from the goods balance. (They will show up in the services balance instead, as a flow of lease payments over time.)

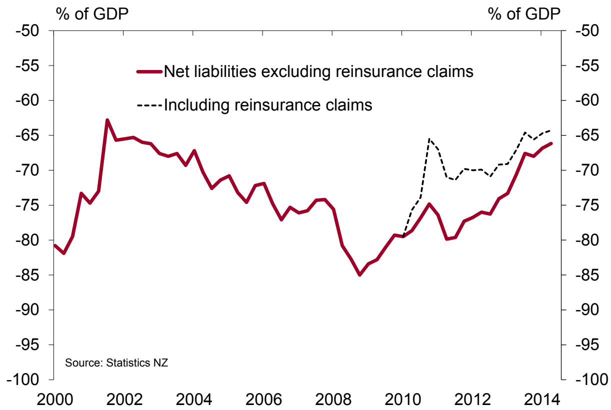
The other surprise for us was on the investment income balance. Profits accruing to overseas-owned firms in New Zealand were $170m lower than in the June quarter, against our assumption of an increase. As we've noted before, rising profits are a sign of a healthy domestic economy, so the smaller than expected income deficit is by no means a positive sign. However, this item can be choppy from quarter to quarter, so this may prove to be a fleeting surprise.

Market implications

While the current account deficit was smaller than the median market forecast of 2.8% of GDP, and our forecast of 2.9%, there was no reaction in the exchange rate. Financial markets have tended to put a low priority on the current account in recent times – although that could change next year, with the deficit set to blow out from a 2 handle to something with a 5 in front in the space of the next few quarters. That in itself is likely to be a temporary development – an improvement in world dairy prices, and slower growth in domestic demand as the Christchurch rebuild passes its peak, should help to narrow the deficit in 2016.

On a more positive note, New Zealand's net overseas liabilities position has continued to improve, which should give some reassurance to the likes of credit rating agencies and the IMF. Even after adjusting for the temporary boost to the balance from unsettled earthquake reinsurance claims (now down to $4.4bn out of an estimated $19.8bn of claims), the net liabilities position has continued to shrink to a 12-year low of 66% of GDP. Upward revisions to the level of nominal GDP have also helped to improve this ratio over history; these revisions will be detailed on tomorrow's GDP release.

International investment position



Michael Gordon
Senior Economist

Current Account components ($m)

	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14
Goods balance (s.a.)	-308	1,580	1,580	300	-405
Services balance (s.a.)	256	204	432	406	376
Balance on primary income	-2,156	-2,631	-2,567	-2,566	-2,320
Balance on secondary income	-118	-20	-121	-181	-184
Current account balance (s.a.)	-2,326	-867	-677	-2,042	-2,532
Annual current account balance	-8,475	-7,349	-6,004	-5,813	-6,090
Annual CAB, % of GDP	-3.9	-3.3	-2.6	-2.5	-2.6

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