15 September 2021

External Deficit Bigger, Liability Position Shrinks

- **Annual current account deficit widens**
- **On track to bigger deficits ahead**
- **Assuming decent activity bounce out of lockdown**
- **High frequency data suggests deficit widening regardless**
- **Net international investment position improves, on asset price changes**
- **Details reinforce upside risk for Q2 GDP tomorrow**

The current account deficit stood at 3.3% of GDP for the year to June 2021. This matched market (and our) expectations. But just because there was no surprise here on the day, we think there is still plenty to consider regards the external accounts going forward. The external deficit is widening, and we think it will widen further.

We should note up front that Stats NZ incorporated several and significant revisions to history in today's release as part of the typical annual revision process. This year's changes covered many areas of the external accounts. But rather than trawl through the many and varied changes made (that extend back to 2015), suffice to say here that the net effect relative to previous estimates was to see a smaller current account deficit over earlier periods, but a larger deficit over the most recent quarters.

For example, today's current account deficit of 3.3% of GDP for the year to June 2021 compares to 2.5% for the year to March 2021. The latter being revised from the 2.2% previously published for that period.

NZ's net international liability position continues to narrow, despite the recent widening in the current account deficit. This follows from another quarter of strong price gains in the country's international assets, reflecting buoyant offshore equity markets (helping boost assets held by the likes of Kiwisaver funds and the New Zealand Super Fund). These asset price swings are having a material influence on the country's net international investment position (NIIP) over and above the influence from changes in flows as measure in the current account.

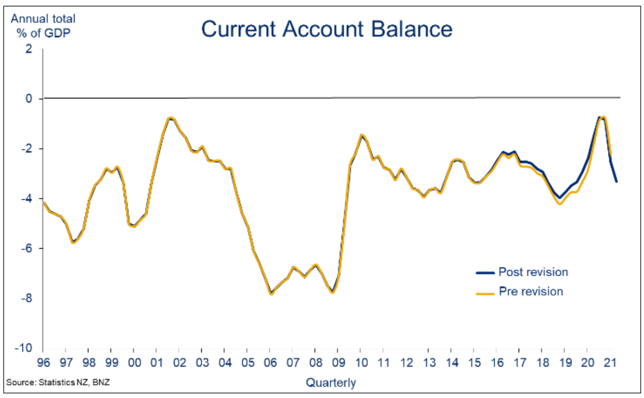
NZ's NIIP stood at -45.7% of GDP as at the end of June 2021, a sharp narrowing from the -50.8% of GDP as at the end of March (the latter revised by Stats NZ from the -49.5% previously estimated).

The recent overarching trend of a widening current account deficit seems intact. Regular readers will know we have long been talking about this and anticipate a material widening in the current account deficit over the coming 12-18 months. We see today's figures as just another step along this path. Indeed, we see the annual current account deficit pushing above 6% of GDP next year. That, as we have said before, would be getting into the zone when financial markets and rating agencies might start paying attention.

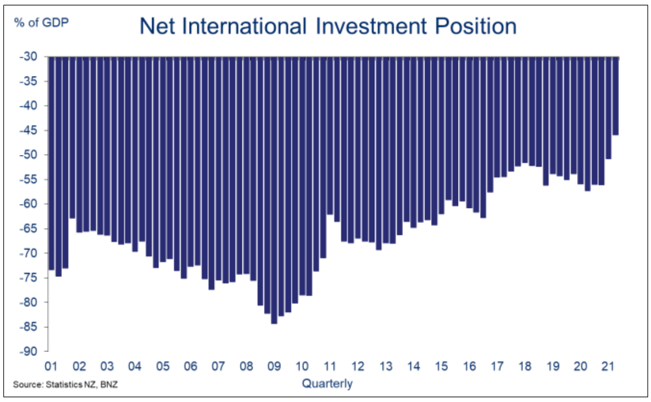
We don't put much stock in today's smaller quarterly seasonally adjusted current account deficit as a guide to the trend. For one thing, support from the Trans-Tasman bubble during Q2 is now no longer there. And we are also wary of interpreting seasonally adjusted estimates given the major change to usual patterns that have taken place since the pandemic started.

All that said, there is a chance that the current Covid outbreak and associated lockdowns alter that deficit-

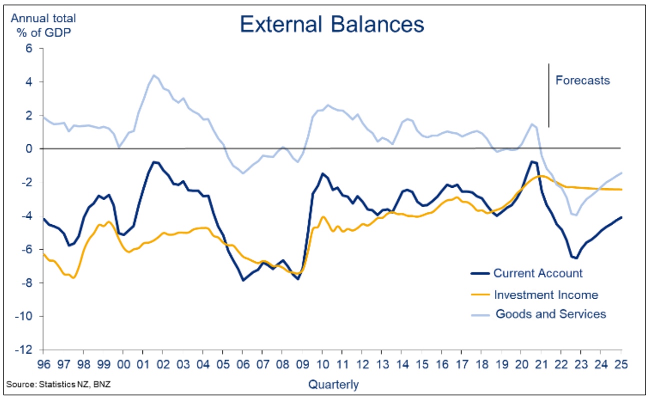
Recent Deficit Widening Survives Revisions



Net Liability Position Narrows On Buoyant Markets



Deficit Expected To Widen Further



widening trend in the near term. But, even if the deficit trend is altered near term, under our base case scenario of alert level restrictions being progressively relaxed, and activity bouncing back, previous trends in the external deficit would be expected to resume.

At this point, it is not clear that the lockdowns will alert the bigger deficit path. We say this noting the latest high frequency trade data released at midday today for the period up to 8 September. While changing alert levels has presented challenges, they have not crushed annual growth in import and exports. As such, these data continue to show a very large gap between annual growth in imports and exports. For example, today's numbers show for the week to 8 September, imports were up more than 41% on the same period a year ago, while exports were up around 5%.

Fundamentally, our wider external deficit view reflects an assessment that domestic saving will fall further behind domestic investment. Or, from a component perspective, we think some important factors to watch are:

- An expected bounce in domestic demand post lockdown and into next year. This will underpin demand for imports. Challenges, as they have been for some time now, on the supply side will need to be navigated. That said, annual growth in imports has

High Frequency Trade Data Indicates Widening Deficit

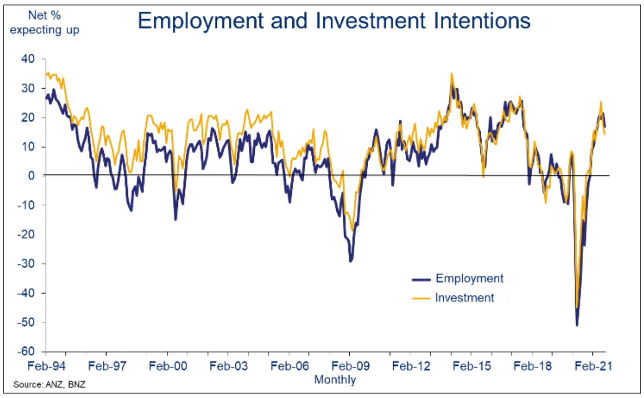
- Shipping costs – these continue to ramp higher adding to the cost of international trade for both importers and exporters. This is a material cost impost to the economy and we expect it to be a drag on the nation's external accounts for some time yet.

- Tourism and education exports – the lack of international tourism, outside of some lift from the Trans-Tasman bubble reflected in today's Q2 figures, has been a major hole in the external accounts since the pandemic started. The hit to education exports falls into a similar category. Exports of travel services lifted $190m in Q2 from Q1 (while imports of travel services rose $57m). Looking ahead, some improvement can be expected when the borders reopen. But there is no guarantee of a fast tourism recovery. Indeed, it seems more likely recovery will take considerable time. Indeed, we wonder if the recovery is even slower than we currently have built into our forecasts, and we are increasingly thinking this might be the case, then the external accounts will be that much worse for it. We will continue to give this some thought along with our forecasts of the flow of NZer's making trips aboard.

- Investment – signals were strengthening on this ahead of the recent lockdown. We anticipate investment to lift over the coming year encouraged by buoyant demand and a tight labour market. Difficulty finding appropriate staff and the rising cost of labour will encourage more capital-labour substitution. The challenge will be in finding the people to install the new buildings, plant, or equipment. It is interesting that business surveys, at least for the initial lockdown period, show firms' intentions to employ and invest have remained positive. Volatility can be expected near term, but we suspect beyond the immediate lockdown challenges there may also be a broad appreciation of significant supply side constraints that are unlikely to erode quickly. However, much depends on the hit to activity at present and the degree of bounce out the other side.

- Primary product prices. It is somewhat disconcerting that the external deficit is already on a widening path despite prices for NZ's major primary export products being generally strong and significantly higher than a year ago (helping the merchandise terms of trade to match its all-time high). We anticipate these prices to remain generally firm, but if that were not to be the case it is another risk to the external accounts to monitor. Annual inflation in NZ's major primary export product prices may well have already peaked for the time being.

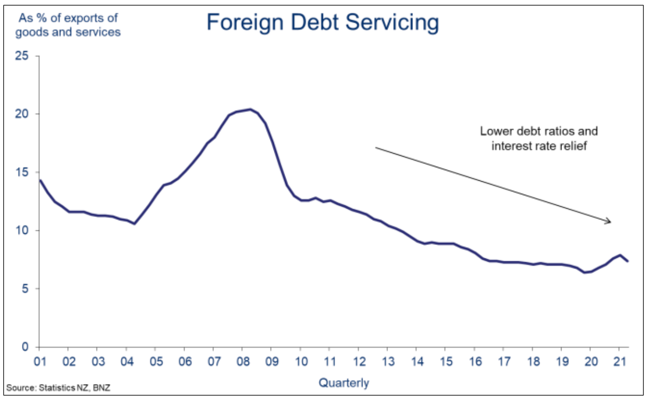
Employment and Investment Intentions Positive



- Higher interest rates may well see a wider deficit in the first instance as the country's debt servicing costs rise. This would follow a long stretch of falling debt servicing costs as a share of exports. This ratio was 7.4% in Q2 2021, a lot lower than the 12.3% it was at 10 years ago. However, in time, higher interest rates will act to dampen domestic demand and encourage saving that would lead to a lower external deficit than would otherwise be the case.

It is worth pointing out that a deficit need not necessarily be a bad thing. It depends on what the money is used for. Invested wisely, the money can lift potential growth and generate positive future returns. But indicators suggesting excessive consumption and less saving is not so good. In any case, if the money is squandered, and future returns are not good enough, a bigger deficit can leave the country more vulnerable to future shocks and downturns.

One To Watch As Interest Rates Rise



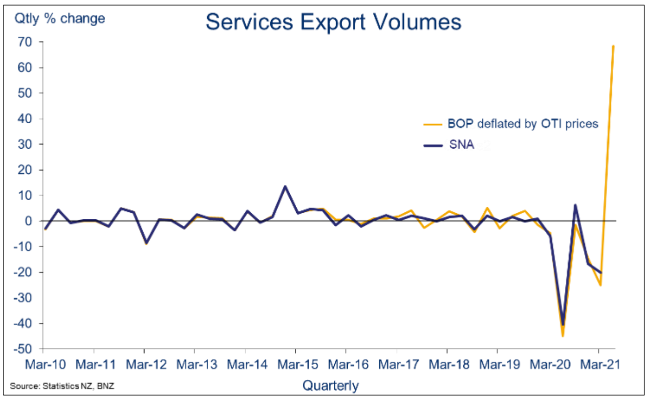
Finally, we were also interested in today's numbers in case they gave any further insight into what tomorrow's Q2 GDP figures might show – although the art of rearranging the nominal trade figures released today into their real seasonally adjusted versions for tomorrow's GDP release is more difficult through the haze of the many revisions.

That said, today's data does confirm some of our priors, including indicating a very large increase in real seasonally adjusted exports of services in Q2 (and possibly even bigger than the 60% gain we have built in). If this is what shows up tomorrow, it would be tempting, as some might do, to put it mostly down to the Trans-Tasman bubble influence. That is part of it, but we think that it has even more to do with the vagaries of seasonal adjustment. Imports of services were in line with our thinking.

On the goods side, exports were in the usual bounds of what the previously released data suggests might be the case of the GDP release tomorrow. But a balance of payments adjustment to goods imports, revealed today, may well see this component weaker than we had assumed for tomorrow's GDP. Overall, it adds to the case that net trade looks like being a very significant positive contributor to economic growth in Q2. The flow through to bottom-line GDP depends on whether such things alter estimates for other components like consumption and investment.

Taken all together, today's data tends to reinforce upside risk to our 1.1% pick for tomorrow's Q2 GDP release. And, in doing so, it supports the idea that tomorrow's growth figure will be well in excess of the RBNZ's 0.6% estimate from the August's Monetary Policy Statement.

Watch For A Massive Lift In Services Exports In GDP



doug_steel@bnz.co.nz

Contact Details

BNZ Research

Stephen Toplis	Craig Ebert	Doug Steel	Jason Wong	Nick Smyth
Head of Research	Senior Economist	Senior Economist	Senior Markets Strategist	Senior Interest Rates Strategist
+64 4 474 6905	+64 4 474 6799	+64 4 474 6923	+64 4 924 7652	+64 4 924 7653

Main Offices

Wellington
Level 4, Spark Central
42-52 Willis Street
Private Bag 39806
Wellington Mail Centre
Lower Hutt 5045
New Zealand
Toll Free: 0800 283 269

Auckland
80 Queen Street
Private Bag 92208
Auckland 1142
New Zealand
Toll Free: 0800 283 269

Christchurch
111 Cashel Street
Christchurch 8011
New Zealand
Toll Free: 0800 854 854

National Australia Bank

Ivan Colhoun	Alan Oster	Ray Attrill	Skye Masters
Global Head of Research	Group Chief Economist	Head of FX Strategy	Head of Fixed Income Research
+61 2 9237 1836	+61 3 8634 2927	+61 2 9237 1848	+61 2 9295 1196

Wellington
Foreign Exchange +800 642 222
Fixed Income/Derivatives +800 283 269

Sydney
Foreign Exchange +61 2 9295 1100
Fixed Income/Derivatives +61 2 9295 1166

London
Foreign Exchange +44 20 7796 3091
Fixed Income/Derivatives +44 20 7796 4761

New York
Foreign Exchange +1 212 916 9631
Fixed Income/Derivatives +1 212 916 9677

Hong Kong
Foreign Exchange +85 2 2526 5891
Fixed Income/Derivatives +85 2 2526 5891