Research
Economy Watch

20 March 2024

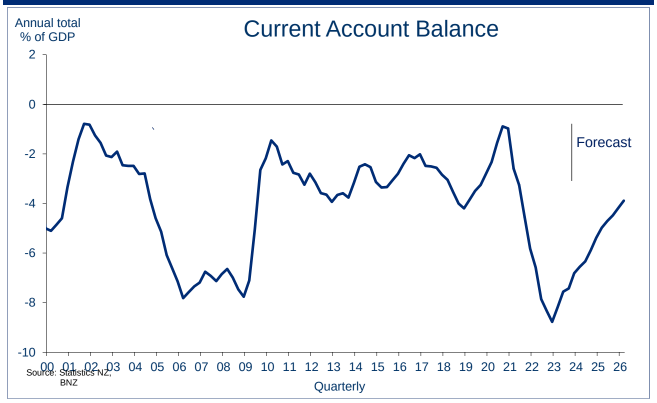
Large Deficit Shrinking

- **Current account deficit dips below 7% of GDP**
- **As imports slump, services deficit shrinks**
- **We expect further deficit narrowing**
- **Reflecting a rebalancing between demand and supply**
- **Nothing (on net) to alter pick for Q4 GDP tomorrow**

NZ’s external deficit is large, but it is narrowing. For the 2023 calendar year, the annual current account deficit stood at 6.9% of GDP. This is smaller than the 7.4% (revised from 7.6%) recorded for the year to September 2023 and a decent chunk narrower than the recent 8.8% peak recorded in calendar year 2022.

The annual deficit matched our expectations although was a tick smaller than market expectations of 7.0%. We expect further deficit narrowing ahead to around 5% in 2024 and near 4% in 2025.

Large Deficit Narrowing



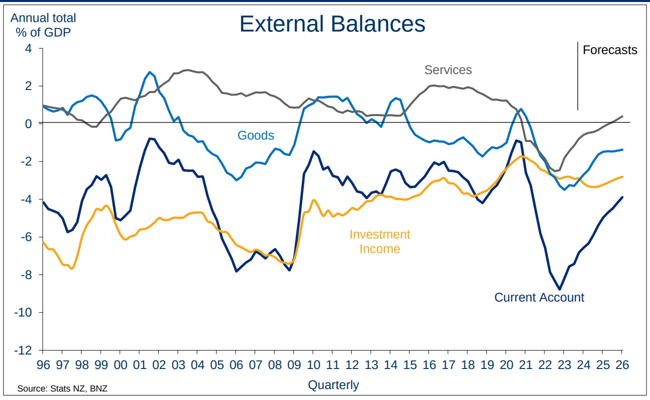
An external deficit reflects NZ living beyond its means. We should note a deficit in and of itself is not necessarily a bad thing. In part, it depends on what the funds are used for and what return is achieved over time. But a large and persistent deficit can increase vulnerability and risk.

A narrowing deficit is moving the right way for the likes of the rating agencies that expressed some concern around the external deficit last year. But, at near 7% of GDP, the current account deficit is still large and likely to remain on their radar for a while yet.

We see nothing, on net, in today’s figures that give reason to alter our +0.1% (with downside risk) pick for tomorrow’s Q4 GDP. This reflects the fact that most of the key trade figures had already been released. That said, the balance of payments trade figures do suggest exports of goods might be a bit stronger in Q4 than other trade data indicated for GDP purposes, but also that imports of goods may not have fallen by as much as other indicators suggested. The balance broadly nets off for GDP considerations.

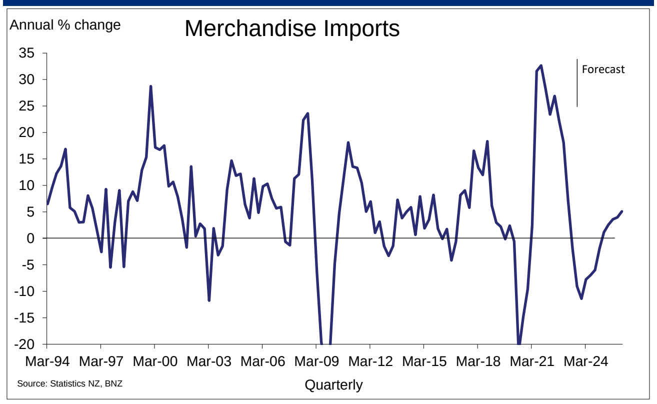
Looking across the major balances within the current account reveals clear narrowing in both the goods and services deficits. We anticipate further narrowing in both.

Many Moving Parts



The goods deficit is expected to narrow as imports continue to track below year earlier levels reflecting soft domestic demand, while exports show modest growth supported by somewhat higher commodity prices in 2024 compared with 2023. The value of goods imports in Q4 were 11.4% below a year ago in today’s data.

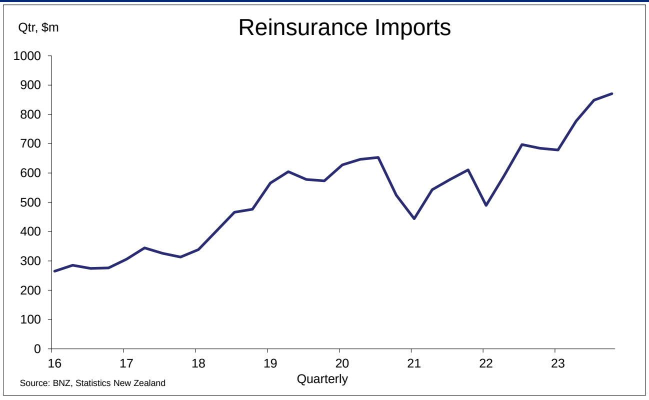
Imports Drop



The annual services deficit shrank to $3.2b in 2023, down from a peak of $9.4b just over two years ago. This deficit is expected to narrow overtime as inbound visitor spending is expected to continue to recoup ground lost during the pandemic. International visitor spending in 2023 was $12.9b, more than double the levels in 2022 (albeit still well behind the $16b annual returns pre covid).

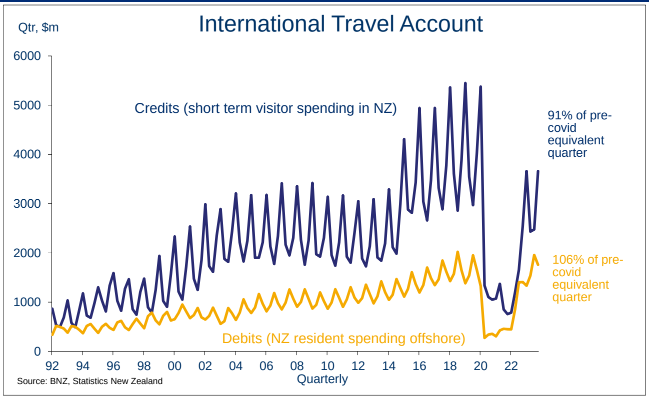
But we see that deficit narrowing progress being slower from here on and we think it will take some time before the services trade balance returns to surplus. There are factors on the import services side like transportation (including international freight rates) and reinsurance components to keep monitoring with various upward pressures of late. Reinsurance imports for 2023 were valued at $3.2b, up 29% or $0.7b from 2022.

Reinsurance Costs Rise



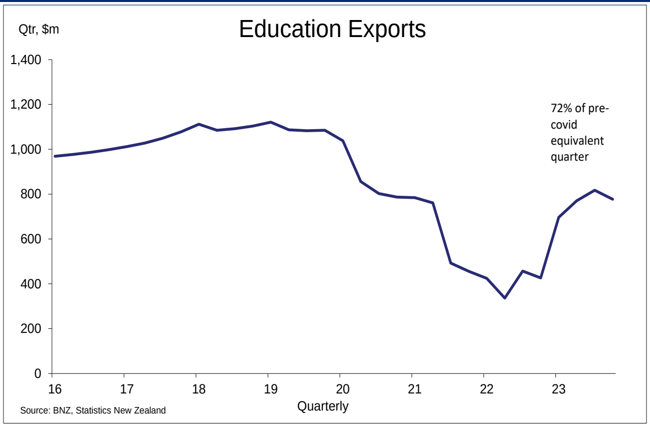
Back to visitor spending. In Q4 itself, it was up about 44% on a year earlier. That looks strong but it is as much a function of the prior year's low base as anything else. Spending growth is slowing. Spending in the quarter was around 91% of the equivalent quarter pre-covid, on a nominal basis. It would be a smaller share on a real basis. We think adjusted for inflation and seasonal factors, visitor spending fell in the quarter (partly an unwind from the FIFA Women's World Cup in Q3) and will be part of the wider exports of services component being a drag on GDP in tomorrow's Q4 figures.

The Ins and Outs of Visitor Spending



Education exports are a part of visitor spending. These looked strong in Q4, being up 82% on a year earlier. But, again, the levels matter. Education export receipts – think foreign student spending in NZ – were only 72% of pre-covid levels for the quarter. For 2023 overall, the $3.1b education exports was 70% of pre-covid levels. That is a hefty hole in pre-covid revenue making its presence felt across various components of the economy exposed to such revenue.

Lower Education



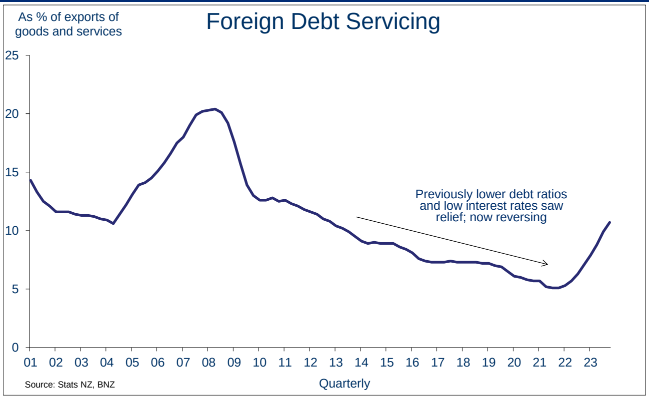
In contrast to total visitor spending in NZ, NZer's spending offshore has pushed above pre-covid levels, at least on a nominal basis. NZer's spending offshore in Q4 was nearly 25% higher than a year ago and 106% of the equivalent quarter pre-covid.

Beyond the details, to the extent that a narrowing overall current account deficit represents a broader rebalance of supply and demand in the economy, it might be viewed favourably by the RBNZ. Not that the Bank targets the external balance. But its policy rate does have influence on domestic savings and investment – the difference between which defines the current account balance. The annual current account deficit came in a touch smaller than the RBNZ's projection of -7.1%.

But change in saving and investment behaviour takes time. Meanwhile, higher interest rates are lifting debt servicing costs which adds to the nation's investment income deficit. Foreign debt servicing has a share of exports of goods and services has pushed out to 10.7% in Q4, from 9.9% in Q3, and 7.1% a year ago. This remains a headwind for the investment income balance.

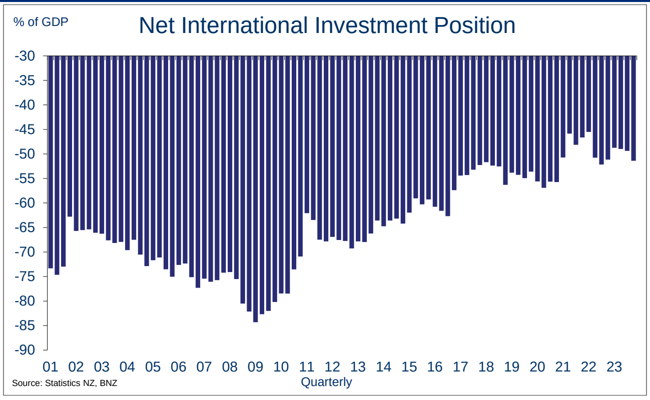
Meanwhile, profit outflows to foreign direct investors in NZ were little changed in Q4 and remain well back from recent peaks – not a good look for GDP although there is hardly a one for one relationship in that regard. The annual investment income deficit edged wider in Q4, although not necessarily as a share of the economy.

Debt Servicing Costs Higher



A large current account deficit adds to NZ's international investment liability. As a share of GDP, the latter has pushed out to 51.7% as at the end of 2023 from 49.3% a quarter earlier. This also includes other factors such as revaluation changes for both assets and liabilities. The trend shrinking in NZ's net liability position in the decade or so after the GFC in 2008/09, looks to have either stalled or at least slowed over recent years.

Net Liability Position Larger In Q4



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