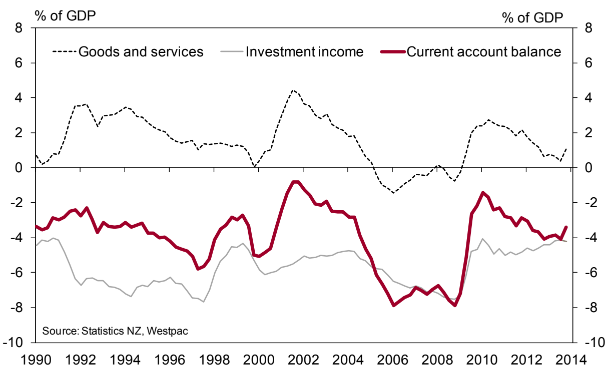
19 March 2014

Hey big earner

Q4 current account deficit narrows to 3.4% of GDP

- New Zealand's current account deficit narrowed from 4.1% to 3.4% of GDP in the year to December, close to expectations.
- A sharp post-drought rebound in dairy export volumes drove the goods surplus to its highest on record.
- The annual current account deficit is likely to narrow further in the near term, as the drought drops out of the equation and export prices remain at favourable levels.
- However, a strengthening domestic economy and the demands of the Christchurch rebuild should see the deficit start to widen again from late 2014.

Annual current account balance



New Zealand saw a sharp improvement in its current account balance over the December 2013 quarter, as goods exports rebounded from drought-depressed levels. The annual deficit narrowed to 3.4% of GDP in the year to December, compared to 4.1% of GDP in the year to September.

While this was an unusually large one-quarter improvement, the reasons behind it were well recognised, and hence the outturn was very close to our forecast (and the market median) of 3.3% of GDP. It's likely that the deficit will remain relatively benign over the course of this year, although we expect it to widen again over the medium term as domestic demand and the Christchurch rebuild continue to pick up speed.

Details

The quarterly balance was dominated by a surge in goods exports. The short but severe drought in early 2013 led to depressed export volumes, particularly for dairy products, over the June and September quarters, only partly offset by stronger prices. But with dairy production back to pre-drought levels by the December quarter, and with world prices remaining at very high levels, export receipts jumped 11.6% for the quarter in seasonally adjusted terms.

Combined with a modest decline in imports (following a sharp rise in imports of capital equipment in the September quarter), this lifted the balance on goods to $1.68bn in seasonally adjusted terms, the highest quarter on record.

The balance on services narrowed to a $140m surplus in December, as spending by overseas visitors slowed. There was a particularly sharp drop-off in the number of Chinese visitors in the December quarter, apparently due to a crackdown on the standards of tour operators in China. There are signs that visitor numbers have bounced back in the early part of this year, although the shifting timing of the Chinese New Year makes it difficult to be certain.

The investment income deficit widened further on the back of stronger profits for foreign-owned firms operating in New Zealand. This accounted for the small 'miss' in our forecast of the current account balance, and doesn't give cause for concern in its own right – healthier profits for New Zealand-based firms are an encouraging barometer of the upturn in the domestic economy.

In terms of financial flows, just over $1bn of quake-related claims on overseas reinsurers were settled in the December quarter, slightly less than the average pace of $1.3bn per quarter over the last couple of years. Total reinsurance claims are now estimated at $19bn (up from $18.7bn last quarter), with around $5.9bn remaining to be settled. Based on the recent pace, these claims should be fully settled by early 2015.

New Zealand's international balance sheet also saw a further improvement in the December quarter, with net liabilities falling from 72.4% to 69.3% of GDP, the lowest since 2004 (after adjusting for outstanding reinsurance claims, which count as an overseas asset). The improvement for the quarter was largely a mark-to-market effect, as the value of holdings of overseas shares rose. Net liabilities are still high by international standards, but having reached almost 86% of GDP during the depths of the global financial crisis, it's an aspect of New Zealand's economic rebalancing that tends to go relatively unnoticed.

Implications

The current account balance was broadly in line with our forecast and market expectations. The NZD was unmoved after the release. Today's release has no obvious implications for tomorrow's GDP release, where we expect 0.9% growth. As we noted in our preview, the story of the post-drought rebound is well understood, and in terms of production it was already largely captured in the September quarter GDP figures.

We currently expect the annual deficit to shrink further to 2.8% of GDP by the June quarter of this year. The drought-affected quarters of 2013 will continue to drop out of the equation, while exports are expected to remain strong over the course of this year. While world prices for dairy products are now coming off their highs, we expected some decline as a surge of product from New Zealand hit the world market; commodity prices are still expected to be higher on average this year than they were last year.

However, we expect the deficit to be widening again by the end of the year. Rising household demand, business investment and reconstruction activity in Christchurch will all need to be met, at least in part, through higher imports. The cost of servicing New Zealand's overseas debt is also likely to rise as interest rates gradually increase over the next few years.

Michael Gordon
Senior Economist

Current Account components ($m)

	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13
Goods balance (s.a.)	66	314	-146	-408	1,678
Services balance (s.a.)	159	326	375	286	140
Balance on investment income	-2,243	-2,240	-2,205	-2,284	-2,578
Balance on current transfers	-91	-140	-205	-153	-23
Current account balance (s.a.)	-2,142	-1,770	-2,212	-2,577	-837
Annual current account balance	-8,590	-8,349	-8,244	-8,871	-7,547
Annual CAB, % of GDP	-4.1	-3.9	-3.9	-4.1	-3.4

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