

# Deficit dipping down

## Q1 Current account preview: 23/06 10:45am NZT

- We estimate that the current account deficit (CAD) narrowed to 2.4% of GDP in the year to March.
- The trade balance has improved substantially, with exports boosted by strong demand from Asia while import demand is picking up only gradually.
- We expect a fall in the investment income deficit, with lower company profits, interest rates still low, and no distortions from banks' tax provisions.

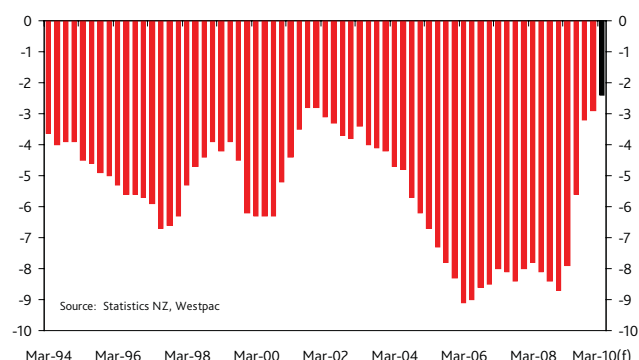
Right now, global markets are gunning for countries than run persistently ugly current account deficits. And a year ago New Zealand could have been at the top of the hit list, with the deficit reaching 8.7% of GDP by the end of 2008. But since then, the CAD has narrowed so dramatically that it would now be the envy of many developed nations. We expect the March quarter balance of payments to show a further narrowing in the annual deficit, to a low point of 2.4% of GDP.

The main feature for Q1 is an improvement in the trade balance – in fact, in seasonally adjusted terms, we're anticipating the largest quarterly trade surplus on record. Export and import prices are both down about 8% on a year ago, due to the rebound in the exchange rate. But in real terms, exports have been the star performer of the New Zealand economy, with volumes up nearly 10% compared to Q1 last year. Import demand is picking up again as the economic recovery becomes established, but volumes are still only 4% higher than a year ago.

Imports as measured in the CAD (and in GDP) will differ from the monthly trade figures due to 'conceptual adjustments', such as the treatment of the timing of oil shipments into the country. In Q4 this adjustment departed from its seasonal pattern, leaving the import bill about \$500m larger than we expected. Timing issues should balance out over time, so we could well get a comparable surprise in the other direction in Q1.

The investment income balance will have the first 'clean' read in a year, with no distortions from banks' tax liabilities. Income outflows – consisting of interest paid on overseas debt and profits earned by overseas-owned firms – have picked up over the last few quarters, but they remain at a relatively low point in the cycle. One major point of uncertainty in our forecast is the profits of overseas-owned firms (excluding banks, which we

Current Account as % of GDP



Current Account Components (\$million)

	Mar-09	Jun	Sep	Dec	Mar-10(f)
Goods Balance s.a.	804	780	642	237	1,460
Services Balance s.a.	-245	-62	16	-18	-100
Investment Inc Bal	-2,781	-1,366	-743	-3,399	-2,570
Transfers Balance	54	288	101	69	180
Current Account Bal s.a.	-2,146	-402	39	-3,110	-1,030
CAB Annual total	-14,569	-10,371	-5,896	-5,473	-4,420
Annual CAB, % of GDP	-7.9	-5.6	-3.2	-2.9	-2.4

can track accurately), which were far stronger than we expected in Q4 – almost back to their pre-recession highs. We have no real guidance for this on a quarterly basis, but we suspect that a moderation in profits is more likely than a further increase to record highs, given that the recovery was still in its early stages.

### Market implications

The median analyst forecast is for a deficit of 2.7% of GDP, with our 2.4% pick marking the bottom end of the range. Markets appear to be less focused on New Zealand's deficit now that it's no longer at cringe-inducing levels. However, there is plenty of scope for a surprise that could see a market response on the day. The factors behind Q4's surprise outturn (2.9% of GDP, against the median forecast of 1.9% and our top-of-the-range pick of 2.3%) are just as much in play this time.

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