

Research Economy Watch

18 September 2024

External deficit reduction stalls

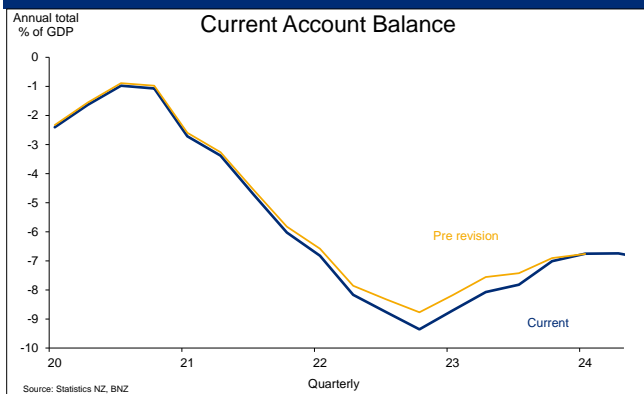
- **Current account deficit 6.7% of GDP**
- **Market ignores it**
- **Will continue to hold attention of rating agencies**
- **We see sticky deficit near term; smaller later**
- **Reinsurance costs dip**
- **Net liability position similar to a year ago**

The current account deficit stood at the equivalent of 6.7% of GDP in the year to June 2024. This is of a size that is likely to keep the external accounts on rating agency radars.

Today's result was a larger annual deficit than the market (6.5%) or we (6.3%) expected, although a touch smaller than the 6.9% seasonally adjusted figure the RBNZ projected in its August MPS. For us, the known revisions to exports of services were offset by other factors and revisions.

Today's outcome of 6.7% matched the annual deficit for the year to March 2024 (which was revised to 6.7% from 6.8%). More historical revisions were even larger, with history now showing that the annual deficit ballooned to a peak of 9.4% of GDP in calendar year 2022 (previously recorded at 8.8%).

Once was 9.4% of GDP



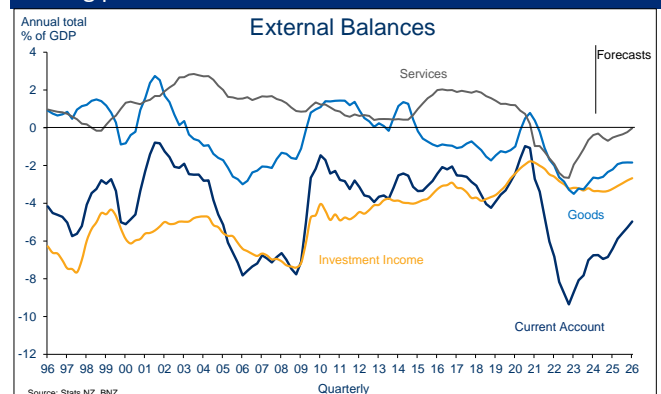
More importantly, today's result hints at a stalling in the prior trend of deficit narrowing. While the annual deficit was a bit larger than we anticipated on the day, its stickiness fits with our broader thinking over the coming quarters. It is the possibility of large deficit persistence that will maintain the attention of the rating agencies.

Our forecasts show the annual deficit near current levels for the next few quarters before narrowing resumes. We see the annual deficit shrinking to around 5% of GDP in two years' time.

We should note a deficit is not necessarily a bad thing. In part, it depends on what the funds are used for and what return is achieved on those funds over time. But a large and persistent deficit can increase vulnerability and risk.

The market remains unperturbed, likely soothed by such things as a floating currency and hedging arrangements. As is often the case with the external account data releases, today's figures were duly ignored by financial markets with no discernible reaction in either currency or interest rate markets.

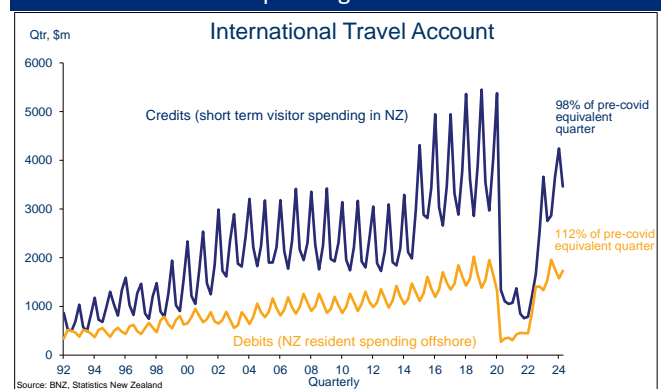
Moving parts



There was nothing in today's data, on balance, to alter our -0.4% q/q pick for Q2 GDP tomorrow.

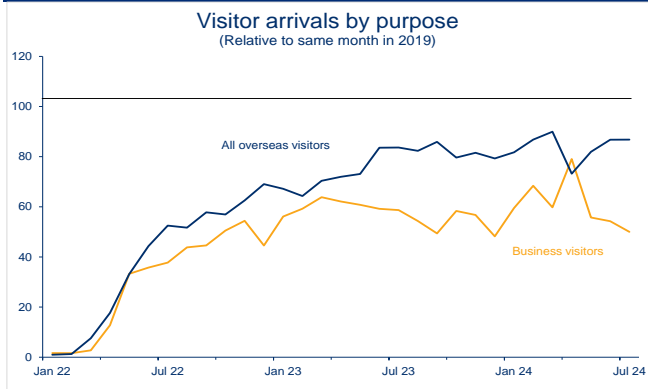
In the details, the annual services trade deficit narrowed to \$1.3b in the year to June 2024, or 0.3% of GDP from 1.6% a year ago, as spending by visitors increased. In Q2, overseas visitor spending in NZ was up 19% on a year ago. But growth continues to slow, and we think it will slow further. While the dollar value of visitor spending is now close to the equivalent quarter pre-covid, it is still well below in inflation adjusted terms.

Ins and outs of visitor spending

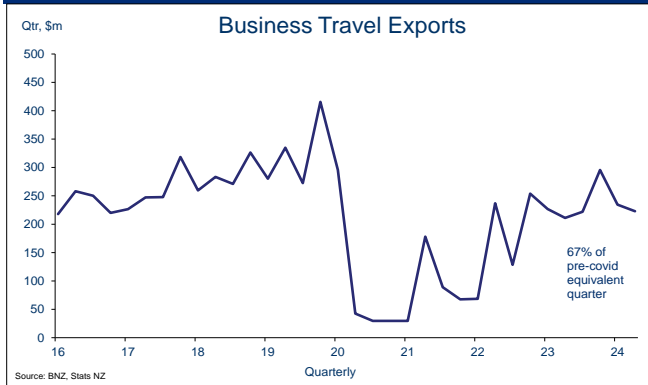


Visitor arrival numbers certainly remain below the equivalent month in 2019, with this metric at 87% in July and a level it has been wobbling around about a year ago now. Interestingly, business visitor numbers have been tracking lower still and in July were only half what they were for the equivalent month pre covid. Today's figures show spending by business travellers in Q2 is only two-thirds what it was pre-covid, in nominal terms.

Business traveller numbers half pre-covid levels

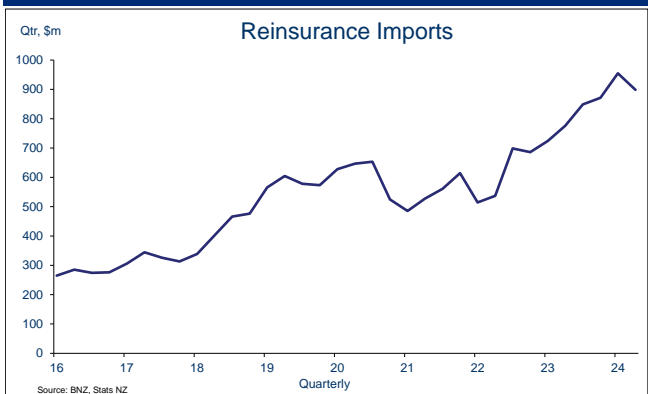


Business travellers spending less



Staying with services, on the imports side there was a 5.9% decline in the value of reinsurance. Reinsurance imports tend to increase in the June quarter so a decline this year is of note. It is just one quarter and reinsurance imports are still up 15.8% on a year ago. But this is worth watching. We don't get a price and volume split of the value change, but to the extent that the dip in the quarter reflects at least some slowing reinsurance inflation one would think this would have flow on effects locally.

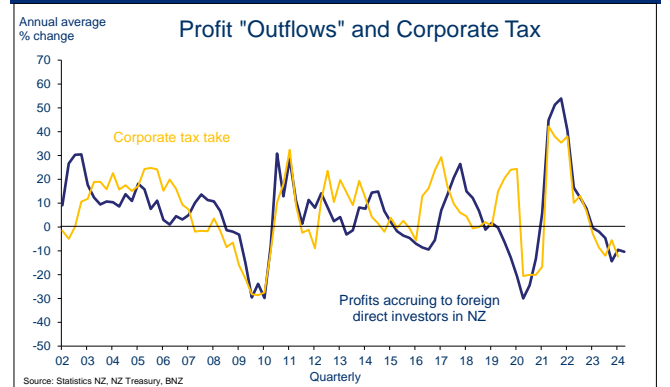
First dip in a while



The terms of trade has bounced off its lows and we think it has further to rise, supported by firming dairy prices and lower oil prices, which will support the goods balance ahead. So too will large horticulture export volumes. But it is unlikely to be one way traffic given currently low meat export volumes, weakness in forestry, and domestic energy issues challenging some energy-intensive export-focused industries.

Profit outflows to foreign direct investors in NZ edged higher in Q2 but are 10.4% lower than a year ago and well back from recent peaks. The general weakness reflects broader economic conditions not that there is a one for one relationship to GDP quarter to quarter. Importantly, it is indicative of downward pressure on profitability more generally. That has been a challenge for many including for the fiscal accounts. Lower profitability has been reflected in the corporate tax to date. We will get an update on the latter with the fiscal accounts in a few weeks.

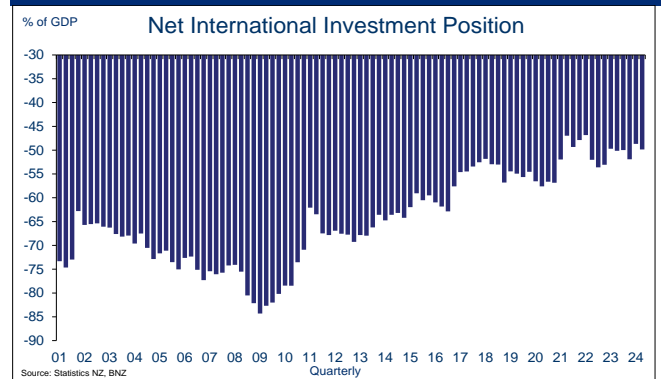
Profitability pressures



Debt servicing costs lifted further in Q2 which add to the nation's investment income deficit. Foreign debt servicing as a share of exports of goods and services has pushed out to 12.4% in Q2, from 11.8% in Q1, and 9.4% a year ago. With interest rates now falling, the upward pressure on debt servicing should abate in time.

A large current account deficit adds to NZ's international investment liability. However, the overall net position as a share of the economy stood at 49.7% in Q2 compared to 48.6% in Q1, as the increase in liabilities outpaced the increase in assets. But the net liability position remains little changed from 50.1% a year ago and remains significantly smaller than its peak of 84.3% of GDP back in 2009.

Net liability position similar to a year ago



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