Westpac Institutional Bank

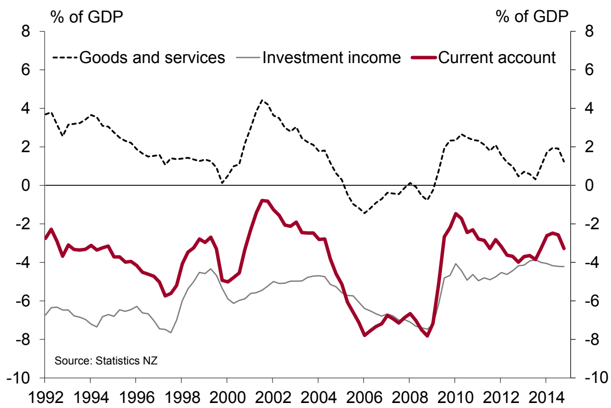
18 March 2015

Devil in the details

Q4 current account deficit widens to 3.3% of GDP

- The current account deficit widened to 3.3% of GDP in the year to December 2014, in line with market expectations.
- The widening of the deficit was largely due to last year's fall in dairy prices, compared to the near-record prices received in the previous year.
- There were offsetting surprises for us from a jump in spending by overseas visitors, and a rise in the outflow of income earned by foreign-owned companies in New Zealand. Both of these are positive signs for the domestic economy.
- On an annual basis, the current account deficit is fated to widen further over the course of this year. However, we expect it to narrow again in 2016.

Annual current account balance



New Zealand's current account deficit widened further in the December 2014 quarter, to 3.3% of GDP. As expected, the widening was driven by the goods balance, as last year's steep fall in dairy prices was reflected with a lag in export earnings. This point is widely recognised by now, and has no new implications for our forecasts.

The devil is always in the details when it comes to the current account – the deficit can widen for both good and bad reasons. There's no doubt that the fall from grace for dairy exports will weigh on the domestic economy over the course of this year. But there were also some positive signs in the December quarter figures, in terms of investment in productive capacity and the profitability of New Zealand-based firms. Overall, the current account reflects the return to a two-speed economy that we've observed lately, with domestic activity thriving while exports lag behind.

In seasonally adjusted terms, goods exports were actually up slightly compared to the September quarter, with strong prices and volumes for meat exports helping to offset the impact of lower dairy prices. However, exports were substantially weaker than the same time a year ago, when world dairy prices were running near record highs.

Goods imports were up 2.4% for the quarter in seasonally adjusted terms, and up 8% on a year earlier. The increase was largely driven by imports of capital equipment, which will contribute to the economy's future growth capacity – a trend that has been prominent for some time.

In terms of the other details, there were two roughly offsetting surprises relative to our forecasts. The first was a strong improvement in the services trade balance, led by a 14% seasonally adjusted increase in travel services (i.e. tourist spending). For us, this wasn't so much a surprise as an uncertainty about how the figures would be treated. The International Visitor Survey was recently overhauled with some substantial revisions to history, but those changes aren't due to be incorporated in the current account until later this year. Nevertheless, we knew this had the potential to be a whopper for the December quarter, driven by both higher visitor numbers and a substantial rise in spending per person.

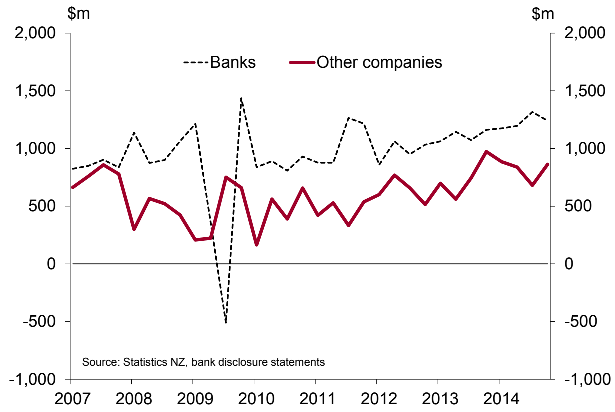
The other surprise factor was a rise in the earnings of foreign-owned businesses in New Zealand. Profits for overseas-owned banks – the part that we can track closely – were lower for the quarter, but this was more than offset by a rebound in profits for other firms. Higher profits are a positive indicator of domestic activity, and are less of a concern in terms of the nation's ability to fund the current account deficit.

The current account deficit is commonly expressed as an annual total. On this basis, the deficit is guaranteed to widen further over the course of this year, as the strong dairy export earnings from early 2014 are replaced by the weaker earnings expected for this year. We expect the deficit to reach 5% of GDP by the end of this year.

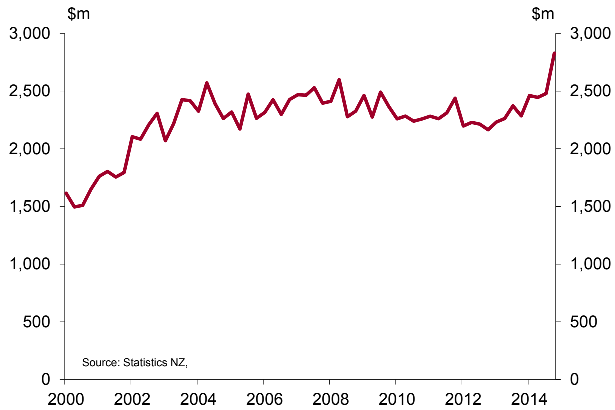
However, we expect the annual balance to improve again from early 2016: dairy export prices have already seen a modest rebound from their lows, while prices for oil imports have fallen sharply and are expected to stay low for some time. A deficit of 5% is not pretty by anyone's standards, but as long as it proves to be a temporary peak it shouldn't trouble the credit rating agencies or market perceptions of New Zealand's riskiness.

Michael Gordon
Senior Economist

Income from foreign-owned firms in NZ



Travel services exports, seasonally adjusted



Current Account components ($m)

	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14
Goods balance (s.a.)	1,522	1,582	293	-356	-458
Services balance (s.a.)	215	400	411	424	655
Balance on primary income	-2,631	-2,567	-2,566	-2,328	-2,762
Balance on secondary income	-20	-121	-181	-186	-55
Current account balance (s.a.)	-915	-707	-2,043	-2,446	-2,621
Annual current account balance	-7,349	-6,004	-5,813	-6,093	-7,822
Annual CAB, % of GDP	-3.3	-2.6	-2.5	-2.6	-3.3

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