

NEW ZEALAND ECONOMICS DATA REVIEW

Balance of Payments – December 2010 quarter

23 March 2011

CONTRIBUTORS

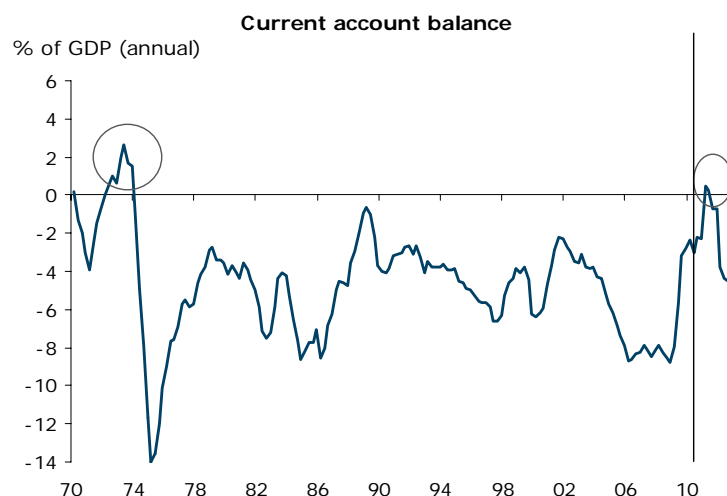
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ANNUAL CURRENT ACCOUNT SURPLUS BECKONS, BUT THIS WILL BE SHORT-LIVED

KEY POINTS

- **The quarterly current account deficit was significantly higher than market expectations of \$2.3b.** In seasonally adjusted terms, a quarterly deficit of \$2.83b was recorded for 2010 Q4. Goods, services and investment income balances all came in below our expectations.
- **For the year, the deficit stands at 2.3 percent of GDP,** as compared to the downwardly revised 2.2 percent in 2010 Q3. Reinsurance inflows for 2010Q3 were influential in the revisions.
- We expect \$6b of reinsurance inflows from the February 22 quake will lead to a large quarterly current account surplus for Q1 this year. **Annual current account surpluses for the first time since the early 1970s are in prospect.** This will be short-lived, however, with the current account set to move back into the red and the annual deficit to approach 5 percent of GDP by late 2012.
- Rebuilding Christchurch and stabilising the domestic economy (via OCR cuts) are expected to slow the much needed rebalancing of the economy. **Our weak external position will continue to be closely scrutinised by the ratings agencies.**
- The current account figures suggest quarterly seasonally adjusted nominal expenditure GDP growth in the region of 1.8 percent for Q4. This presents some modest downside risk to our 0.2 percent pick for Q4 real GDP growth.



Sources: ANZ, National Bank, Statistics NZ

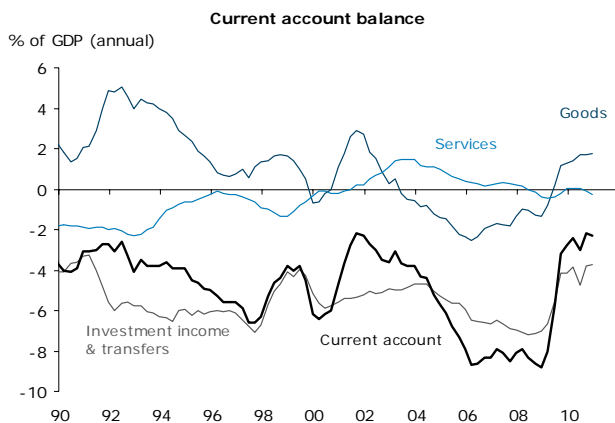
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ASSESSMENT

The quarterly current account deficit was higher than market expectations at **-\$3.5b**. In seasonally adjusted terms, a large \$2.8b deficit was registered, which followed an upwardly revised \$1.7b surplus in Q3. The deficit ended the 2010 year at 2.3 percent of GDP.

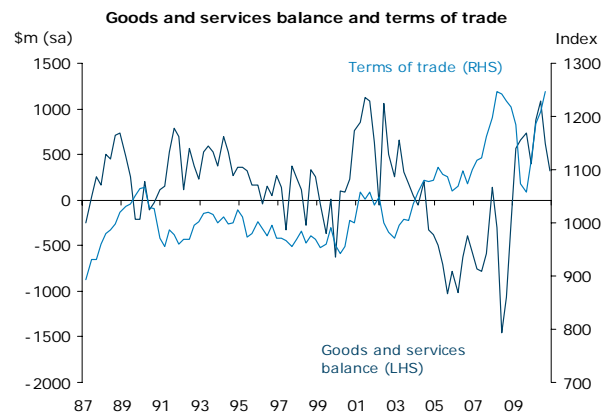
	Goods Balance (\$m) sa	Services Balance (\$m) sa	Invst. & Trsf. Balance (\$m) sa	Current Account Balance (\$m) sa	Current Account Balance (\$m) actual	Annual CAB as % of GDP
Mar-08	-326	25	-3,332	-3,633	-2,098	-7.9
Jun-08	-1,282	-177	-3,350	-4,810	-3,939	-8.3
Sep-08	-871	-198	-3,110	-4,179	-6,123	-8.6
Dec-08	95	-339	-3,197	-3,442	-4,074	-8.8
Mar-09	712	-148	-2,666	-2,102	-587	-8.0
Jun-09	663	-5	-1,217	-558	262	-5.7
Sep-09	647	83	-637	93	-1,547	-3.2
Dec-09	327	71	-3,160	-2,762	-3,332	-2.8
Mar-10	919	-44	-2,179	-1,305	159	-2.4
Jun-10	1,166	-86	-3,006	-1,927	-987	-3.0
Sep-10	790	-166	1,113	1,737	-29	-2.2
Dec-10	567	-247	-3,133	-2,813	-3,524	-2.3
ANZ	-	-	-	-	-1,900	-1.7
Market	-	-	-	-	-2,200	-2.5

Despite the large Q4 quarterly deficit, the annual current account deficit was only **\$4.4b**, or **2.3 percent of GDP**. Larger estimates of reinsurance flows from the September 2010 earthquake resulted in the Q3 deficit being revised down to \$29m. Reinsurance flows are recorded in the quarter that the event occurs, rather than when the flows arrive. A total of \$3.56b in reinsurance inflows from the September 2010 earthquake pushed the Q3 transfers balance into a \$3.5b surplus, with the actual current account deficit revised up to **-\$29m**.

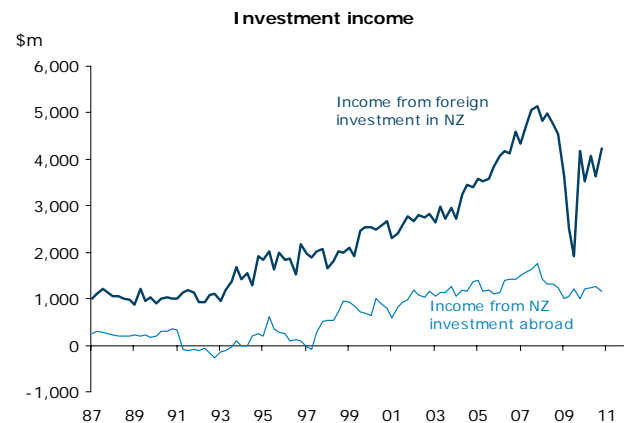


Largely on account of booming export commodity prices, a seasonally adjusted quarterly goods trade surplus of \$570m was recorded. However, another quarterly services deficit was evident. In seasonally adjusted terms, visitor arrival numbers were broadly

unchanged on Q3 levels. However, a lower proportion of high spending visitors are clearly having an impact. With visitor numbers likely to be adversely affected by the February earthquake, the services balance is unlikely to show much of a material improvement in the near-term.



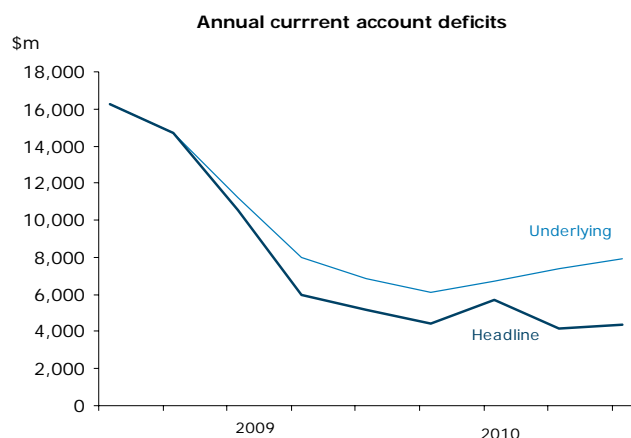
A higher investment income deficit was also influential in driving the quarterly current account deficit higher. The main contributors were a \$589 million rise in income earned by foreign investors from their investments in New Zealand, and a \$113 million fall in income earned from New Zealand's investments abroad. Investment income from foreign investment in New Zealand rose to \$4,224 million in the December 2010 quarter. The increase was primarily driven by a combined \$534 million rise in income earned by foreign direct and portfolio investors on equity investments in New Zealand companies. Investment income earned from New Zealand investment abroad increased \$33m to \$1,270m, largely as a result of increased earnings from overseas subsidiaries of New Zealand direct investors.



With no reinsurance inflows booked in Q4, the transfers balance reverted to a small deficit.

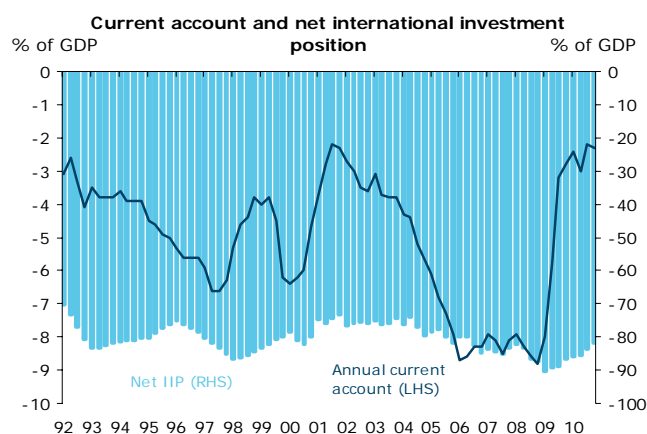
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However, reinsurance inflows from the February 22 Christchurch earthquake of around \$6b look set to boost the 2011Q1 transfers balance and lead to a large quarterly current account surplus. We are set for a brief period of annual current account surpluses – the last time we had an annual current account surplus was in the early 1970s!



Sources: ANZ, National Bank, Statistics NZ

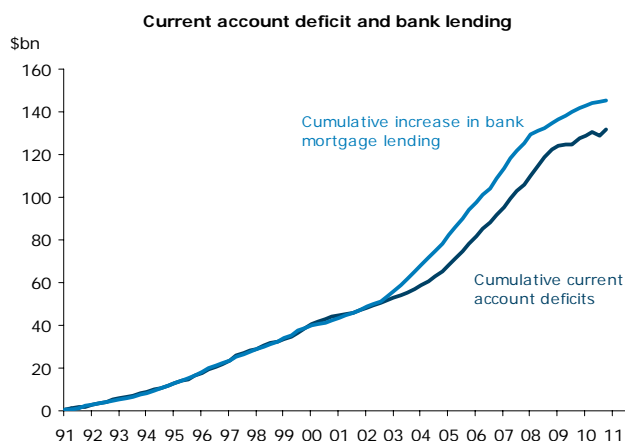
One-offs have been a feature improving the external accounts. Statistics New Zealand estimate excluding the reinsurance claims and unusual tax transactions, the underlying current account deficit deteriorated by \$1.1b in the 2010 year. In an underlying sense, the annual deficit was \$7.9b in 2010 (4.1 percent of GDP).



Sources: ANZ, National Bank, Statistics NZ

While re-insurance inflows have temporarily helped, New Zealand's external debt, at 81.7 percent of GDP, remains very high. The onus remains on government to portray a responsible message, with May's *Budget* likely to involve some tough choices. As a country we need to save more. We also need to invest smarter to improve returns. Households will also need to do their bit to improve national savings and the caution of household

spending suggests they are starting to become aware of that fact. It is unclear whether this restraint will be sufficient and long-lasting enough to make a perceptible difference to national savings and investment behaviour.



Sources: ANZ, National Bank, Statistics NZ, RBNZ

IMPLICATIONS

One-offs continue to flatter the external position. First it was the judgements against the banks, for structured tax transactions, now it is reinsurance inflows from the Canterbury earthquakes. The high terms of trade are also providing a supporting role.

Rebuilding Christchurch and stabilising the domestic economy (via OCR cuts) are expected to slow the much needed rebalancing of the economy. Our weak external position will continue to be closely scrutinised by the ratings agencies.

The monetary policy implications of today's release are limited. A strengthening economy and stubbornly high inflation will be sufficient to see the RBNZ start removing this insurance by the end of the year, with a 25 basis point hike envisaged in the December MPS.

The quarterly current account deficit was larger than what we had expected (a deficit of \$1.9b). The current account figures suggest quarterly seasonally adjusted nominal expenditure GDP growth in the region of 1.8 percent for Q4. This presents some modest downside risk to our 0.2 percent pick for Q4 real GDP growth.

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The Bank (in respect of itself and its principal officers) makes the following investment adviser disclosure to you pursuant to section 41A of the Securities Markets Act 1988.

The Bank (in respect of itself and its principal officers) makes the following investment broker disclosure to you pursuant to section 41G of the Securities Markets Act 1988.

Qualifications, experience and professional standing

Experience

The Bank is a registered bank and, through its staff, is experienced in providing investment advice about its own securities and, where applicable, the securities of other issuers. The Bank has been selling securities, and providing investment advice on those securities, to customers as a core part of its business for many years, drawing on the extensive research undertaken by the Bank and its related companies and the skills of specialised staff employed by the Bank. The Bank is represented on many bank, finance and investment related organisations and keeps abreast of relevant issues by running seminars and workshops for relevant staff and having its investment adviser staff attend external seminars where appropriate. The Bank subscribes to relevant industry publications and, where appropriate, its investment advisers will monitor the financial markets.

Relevant professional body

The Bank is a member of the following professional bodies relevant to the provision of investment advice:

- New Zealand Bankers Association;
- Associate Member of Investment Savings & Insurance Association of NZ;
- Financial Markets Operations Association; and
- Institute of Finance Professionals.

Professional indemnity insurance

The Bank (and its subsidiaries), through its ultimate parent company Australia and New Zealand Banking Group Limited, has professional indemnity insurance which covers its activities including those of investment advisers it employs.

This insurance covers issues (including 'prior acts') arising from staff fraud, electronic crime, documentary fraud and physical loss of property. The scope of the insurance also extends to third party civil claims, including those for negligence. The level of cover is of an amount commensurate with the size and scale of the Bank.

The insurer is ANZcover Insurance Pty Limited.

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The Bank has a process in place for resolving disputes. Should a problem arise, you can contact any branch of the Bank for more information on the Bank's procedures or refer to any of the Bank's websites.

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In the five years before the relevant investment advice is given none of the Bank (in its capacity as an investment adviser and where applicable an investment broker) or any principal officer of the Bank has been:

- Convicted of an offence under the Securities Markets Act 1988, or the Securities Act 1978 or of a crime involving dishonesty (as defined in section 2(1) of the Crimes Act 1961);
- A principal officer of a body corporate when that body corporate committed any of the offences or crimes involving dishonesty as described above;
- Adjudicated bankrupt;
- Prohibited by an Act or by a court from taking part in the management of a company or a business;

- Subject of an adverse finding by a court in any proceeding that has been taken against them in their professional capacity;
- Expelled from or has been prohibited from being a member of a professional body; or
- Placed in statutory management or receivership.

Fees

At the time of providing this disclosure statement it is not practicable to provide accurate disclosure of the fees payable for all securities that may be advised on. However, this information will be disclosed to you should you seek advice from one of the Bank's investment advisers on a specific investment.

Other interests and relationships

When a security is sold by the Bank, the Bank may receive a commission, either from the issuer of a security or from an associated person of the Bank. Whether that commission is received and, if received, its value depends on the security sold. At the time of providing this disclosure statement it is not practicable to provide a detailed list of each security that may be advised on, the name of the issuer of that security and the rate of the commission received by the Bank. However, this information will be disclosed to you should you seek advice from one of the Bank's investment advisers on a specific investment.

In addition to the interest that the Bank has in products of which it is the issuer, the Bank, or an associated person of the Bank, has the following interests or relationships that a reasonable person would find reasonably likely to influence the Bank in providing the investment advice on the securities listed below:

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- UDC Finance Limited (UDC), as a wholly owned subsidiary of the Bank, is an associated person of the Bank. UDC may receive remuneration from a third party relating to a security sold by the Investment Adviser.
- ING (NZ) Holdings Limited (ING), as a wholly owned subsidiary of the Bank, is an associated person of the Bank. ING and its related companies, including ING (NZ) Limited, may receive remuneration from a third party relating to a security sold by the Investment Adviser.
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The Bank provides investment advice on the following types of securities:

- Debt securities including term and call deposits, government stock, local authority stock, State-Owned Enterprise bonds, Kiwi bonds and corporate bonds and notes;
- Equity securities such as listed and unlisted shares;
- New Zealand and overseas unit trusts;
- Share in a limited partnership;
- Superannuation schemes and bonds;
- Group investment funds;
- Life insurance products;
- Derivative products including interest rate and currency forward rate contracts and options; and
- Other forms of security, such as participatory securities.

PROCEDURES FOR DEALING WITH INVESTMENT MONEY OR INVESTMENT PROPERTY

If you wish to pay investment money to the Bank you can do this in several ways such as by:

- Providing cash;

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- Providing a cheque payable to the relevant product or service provider and crossed 'not transferable'; or
- Making an automatic payment or payment through another electronic delivery mechanism operated by the Bank.

Investment property (other than money) may be delivered to the Bank by lodging the relevant property (for example, share certificates) with any branch of the Bank offering a safe custody service, or by posting (using registered post) the documents or other property to a branch of the Bank, identifying your name, account number and investment purpose.

Any investment money lodged with the Bank for the purchase of securities offered by the Bank, its subsidiaries or any third parties will be deposited in accordance with your instructions, to your nominated account or investment. Such money will be held by the Bank according to usual banking terms and conditions applying to that account or the particular terms and conditions relating to the investment and will not be held by the Bank on trust unless explicitly accepted by the Bank on those terms. Any investment money or property accepted by the Bank on trust will be so held until disbursed in accordance with your instructions. Any investment property lodged with the Bank will be held by the Bank as bailee according to the Bank's standard terms and conditions for holding your property.

Record Keeping

The Bank will keep adequate records of the deposit of investment moneys or property and all withdrawals and dealings with such money or property, using the account/investment number allocated to your investment. You may have access to those records upon request.

Auditing

The Bank's systems and operations are internally audited on a regular basis. The financial statements of the Bank and its subsidiaries are audited annually by KPMG. However, this does not involve an external audit of the receipt, holding and disbursement of the money and other property.

Use of Money and Property

Money or property held by the Bank for a specific purpose communicated to the Bank (e.g. the purchase of an interest in a security) may not be used by the Bank for its own purposes and will be applied for your stated purpose. No member of the Bank's staff may use any money or property deposited with the Bank, for their own purposes or for the benefit of any other person. In the absence of such instructions, money deposited with the Bank may be used by the Bank for its own purposes, provided it repays the money to you upon demand (or where applicable, on maturity), together with interest, where payable.

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