

# Alternating current

Q4 Current account preview: 24/03 10:45am NZT

- We estimate that the current account deficit narrowed to 2.3% of GDP by the end of 2009.
- The trade balance remained strongly positive, with exports holding up and import volumes growing only modestly.
- Improved company profits and a partial reversal of bank tax provisions mean a much larger income deficit than in recent quarters.
- The underlying deficit has turned the corner, and we expect the annual balance to be rising again by mid-year.

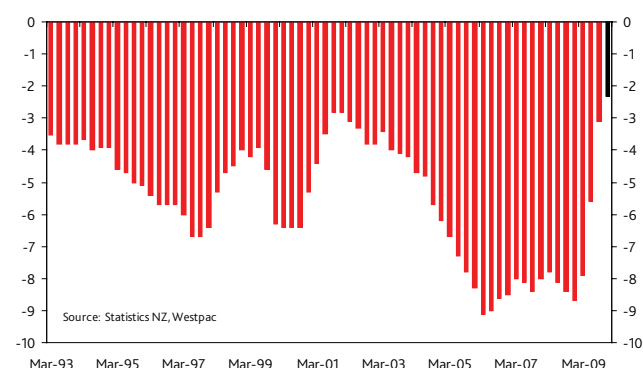
New Zealand's current account deficit (CAD) shrank dramatically last year, starting from an eye-watering 8.7% of GDP at the end of 2008 to reach an estimated 2.3% a year later. Some one-off factors contributed to the decline, but it was mostly a product of the drawn-out recession that began in 2008 (the CAD tends to follow the economic cycle). With the economy regaining momentum, the improvement in the deficit has now run its course – indeed, we expect to see a substantial rise in the underlying deficit in the December quarter.

In seasonally adjusted terms, the trade balance remained strongly positive in Q4. Export volumes have held their ground through the global recession, and import volumes have only risen modestly to date (and remain about 20% below their mid-2008 peak). The services balance deteriorated slightly, with the stronger NZ dollar clawing back most of the benefits of a strong tourist season, while the modest growth in goods imports also meant higher transport costs.

We expect to see a significant rise in the investment income deficit, specifically on the outflows side. The profits of overseas-owned firms, the largest component of the deficit, fell sharply during the most severe part of New Zealand's recession. However, our calculations suggest there was a substantial rebound in Q4, though normal quarterly variations may be overstating the improvement in the overall trend.

The final act of the bank tax saga is another factor behind the higher deficit. In December the major banks reached a

Current Account as % of GDP



Current Account Components (\$million)

	Dec-08	Mar-09	Jun	Sep	Dec(f)
Goods Balance s.a.	-74	814	789	734	690
Services Balance s.a.	-438	-241	-77	55	-70
Investment Inc Bal	-3,256	-2,781	-1,366	-574	-2,970
Transfers Balance	163	54	288	99	40
Current Account Bal s.a.	-3,611	-2,131	-406	340	-2,310
CAB Annual total	-15,969	-14,569	-10,371	-5,723	-4,310
Annual CAB, % of GDP	-8.7	-7.9	-5.6	-3.1	-2.3

settlement with the IRD, whereby they would pay 80% of the assessed amount of tax owed on structured finance transactions. In most cases this meant they had over-provisioned in Q2 and Q3, so 'writebacks' in Q4 added \$379m to their bottom line and hence to the income deficit. In the final wash-up, these tax payments reduced the deficit by \$1.65bn last year, equal to 0.9% of nominal GDP.

It's likely that the annual deficit has now bottomed out, though at the moment we have a slight further narrowing pencilled in for Q1 this year. From there on the deficit will start to climb again – import spending is rising, company profits are improving, and banks' tax provisions will start to drop out of the annual balance in Q2. We expect the CAD to return to a sustainable balance of around 5% of GDP by the end of next year.

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### **Market implications**

Our CAD forecast is higher than the market median of 1.9% of GDP, so if realised would probably prompt a small drop in the NZ dollar. However, we think the most likely source of surprise for the market will be the strength in company profits – not entirely a bad thing in the context of a recovering economy, just as the narrowing in the CAD over the last year wasn't entirely for positive reasons.

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