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Westpac Institutional Bank

Shifting sands

Q4 current account deficit widens to 2.3% of GDP

- **The annual current account deficit widened marginally in Q4 to 2.3% of GDP.**
- **Contrary to expectations, the trade surplus narrowed slightly in the quarter, while profits of overseas-owned NZ firms rebounded strongly.**
- **September quarter's reinsurance inflows were revised up to the tune of $1.86bn, bringing estimates of reinsurance flows stemming from the first Canterbury earthquake to $3.65bn.**

The current account deficit widened marginally from a revised -2.2% of GDP to -2.3% in the March quarter. However, while the headline balance was very close to expectations, the December quarter itself was significantly larger than we, or the market, had forecast.

That said, the larger than expected deficit should not be taken as a sign of a deteriorating outlook for the New Zealand economy. Rather, it was the combination of a couple of one-off surprises: stronger imports, which were largely a timing issue that should resolve itself in due course, and stronger NZ earnings by overseas-owned firms, which could be read as a signal of improved activity.

In seasonally adjusted terms, the goods balance narrowed slightly in Q4 – but remains firmly in surplus. Exports were up a solid 4.2% in the quarter, while imports surged 6.8%. Since we're generally given a pretty good heads up on the value of traded goods via the more timely merchandise trade data, the degree of strength in imports came as something of a surprise. Delving into the detail, the difference between the monthly merchandise trade numbers and today's quarterly data can be attributed to the opaque "conceptual adjustment" category. If goods change ownership before arriving New Zealand (and are captured in the merchandise trade figures), the appropriate adjustment is recorded here. While we don't know for certain what goods in particular were responsible for this quarter's increase, Stats NZ strongly hinted that it was down to the timing of oil shipments into the country.

Figure 1: NZ Balance of Payments

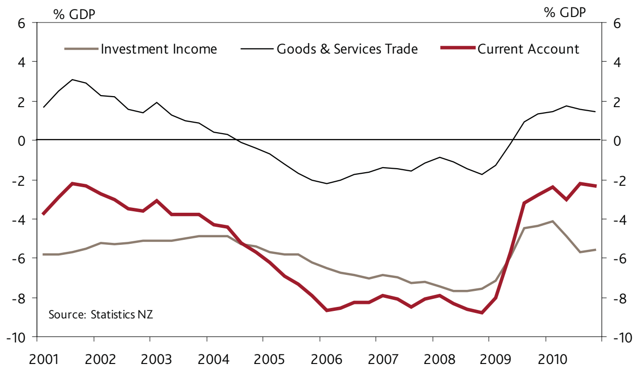
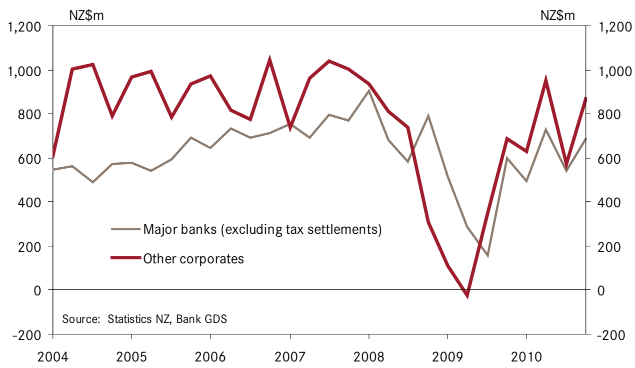


Figure 2: Profits of overseas-owned firms in NZ



Current Account Components ($million)

	Dec-09	Mar-10	Jun	Sep	Dec
Goods Balance s.a.	327	919	1,166	790	567
Services Balance s.a.	71	−44	−86	−166	−247
Investment Inc Bal	−3,201	−2,346	−2,885	−2,393	−3,121
Transfers Balance	41	167	−121	3,506	−12
Current Account Bal s.a.	−2,762	−1,305	−1,927	1,737	−2,813
CAB Annual total	−5,204	−4,458	−5,707	−4,188	−4,380
Annual CAB, % of GDP	−2.8	−2.4	−3.0	−2.2	−2.3

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Following a steep decline in Q3, the investment income deficit widened sharply this quarter, as profits of foreign-owned companies improved markedly. This component of the current account tends to be pretty choppy at the best of times – and we had earlier been sceptical of the pace of the rebound to pre-recession levels, given such a muted economic recovery – nonetheless the latest increase means non-bank corporate profits are again sitting around these sorts of levels. On its own, this could even sound a positive note for activity in Q4.

The larger quarterly deficit was offset in the headline annual measure by a significant upward revision to the Q3 current account balance. This was almost entirely due to the upward revision to estimates of reinsurance flows associated with the September Canterbury earthquake (reinsurance claims have been revised up by $1.86bn to $3.56bn for the quarter). While the September quarter's figure will continue to be revised, at close to $4bn it does start to make the Reserve Bank's estimate of $6bn reinsurance flows in Q1 for the even more devastating February 22 earthquake start to look a little light. Our own working assumption is that reinsurance flows from the second earthquake will eventually be worth around $10bn in Q1.

Market Implications

As has been the case in recent quarters, there was no market reaction to today's current account data. With current account deficits in the recent past approaching double digit territory, on the face of it a -2.3% deficit provides little cause for concern. But with the current account set to widen over the medium term (reinsurance flows aside) as the economy gains momentum, attention will eventually drift back to the sustainability of deficits – just not today.

Next quarter's balance of payments data is likely to garner more time in the spotlight as reinsurance flows propel the annual balance into unfamiliar surplus territory.

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