ANZ Research

Balance of Payments – Q1 2023

14 June 2023

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Contact

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Data summary

	Latest	Prev
Current account ($m, actual)	-5,215	-10,065
Current account ($m, sa)	-8,307	-9,228
Goods & Services ($m, sa)	-5,657	-5,901
Primary & Second. Income ($m)	-2,650	-3,327
Annual CAB		
($m)	-33,034	-34,394
as % of GDP	-8.5	-9.0
Net IIP (% GDP)	-48.8	-51.1

The slightly less wonky economy

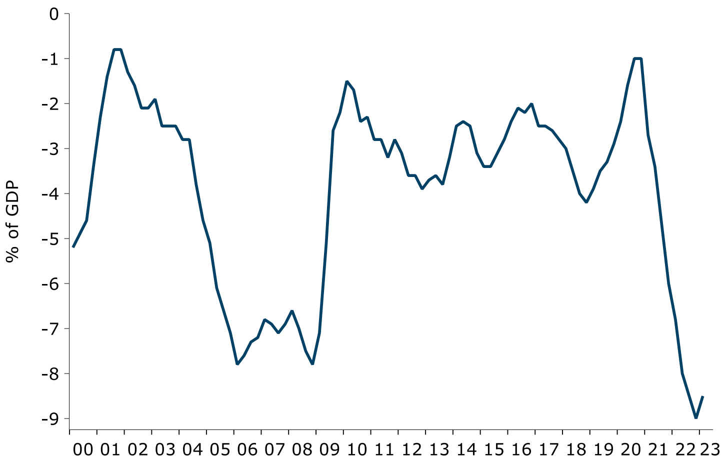
Bottom line

- The annual current account deficit came in at 8.5% of GDP in Q1 2023, narrowing from a revised 9.0% in Q4 2022 (was 8.9%).
- New Zealand's net international liability position narrowed $5.5bn from Q4 to a still-whopping $189bn. As a share of GDP it narrowed 2.3ppt to 48.8%.
- All up, New Zealand remains severely out of balance, but with tourism recovering, we now appear past the worst of it. That said, it could be a long road to something more sustainable.
- All else equal, New Zealand's severe external imbalance continues to hint towards a need for a weak NZD and higher interest rates.

Key points

The annual current account deficit narrowed by $1.4bn in Q1 to $33bn. As a share of GDP, it narrowed from 9.0% in Q4 (which was revised wider from 8.9%) to 8.5% in Q1, which is still wider than pre-GFC levels (figure 1).

Figure 1. Annual current account balance



Source: Stats NZ, Macrobond, ANZ Research

New Zealand's external sector imbalance is a result of a perfect storm:

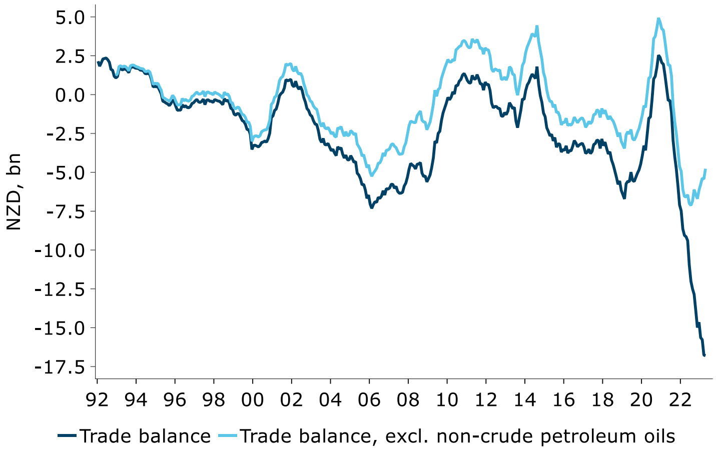
The quarterly services balance (exports less imports, figure 5 on page 4) flipped from surplus to deficit after COVID-19 restrictions closed the border and annihilated international tourism and education exports. Fewer Kiwis going on holiday abroad provided a partial offset, but services imports are less concentrated in travel, meaning the closed border had a less dramatic impact on services imports.

The good news is that the recovery in international tourism and education is progressing well, and with the FIFA Woman's World Cup set to kick off in July, that recovery should hopefully persist with vigour though the NZ winter (when international tourism is typically at its lull). But while we're past the worst in terms of the annual services deficit, it may be a while before the annual services balance is back in surplus. Exports not only need to catch up to their pre-COVID level, they also need to overtake imports, which have continued to grow beyond their pre-COVID level.

The annual goods balance has deteriorated meaningfully with exports struggling in the wake of bad weather, pending regulatory change, labour constraints, and shipping disruptions. Falling export prices relative to import prices (a weaker terms of trade) have also weighed over the past year.

Meanwhile, an overstimulated domestic demand pulse (too much fiscal and monetary stimulus for the conditions), has resulted in strong demand for imported goods. As shown in the monthly merchandise trade data (figure 2), the end of domestic fuel refining combined with high global fuel prices has also added significant widening pressure to the goods balance.

Figure 2. Monthly merchandise trade balance (annual sum)



Source: Stats NZ, Macrobond, ANZ Research

Our expectation is that cooling domestic demand will take the heat out of goods imports. However, a higher dependency on fuel imports means the hurdle to eventually achieving a goods surplus is high (ie imports are now structurally higher). On the other side of the ledger, lasting damage from cyclone Gabrielle means NZ’s capacity to export will be smaller than otherwise for a while yet (eg damage to root stock). In other words, it could be a very long time before the goods balance is back in surplus.

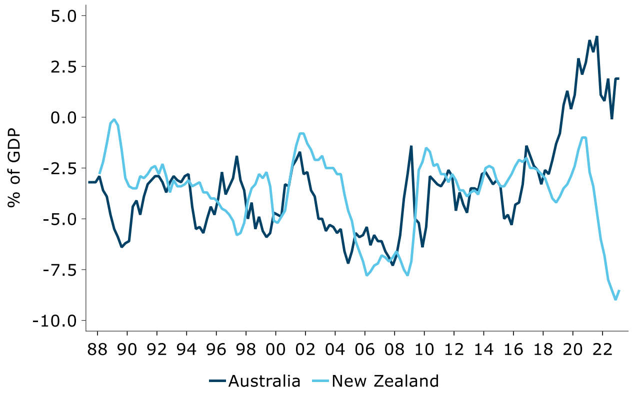
The **primary income deficit** is widening as the higher global interest rate environment weighs. The annual primary income deficit was $11.9bn as at Q1. We expect it to continue to widen over coming quarters, partially offsetting an improving goods and services trade balance.

A sizable net liability position

New Zealand is a net borrower from the rest of the world, and this is reflected in the net international investment position (NIIP). All else equal (ie. ignoring valuation changes on both the asset and liability sides of the ledger), the net liability position deteriorates with the current account deficit. That is, the NIIP is the stock measure, and the current account balance is the flow. In practice, valuation changes can be sizable, and have tended to favour New Zealand’s NIIP over the past decade. As at Q1 2023, New Zealand’s net liability position was sitting at $189bn (48.8% of GDP).

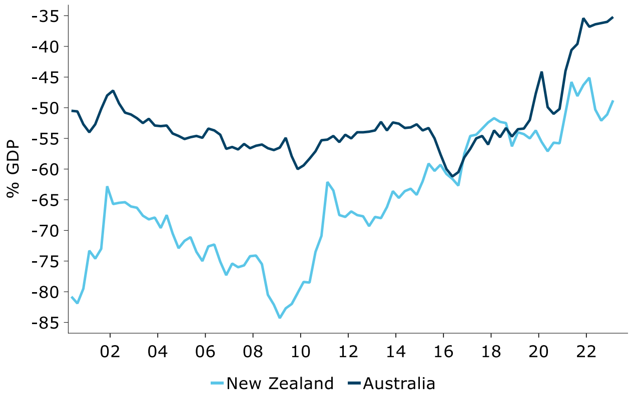
Compared to Australia, which has been running sizable current account surpluses for the past few years (figure 3, over), New Zealand’s deficits are significant. And from a position of parity in 2019, the gap between New Zealand’s and Australia’s NIIP has widened (figure 4, over).

Figure 3. Annual current account deficit



Source: Stats NZ, ABS, Macrobond, ANZ Research

Figure 4. Net international investment position



Source: Stats NZ, ABS, BEA, ONS, Macrobond, ANZ Research

Why does the current account matter?

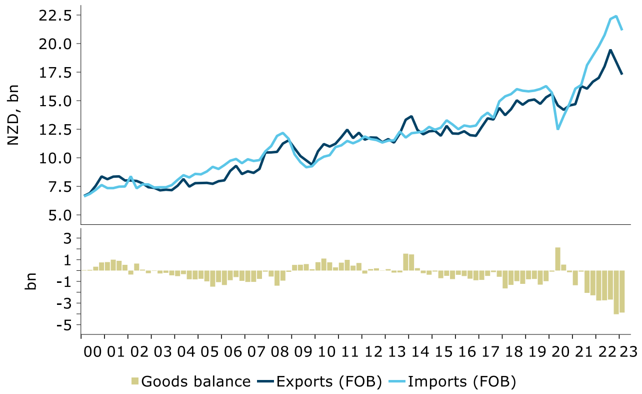
New Zealand isn't the best saver in the world, meaning it's an economy dependent on foreign capital to meet some of its investment demand. The result: persistent current account deficits, which have tended to run at around 3-4% of GDP in 'normal times'. Provided this foreign capital is put to productive use, running a deficit may not be a bad thing. It can grow the economic pie, making all parties better off. But when the deficit widens, as it has in the wake of the pandemic, there is a greater risk that foreign capital is allocated less efficiently than otherwise. Should something go wrong and foreign creditors reassess the risks, New Zealand may find itself needing to live within its means very quickly, or face potentially unsustainable borrowing costs. In other words, both private and public sector activity could face a sharper adjustment than desired, damaging confidence.

In a nutshell, the current account provides an indication of whether or not an economy is living within its means, and New Zealand's deficit suggests it hasn't been. However, reopened borders and monetary tightening (which will weigh on domestic demand and therefore imports) mean the deficit should narrow further from here, and that's something sovereign credit rating agencies are likely to be keeping in mind as they assess NZ's external sector sustainability.

New Zealand's external balance suggests inflation isn't the only reason for monetary tightening to guide the economy towards a more sustainable path. As we noted in our Budget 2023 Review, fiscal policy has a role to play in ensuring the NZ-wide savings-investment balance returns to more sustainable levels. While that is expected to happen eventually, the additional government spending announced in the Budget means it'll happen slower than otherwise and/or require a sharper adjustment by the private sector.

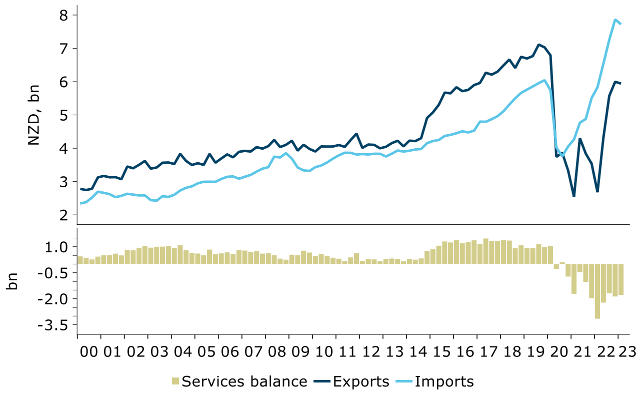
Perhaps most importantly, even though the outlook is for a narrowing current account deficit, New Zealand appears to be on relatively thin ice from an external balance perspective, and is potentially only one significant terms of trade shock away from pushing the outlook into territory that threatens how ratings agencies asses New Zealand's risk profile. Indeed, sovereign ratings do tend to be a relative concept over the longer run, and the NZ vs Australia story is a stark reminder that a significant adjustment is required. All else equal, that hints towards a need for a weak NZD and higher domestic interest rates.

Figure 5. Quarterly goods balance



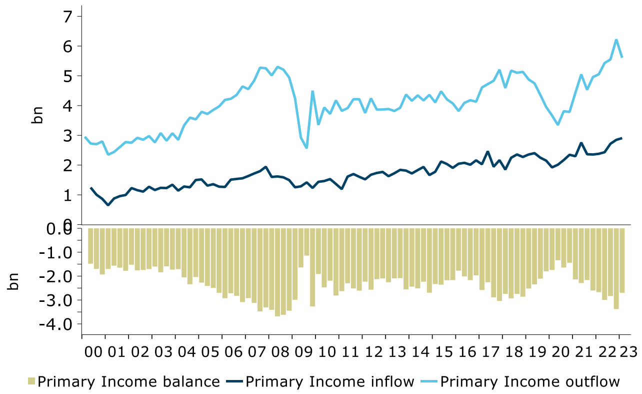
Source: Stats NZ, Macrobond, ANZ Research

Figure 7. Quarterly services balance



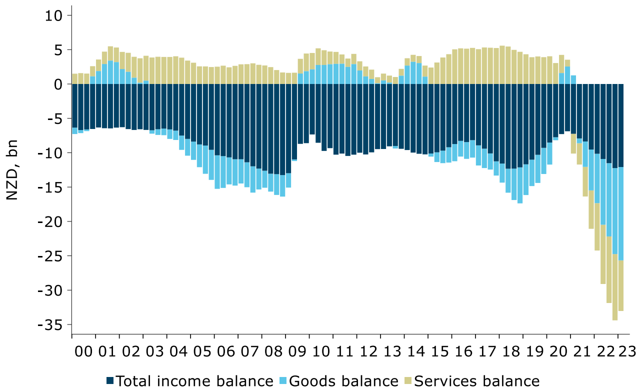
Source: Stats NZ, Macrobond, ANZ Research

Figure 6. Quarterly income balance



Source: Stats NZ, Macrobond, ANZ Research

Figure 8. Contributions to annual current account



Source: Stats NZ, Macrobond, ANZ Research

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