

# New take on an old theme

## Q2 current account deficit widens to 3.0% of GDP

- Record surplus on trade in goods, thanks to strong export commodity prices.
- Foreign owners of NZ assets realised more profit and paid less withholding tax.
- History of current account deficit revised sharply, NZ's savings problem now looks slightly less severe.

The annual current account deficit (CAD) widened to 3.0% of GDP in the June quarter, from an unrevised 2.4% in Q1. The seasonally adjusted quarterly deficit was a little wider than expected at \$1.8bn. New Zealand exports had a great quarter, and imports were contained. However, foreign owners of New Zealand assets realised greater profit and paid less withholding tax, resulting in a wider deficit overall.

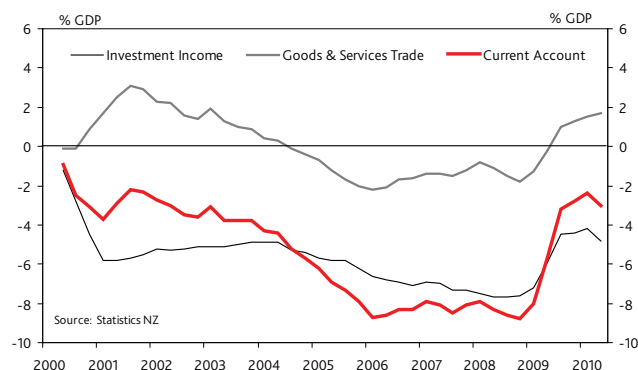
New Zealand registered its largest seasonally adjusted surplus on trade in goods since official data began in 1987, albeit not so large as we anticipated. This was driven by sharply rising prices for export commodities, especially dairy, as well as higher export volumes. On the import side of the ledger, there were modest increases in price and volume.

The balance on services held up better than expected. Although exports of transportation services (tourism) were down 3.2% as anticipated, there was an offsetting increase in other services (mainly merchanting, management consulting, and engineering services). Imports of services rose more than expected, as NZ paid more for international freight on the aforementioned buoyant trade in goods.

The investment income deficit widened quite sharply, mainly because foreign-owned New Zealand companies recorded better profits, and to a lesser extent because overseas holders of NZ debt enjoyed an increase in interest rates. See below for more detail on substantial revisions to the investment income balance that have reduced NZ's historical average current account deficit by 0.5 percentage points.

The balance on transfers, which doesn't normally rate a mention, fell sharply because of tax changes that reduced payments of non-resident withholding tax for some overseas entities.

NZ Balance of Payments



Current Account Components (\$million)

	Jun-09	Sep	Dec	Mar-10	Jun
Goods Balance s.a.	713	595	296	936	1,226
Services Balance s.a.	-19	112	65	-55	-76
Investment Inc Bal	-1,488	-738	-3,201	-2,346	-2,795
Transfers Balance	272	101	41	167	-120
Current Account Bal s.a.	-570	83	-2,808	-1,254	-1,814
CAB Annual total	-10,522	-5,946	-5,204	-4,458	-5,600
Annual CAB, % of GDP	-5.7	-3.2	-2.8	-2.4	-3.0

The latest official estimate of New Zealand's net international liabilities is 86.5% of GDP, up from 85.9% in March 2010. As mentioned below, the level of net liabilities is likely to be overstated, because assets held by New Zealanders in trusts and partnerships is understated.

### A revised estimate of New Zealand's savings challenge

The Q2 release incorporated some major changes to the history of the balance of payments. As well as the usual annual revisions to the national accounts, Statistics NZ has made some improvements to the measurement of investment income. The most significant of these is to use tax data from the IRD to infer overseas income earned and paid by trusts and partnerships, which are not captured in the usual surveys.

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The net effect of these improvements has been to narrow the CAD over the last decade, except for the last two years. The average current account deficit from June 2000 to today is now estimated as 5.4%, instead of the previously published 5.9%; the March 2006 peak in the deficit has been revised from 9% to 8.7% of GDP. While the net revisions don't change the story much, the gross changes are significant. The new data adds more than \$2bn to both inflows and outflows of investment income; in the case of inflows, it amounts to a near-doubling of previous estimates.

Statistics NZ did not use information from the tax data to revise its estimate of the underlying assets and liabilities that produced these income flows, leaving a 'known unknown' in the international investment position (IIP). It is likely that New Zealanders hold more international assets than are officially counted. If we assumed that the rates of return on these assets were the same as for the assets that are already surveyed, that would imply a hole of \$113bn of assets and \$56bn of liabilities. New Zealand's net international liabilities would not be 87% but 60% of GDP, more in line with Australia.

We're not saying that our estimate of the missing assets is the right one – in fact we have no way of knowing. But this further highlights the problems with holding a debate about New Zealand's savings behaviour or level of indebtedness, based on data that are known to have major gaps. It also highlights the folly of comparing net debt positions across countries.

### Market implications

There was no reaction in the NZ dollar or interest rates. The broad picture of a strong performance in net exports combined with a chronic income deficit is well understood.

The annual deficit has probably bottomed out; the challenge from here on is to identify how far it will widen as the economy recovers. We're becoming more confident that there has been a step-change in New Zealand's trade performance compared to the last cycle. Strong demand from developing Asia (particularly China) will continue to support export prices and volumes, and we expect to see more frequent trade surpluses in coming years. We expect imports will be more contained this decade than they were in the 2000s, because consumers are expected to be more subdued. While the investment income deficit will remain large, this should still be enough to see the overall deficit settle into a range of around 5% of GDP, compared to the 8.7% peak last decade.

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