Dynamics More Interesting Than Deficit

- Current account deficit steady at 3.3%
- Profit dip indicative of corporate margin squeeze
- Deficit to narrow near term, then expand
- Nothing to alter our 0.5% pick for tomorrow’s GDP

New Zealand’s current account deficit came in at 3.3% of GDP for the year to September 2019. This was marginally lower than market (and our) expectations of 3.4%, although this seemed as much to do with a small downward revision to history as anything fundamental.

Looking across the detail of exports and imports, for both goods and services, there were some small unders and overs relative to our expectations but nothing to alter our view of the world. So nothing to change our view for tomorrow’s Q3 GDP growth estimate that remains at 0.5%.

If you wanted to nitpick for signs of any risk to tomorrow’s GDP from the external accounts you’d probably point to the dip in profits accruing to foreigners in the September quarter. But given these are nominal figures and only loosely related, period to period, to economy wide profits you wouldn’t want to overstate that case. That said, the dip in profits accruing to offshore does square with the intense margin squeeze businesses were reporting through that period. Profit indicators have improved since then.

For the current account ahead, we see further narrowing in the annual deficit before widening further down the track. Recent strength in commodity prices promises to boost exports as the current season’s agricultural produce is sold. Meanwhile, we wonder if investment may be somewhat less responsive to stronger export cash flow than it has been in the past. Generally subdued business confidence over the past year has tempered investment intentions. We expect such dynamics to combine and narrow the external deficit further in the near term to around 3% of GDP.

We say the near term because there are some signs that these factors are turning.

For a start, some primary product prices have pulled back from recent highs. This includes dairy as witnessed by the 5.1% decline in prices at auction overnight. It also includes beef prices, which have recently been rapidly unwinding from a massive surge higher on account of African Swine Fever issues in China.

Secondly, the prospects for investment have brightened somewhat with the likes of investment intentions in yesterday’s ANZ business survey posting its second consecutive positive reading. Investment intentions are not quite back to average levels but they are significantly better than the negative readings recorded through the middle of the year. As the pendulum swings a little back toward investment and away from savings this is tantamount to the external deficit widening.

Another reason to think that the current account deficit will not continue shrinking beyond the near term is the

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### Current Account - Q3

<table>
<thead>
<tr>
<th>BNZ billions</th>
<th>Actual</th>
<th>Mkt Expected</th>
<th>Previous</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual Balance (% GDP)</td>
<td>-3.3</td>
<td>-3.4</td>
<td>-3.3R</td>
</tr>
<tr>
<td>Annual Balance</td>
<td>-10.3</td>
<td>-10.2R</td>
<td></td>
</tr>
<tr>
<td>Unadjusted Q1y Balance</td>
<td>-6.4</td>
<td>-6.3</td>
<td>-1.0</td>
</tr>
</tbody>
</table>

Source: Statistics NZ, BNZ

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### Profits Dip On Margin Squeeze

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Another reason to think that the current account deficit will not continue shrinking beyond the near term is the
outlook for fiscal policy. Yes, a fiscal deficit is projected for this year with surpluses forecast thereafter indicating expectations of rising government saving. But, at the same time, the investment side of the equation could move more aggressively as indicated by the intentions in the latest Half Year Economic and Fiscal Update. Moreover, government saving may not be as strong as currently projected if operational spending is lifted in next year’s Budget as has been recently signaled.

In all of this, it is worth remembering that deficits are not necessarily bad. At least as important, if not more so, is to what use the money is put. Think quality of government expenditure over quantity or the rate of return of private investment over the cost of funds.

NZ’s net international liability position has pushed higher, up to 56.3% of GDP as at the end September from 54.9% as at the end of June. A range of capital flows drove the change this quarter including foreign buying of government bonds and bank debt along with some foreign direct investment (including retained earnings) and divestment of NZ investment abroad. Although the net liability position is still significantly lower than the peak of over 84% in 2009, there is a sense of a mild trend deterioration developing over the past 18 months or so. It’s worth keeping an eye on.

For the meantime, NZ’s external accounts are off the radar of the market (and rating agencies). There was certainly no market reaction to today’s figures.

![Net Liabilities Edging Larger](image-url)