

NEW ZEALAND ECONOMICS DATA REVIEW

Balance of Payments – March 2011 quarter

22 June 2011

CONTRIBUTORS

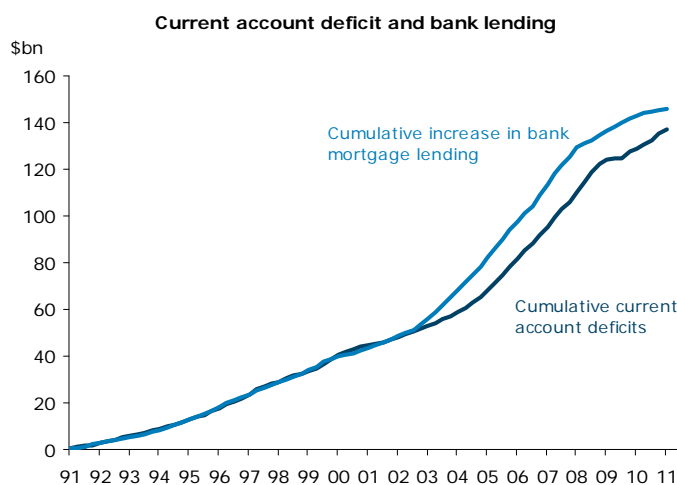
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NORMAL SERVICE RESUMES BUT A BLOW-OUT IN THE CURRENT ACCOUNT DEFICIT SHOULD BE AVOIDED

KEY POINTS

- **The quarterly current account deficit of \$97m was better than market expectations of a \$900m deficit.** For the year, the deficit stands at 4.3 percent of GDP, as compared to the revised 4.1 percent in 2010 Q4. **If it were not for statistical changes, the first annual current surplus since 1973 would have been recorded.**
- **Largely as a result of record commodity export prices and the seasonal lull in imports,** a quarterly goods trade surplus of \$1.5b was registered. In seasonally adjusted terms, the surplus widened to \$800m. The services balance recorded a \$770m surplus in raw terms but a deficit of \$189m in seasonally adjusted terms.
- **Lower domestic corporate profitability was the major driver behind the lower invisibles deficit, which narrowed sharply** from \$3.2b to \$2.4b in seasonally adjusted terms.
- **The key focus for the market will be the trajectory for the deficit.** We expect the current account deficit to head further into the red, passing 5 percent of GDP by the end of this year. We then expect deficits in the 5 to 6 percent range over the next few years. **We do not see the return to 7 percent plus deficits.** If a return to 7 percent plus deficits occurs it implies New Zealanders have not learnt from past excesses, which runs the risk of financial markets forcing an adjustment upon us.



Sources: ANZ, National Bank, Statistics NZ, RBNZ

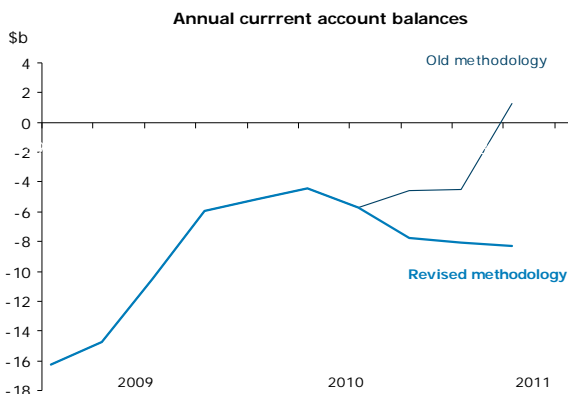
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ASSESSMENT

The quarterly current account deficit of \$97m was better than market expectations of a \$900m deficit. In seasonally adjusted terms a deficit of \$1.8b was recorded. For the year, the deficit stands at 4.3 percent of GDP, as compared to the revised 4.1 percent in 2010 Q4.

	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-09	693	-147	-2,666	-2,120	-587	-8.0
Jun-09	658	-7	-1,217	-566	262	-5.7
Sep-09	635	80	-637	79	-1,547	-3.2
Dec-09	364	80	-3,160	-2,716	-3,332	-2.8
Mar-10	894	-43	-2,179	-1,328	159	-2.4
Jun-10	1,161	-90	-3,006	-1,935	-987	-3.0
Sep-10	776	-172	-2,447	-1,843	-3,589	-4.1
Dec-10	610	-229	-3,236	-2,854	-3,627	-4.1
Mar-11	842	-185	-2,410	-1,753	-97	-4.3
ANZ	-	-	-	-	-852	-4.5
Market	-	-	-	-	-900	-4.4

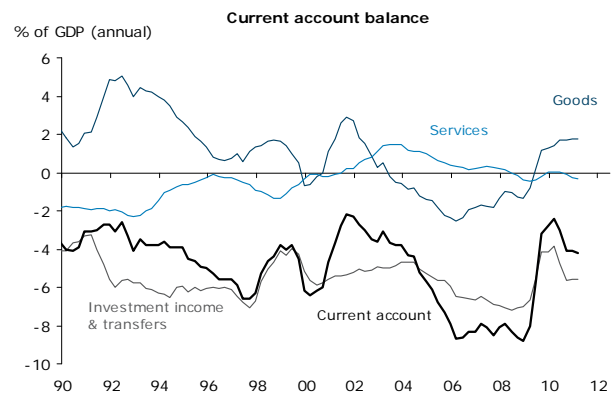
Statistics NZ have changed the methodology for calculating the deficit by removing the reinsurance inflows from the September 2010 and February 2011 earthquakes. **If it were not for statistical changes, the first annual current surplus since 1973 would have been recorded.**



Sources: ANZ, National Bank, Statistics NZ

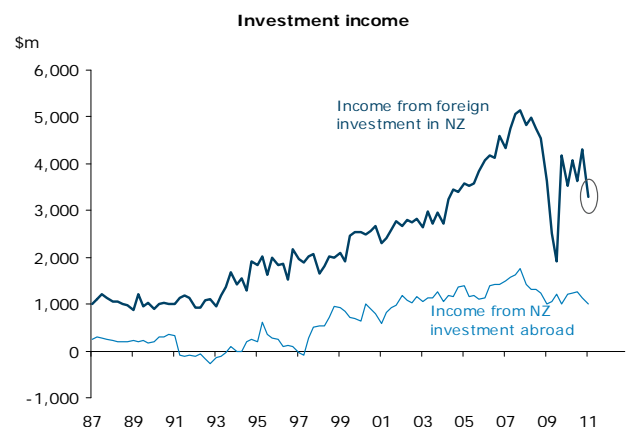
Largely on account of booming export commodity prices, a seasonally adjusted quarterly goods trade surplus of \$842m was recorded. Export values are about 12 percent higher than a year earlier, and while the annual growth in imports was higher (up 14 percent), it was off a low base. **With the terms of trade at a 37-year high, we expect ongoing trade surpluses for a while to come, although this will narrow given import demands (capital equipment and consumer durables) posed by earthquake reconstruction work.**

However, a quarterly seasonally adjusted services deficit of \$185m was recorded. Visitor arrival numbers were broadly unchanged on Q4 levels, but a higher proportion of visitors came from Australia, who have shorter stays and spend less per day. With higher spending Asian tourist numbers expected to remain weak in Q2 on account of seismic disruptions, and with the high NZD set to weigh on spending from European and American tourists, this balance is unlikely to show improvement until around the Rugby World Cup.



Sources: ANZ, National Bank, Statistics NZ

The seasonally adjusted invisibles deficit of \$2.4b was narrower than what we had expected. Driving the fall was a decline in investment income debits, with the major driver due to a fall in profits from the insurance industry underwriting losses from the Canterbury earthquakes. Despite the lower NZD (down 1.1 percent on a TWI basis since the December quarter) and stronger overseas equity markets (US equities rose 9 percent in the March quarter) investment income debits actually fell slightly.

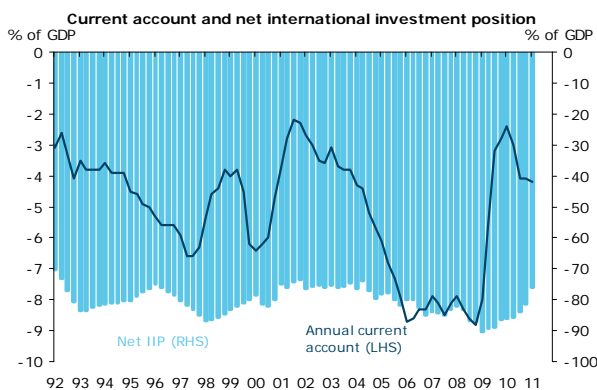


Sources: ANZ, National Bank, Statistics NZ

Statistics NZ have expressed the current account deficit and IIP to GDP ratios using the December quarter GDP. If nominal GDP increases

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in the March quarter are used (we are expecting at least a 1 percent increase in nominal GDP in the March quarter), this points to a slightly better starting position (i.e. lower deficits). **We were not provided with much information on March quarter GDP, but on the face of it the stronger trade balance suggests GDP growth of about 0.4 percent in Q1** (we were previously expecting a 0.2 percent increase). It is possible, however, that the earthquake disruptions could have an offsetting impact if Statistics NZ make adjustments to the GDP figures. **We will have to wait till July 7 to find out.**



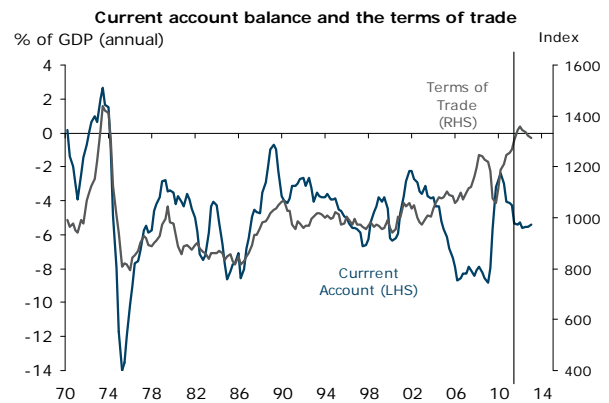
Sources: ANZ, National Bank, Statistics NZ

Net external debt fell to 76.7 percent of GDP. New Zealand's net international liabilities were \$148.2b at 31 March 2011. The \$10.4b fall in the net IIP from 31 December 2010 was the largest quarterly fall since at least June 2000, and returns the net IIP to its lowest level since 30 June 2007. The improvement was mainly driven by greater increases in lending than borrowing, with the latter weighed down by \$6.8b reinsurance claims. As these claims are settled, we expect the international investment position to move higher, which would push the IIP back up to around 80 percent of GDP, all else equal. With deficits of around 5 percent of GDP, we expect net external debt to remain around the 80 percent of GDP mark. Uncomfortably high, but off the radar screen of the ratings agencies for now.

IMPLICATIONS

At 4.3 percent of GDP the current account deficit is in the "problematic but not alarming" zone. It's problematic because it'll keep New Zealand's net external debt position elevated. It's not alarming as yet as net external debt will continue to hover around current levels in relation to GDP, which should be able to be serviced out of current income.

The key focus for the market remains the trajectory of the deficit. We expect that the current account deficit will head above 5 percent of GDP by the end of the year. The reality is that the insurance nature of the March OCR cut and the Government's intention to use its balance sheet to provide economic support at a crucial juncture for the New Zealand economy, will delay the economic rebalancing. The mix of monetary conditions is also providing more stimulus to the spending side of the economy than the earning side.



Sources: ANZ, National Bank, Statistics NZ

A return to 7 percent plus external deficits is not yet in prospect. We assume there is a structural aspect to household behaviour that will temper consumer spending and contain the current account deficit. Fiscal consolidation is also assumed to provide an effective counterweight. To assume otherwise would see higher deficits, which is likely to see overseas creditors reassessing their willingness to lend to NZ.Inc. **This will mean the adjustment is forced upon us with higher debt servicing costs for future generations.** However, this would change the mix of monetary conditions to provide lesser stimulus to the spending side of the economy but more of a helping hand to the export sector (and economic rebalancing) via a weaker NZD.

For now at least, there are limited implications of today's release, despite the deficit being higher than the June MPS projection. Considering statistical changes, the February earthquake, March OCR cut and subsequent events, this historical Q1 data has less relevance than usual. The RBNZ June MPS pick adjusting for the new statistical changes would be a Q1 deficit of about \$1.0b (4.6 percent of GDP), so today's result is actually considerably better. We still expect that a strengthening economy and stubbornly high inflation will be sufficient to see the RBNZ start removing the March MPS insurance cut by the end of the year, with a 25 basis point hike envisaged in the December MPS.

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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.

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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.

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

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

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- 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.

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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.

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- 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.

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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.

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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.

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