

## NEW ZEALAND ECONOMICS DATA REVIEW

### Balance of Payments – September 2011 quarter

21 December 2011

#### CONTRIBUTORS

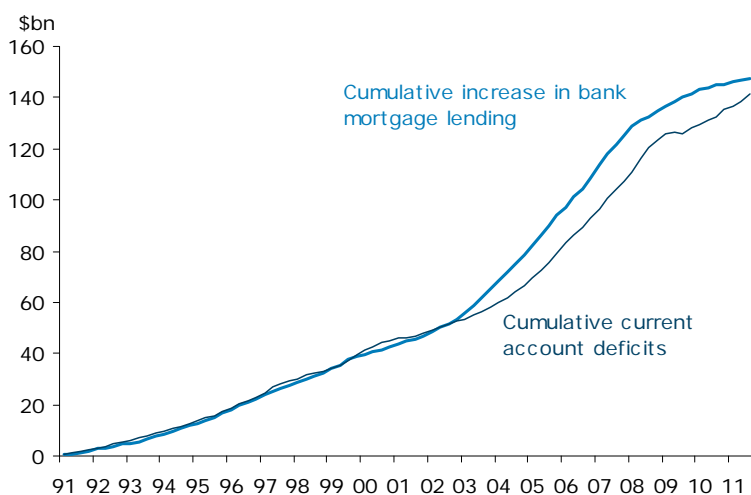
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## HIGHER CURRENT ACCOUNT DEFICIT AND RISING EXTERNAL DEBT HIGHLIGHTS OUR VULNERABILITIES

#### KEY POINTS

- The Q3 quarterly current account deficit at 4.3 percent of GDP was higher than the market expectations. The international investment position at the end of September 2011 rose to 72.9 percent of GDP from 69 percent in June.
- The combination of a weakening goods trade surplus and a widening investment income deficit drove the deterioration.
- On the services side, the Rugby World Cup impact has a positive net impact. However, the seasonally adjusted services deficit looks set to widen further given the fragile global outlook.
- Increased profits earned by foreign investors saw the investment income deficit continue to move higher from the rise in the previous quarter.
- We expect current account deficits in the 4 to 5 percent of GDP zone next year, significantly higher deficits will be capped by a structural change in behaviour.
- Tomorrow's Q3 GDP is the last major local data print for 2011. The Q3 current account numbers suggest a slightly more negative net trade position, adding to downside risk around our +0.9 percent pick.

**Current account deficit and bank lending**



Sources: ANZ, National Bank, Statistics NZ

## DATA REVIEW

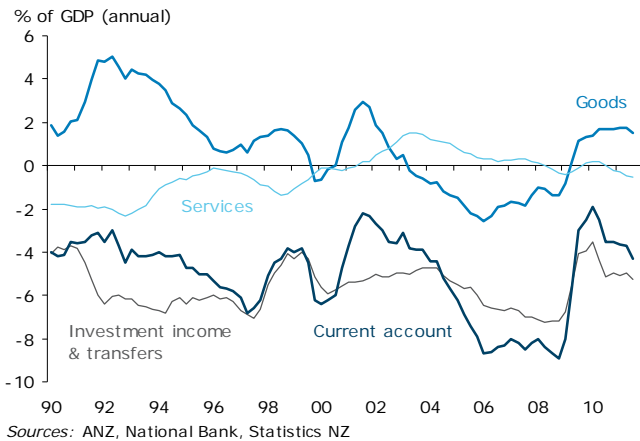
## ASSESSMENT

The Q3 quarterly current account deficit came in at \$4.6bn, which was higher than the market expectation of a \$3.75bn deficit and our \$3.9bn pick. In seasonally adjusted terms, a quarterly deficit of \$2.7bn was recorded. For the year, the deficit was 4.3 percent of GDP. The international investment position as at September 30 was \$142.9bn, or 72.9 percent of GDP.

	Goods balance (\$m)	Services balance (\$m)	Inv. & Trsf. Balance (\$m)	Current Account Balance (\$m)	Annual CAB as % of GDP	Net IIP (% GDP)
Mar-10	1,478	915	-1,894	499	-1.9	-80.4
Jun-10	2,359	-268	-2,734	-644	-2.5	-80.7
Sep-10	-346	-799	-2,175	-3,320	-3.5	-77.5
Dec-10	-145	-263	-2,914	-3,322	-3.5	-75.1
Mar-11	1,563	768	-2,240	91	-3.6	-68.0
Jun-11	2,379	-633	-2,590	-844	-3.7	-69.0
Sep-11	-752	-949	-2,898	-4,599	-4.3	-72.9
<b>ANZ</b>				-3,890	-4.0	
<b>Market</b>				-3,750	-3.9	

The climb in the annual current account deficit reflected a combination of a goods surplus starting to head lower, combined with a rising investment income deficit.

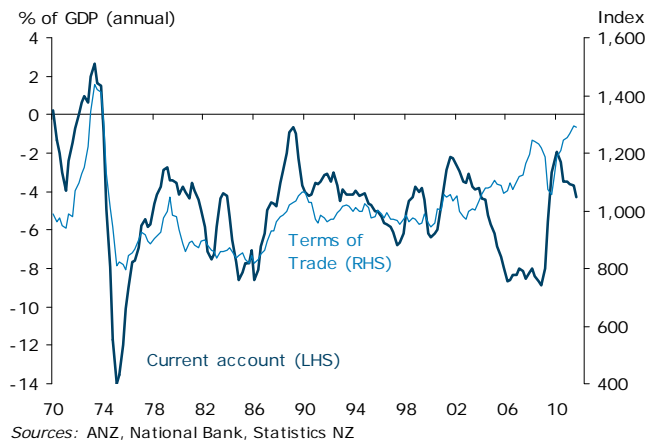
Current account balance



With commodity export prices (and the goods terms of trade) now past their peak, the annual good surplus edged lower to 1.5 percent of GDP in the September 2011 year. This is the lowest annual goods surplus since early 2010. In seasonally adjusted terms, the goods surplus fell to \$481m s.a., the narrowest since late 2009. A 5.0 percent seasonally adjusted fall in export values was broad-based, with both primary and ex-primary export values down. Meat products, dairy products, and logs were behind the decrease in goods exports, mainly due to falling prices, courtesy of the high NZD. Despite the higher NZD, the fall in import values (-0.9 percent s.a.) was modest and is indicative of a

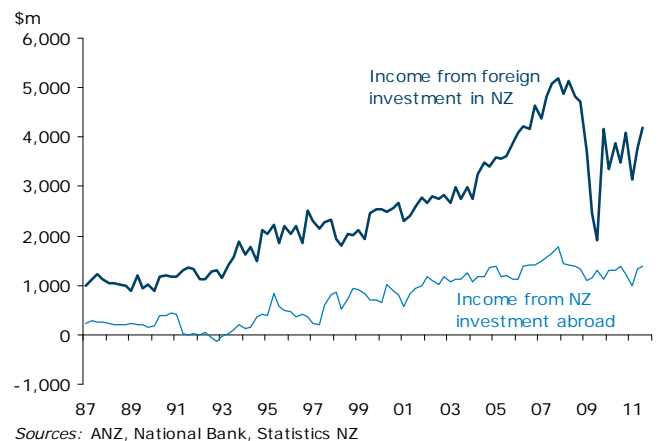
resilient domestic economy, with higher investment goods a positive sign for capacity building.

Current account balance and the terms of trade



On the services side, the Rugby World Cup impact had a positive net impact. Exports of services were up a seasonally adjusted 6.0 percent from the previous quarter, boosted by higher visitor numbers and higher ticket sales for NZ airlines. Imports of services were boosted 2.1 percent s.a., driven by an increase in royalties and licence fees paid. However, the seasonally adjusted services deficit remains large (\$290m) and will rise further with the likelihood of a post-RWC rebound in overseas trips by kiwis and the impact of increasing global headwinds on incoming tourism.

Investment income



On the income side, increased profits earned by foreign investors saw the investment income deficit continue to move higher from the rise in the previous quarter, with foreign investors earning \$4.22bn from their NZ investments. Much of the lift in the investment position was driven by an increase in bank profitability. Non-bank profitability also held up. Without a commodity-price induced camouflage provided by the rising terms of trade, the rising

## DATA REVIEW

invisibles balance (5.2 percent of GDP in the September quarter) is rapidly becoming anything but invisible.

The net international investment position rose to \$141.5bn or 72.9 percent of GDP (69 percent in Q2). Most of the rise in New Zealand's net international liabilities was from a rise in net overseas debt, with falling overseas equity markets decreasing the value of New Zealand's investments abroad by \$4.1 billion.

**While this is a significant improvement compared to the March 2009 peak (\$157bn, 85 percent of GDP) it still highlights a vulnerable external position.** With debt an ugly word at present, more progress will be needed to boost nationwide saving performance so that an unwelcome adjustment is not forced upon us. Households are starting to get the message, but are only about two-thirds along the journey towards lifting saving. The onus will increasingly be placed on fiscal policymakers to mitigate our saving and investment imbalances via ongoing focus on restraint. It will be painful, but necessary.

Net international investment position



Sources: ANZ, National Bank, Statistics NZ

**The unwinding of the reinsurance flows will work against this**, with the value of New Zealand assets boosted by \$12.7 billion of outstanding reinsurance claims from non-residents for the Canterbury earthquakes. Excluding these outstanding claims, our net IIP would have been \$160.9 billion (79.1 percent of GDP), and \$151.8 billion (75.7 percent of GDP) at 30 June 2011. **This is a much less comfortable starting point.**

### IMPLICATIONS

**With the current account deficit at 4.3 percent and net international liability position at 73 percent of GDP, the starting point for NZ's external position is in a worse position than seemed apparent a few months ago.** The

economy still needs to rebalance towards an export-driven model and this will take time.

**The key focus for the market remains the trajectory of the deficit.** We expect that the current account deficit will remain in the 4 to 5 percent of GDP zone over 2012 before moving above 5 percent of GDP over 2013. Driving this will be the combined influences of the mix of monetary conditions (low OCR but high NZD), a weaker global outlook and resourcing implications of earthquake reconstruction.

**A return to 7 percent plus current account deficits is not yet in prospect.** This is shown by the household saving rate returning to positive territory, the message of living within your means appears to be sinking in for NZ households. We expect the ongoing focus on deleveraging and balance sheet repair by households and government to cap the increase in the deficit. Increased focus on fiscal restraint and the eventual return to fiscal surpluses will reinforce this. With debt an ugly word at present, rating agencies and overseas lenders will take a dim view if they see higher deficits eventuating and will not stand idly by.

Given the historical nature of the data, the market implications of today's data are limited. **However, they highlight a less positive starting point, and provide the New Zealand economy with less flexibility to cope with adverse shocks.**

Tomorrow's Q3 GDP is the last major local data print for 2011. The current account numbers suggest a slightly more negative net trade position than what we have previously assumed with more downside risk around our +0.9 percent pick for Q3 GDP.

## DATA REVIEW

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