Economic Note

NZ Q1 Current Account Review

17 June 2020

Narrower deficit in a downturn

- The Q1 current account deficit narrowed as expected to -2.7% of GDP, from -3.0%.
- The goods balance lifted, while the services and income balances weakened over the quarter.
- We expect the current account deficit will narrower further over 2020, despite the border closure.

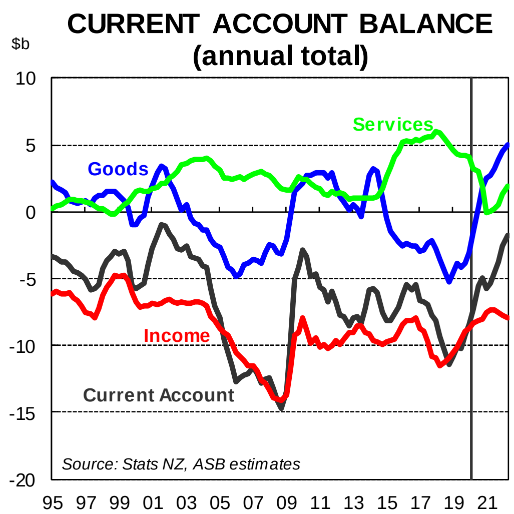
	Result	ASB	Market
Quarterly Current Account Balance ($m)	1,557		
Annual Current Account Balance (% of GDP)	-2.7	-2.6	-2.7
Quarterly Goods and Services Balance s.a. ($m)	770	-	-
Quarterly Income and Transfers Balance s.a. ($m)	-2,324	-	-

The current account deficit narrowed over the year to March 2020, to $-8.4 billion (-2.7% of GDP). This outcome was very close to what markets had been expecting. Goods trade held up, while services earnings were impacted by the border closure and returns on NZ's overseas investments softened.

We expect the current account deficit will continue as the impact of the COVID-19 shock becomes more apparent over the remainder of 2020. Goods exports are likely to remain relatively resilient, and are recovering from disruption earlier in the year. Meanwhile, weak domestic demand will reduce cash outflows for imports and investment income earned by foreign investors. We expect these reduced outflows to offset the impact of weaker tourism earnings.

Resilient goods, softer services

In seasonally-adjusted terms, NZ's goods exports lifted over Q1 compared to the closing quarter of Q4 – quite a good performance given that NZ's export shipments to China were disrupted during the peak of China's COVID shutdown. The high-frequency provisional trade data Statistics NZ is releasing show that NZ's export values are tracking very closely to last year's performance. Meanwhile, the value of goods imports softened slightly, and were clearly affected by disruption to China's logistics and probably the initial phase of NZ's Level 4 lockdown.



The impact of the border closure was apparent in services trade. Exports of travel services (i.e. tourist spending) fell 8.3% seasonally adjusted from Q4, with transportation services down 9.4%. Imports (New Zealanders' overseas travel spending) were also softer, down 9.7% seasonally adjusted for travel services and 5.1% for transportation. The net dollar impact contributed to the overall $83 million fall in the seasonally-adjusted services balance. The fall will be larger in

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subsequent quarters given that a net surplus in travel earnings is the norm.

Outlook: narrower over time

We expect the current account deficit will reduce over the next year. NZ current account deficits often reduce during downturns for all the wrong reasons, namely that a weak domestic economy creates weaker spending and domestic corporate profitability as well triggering interest rate cuts to resuscitate economic activity. This year is no different in that sense, though the circumstances are more extreme.

A positive state for the deficit over the year ahead is that NZ's goods exports are proving resilient, and are recovering from the disruption to Chinese-bound products earlier this year. Goods exports are essentially holding the line in a challenging time. The other reasons for a narrowing deficit are, however, symptoms of a weaker economy. Weaker consumer and investment spending will reduce imports. Weaker profits for companies with a degree of foreign ownership will reduce the outflow attributable to them. The considerably lower interest rates will progressively reduce the cost of servicing NZ's foreign borrowings. These impacts will offset the net loss of income from the border closure.

Net international investment position weaker on volatility

NZ's net international's investment liabilities headed further into the negative over Q1. However, it was a quarter of extreme valuation movements, with equity markets and the NZ dollar weakening considerably over the quarter. Changes in market prices resulted in bigger reductions in the value of NZ's assets relative to NZ's liabilities (which are more heavily weighted to debt instruments). Some of these shifts have unwound to an extent, with the NZD and equities back up.

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