

NEW ZEALAND ECONOMICS DATA REVIEW

Balance of Payments – September 2010 quarter

22 December 2010

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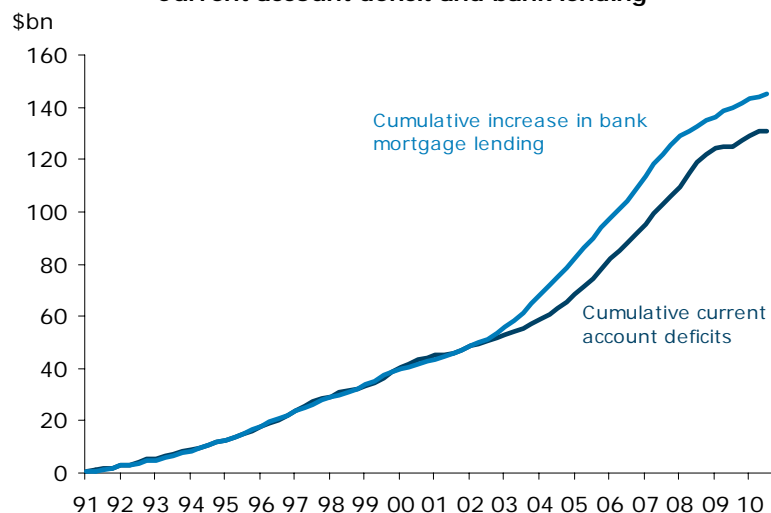
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ONE-OFFS AND LOW DOMESTIC PROFITABILITY CAP CURRENT ACCOUNT DEFICIT

KEY POINTS

- In non-seasonally adjusted terms a quarterly deficit of \$1.77b was recorded for 2010Q3. In seasonally adjusted terms a \$35 surplus was registered, only the third quarterly current account surplus since 1987.
- Were it not for re-insurance inflows from the Canterbury earthquakes (which added at least \$1.7b to the transfers surplus), the current account position would have been much worse.
- Higher earnings on overseas investments and low domestic profitability also contributed to the second lowest quarterly seasonally adjusted invisibles deficit since the early 1990s recession.
- A decline in net international equity liabilities contributed to a small decline in our net overseas external debt. At \$162.5b (85.2 percent of GDP), however, it remains very high.
- We do not foresee a return to significantly larger deficits. With rating agencies closely watching the NZ situation, a return to larger deficits is likely to have adverse consequences. We expect external deficits in the 2 to 4 percent range over the next couple of years.
- There are limited monetary policy implications from today's release.

Current account deficit and bank lending



Sources: ANZ, National Bank, Statistics NZ, RBNZ

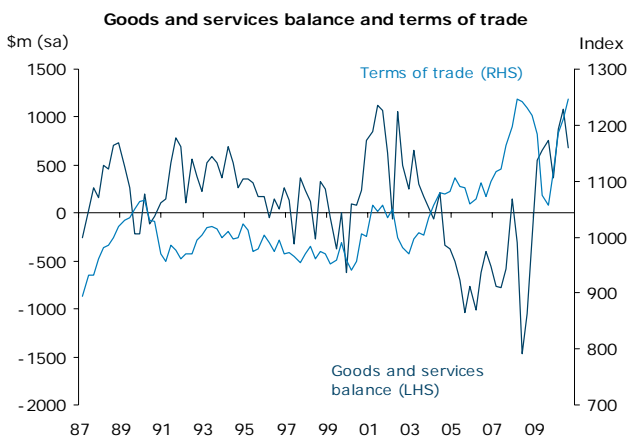
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ASSESSMENT

The current account deficit came in narrower than market expectations at -\$1.77b. In seasonally adjusted terms, a small \$35m surplus was registered, only the third quarterly surplus since 1987. For the year, the September deficit stands at 3.1 percent of GDP.

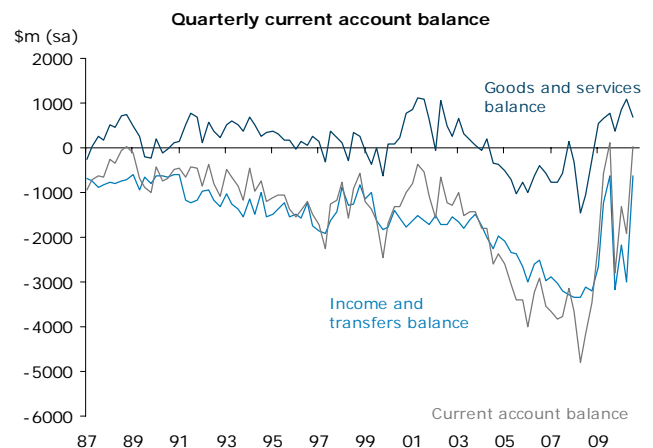
	Goods Balance (\$m) sa	Services Balance (\$m) sa	Invst. & Trsf. Balance (\$m) sa	Current Account Balance (\$m) sa	Current Account Balance (\$m) actual	Annual CAB as % of GDP
Mar-08	-334	23	-3,332	-3,643	-2,098	-7.9
Jun-08	-1,280	-183	-3,350	-4,813	-3,939	-8.3
Sep-08	-860	-190	-3,110	-4,160	-6,123	-8.6
Dec-08	83	-339	-3,197	-3,453	-4,074	-8.8
Mar-09	707	-151	-2,666	-2,110	-587	-8.0
Jun-09	667	-9	-1,217	-559	262	-5.7
Sep-09	667	93	-637	124	-1,547	-3.2
Dec-09	301	68	-3,160	-2,791	-3,332	-2.8
Mar-10	917	-46	-2,179	-1,308	159	-2.4
Jun-10	1,176	-92	-3,006	-1,922	-987	-3.0
Sep-10	835	-159	-641	35	-1,770	-3.1
ANZ	-	-	-	-	-1,510	-2.9
Market	-	-	-	-	-2,320	-3.4

Despite booming export commodity prices, a non-adjusted quarterly trade deficit of \$1.1b was registered. The September quarter is typically the low point for the trade balance, with the trade surplus a respectable \$676m in seasonally adjusted terms. Other Q3 trade data had suggested a fall in export volumes for Q3, with import volumes continuing to recover from cyclical lows. A negative net export position will contribute towards a weak Q3 GDP print tomorrow. Given where commodity prices are and the lags that are still to flow through into our merchandise trade data, we can expect our goods export numbers to bounce back in the December quarter, this should move the goods balance back into surplus. A downside risk to this will be if dry weather conditions have a more marked impact on agricultural production.



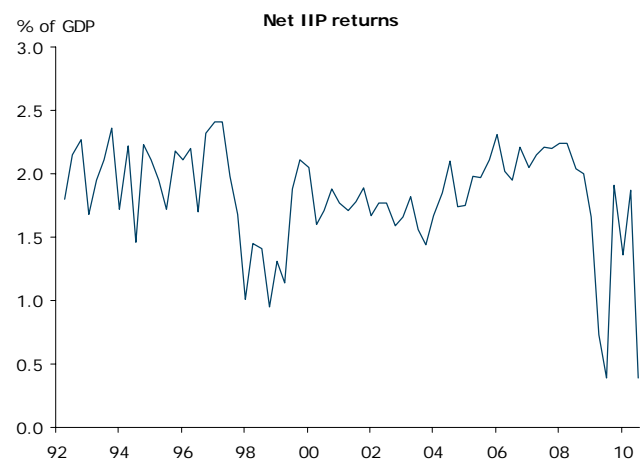
Sources: ANZ, National Bank, Statistics NZ

However, the Services balance remains in deficit. Increasing services imports was driven by broad-based increases in transport and travel services, with spending by NZ residents overseas and higher international freight costs particularly influential. Exports of services remained flat. While visitor arrivals continued to trend higher in the September quarter, the composition has changed, with less coming from the higher spending countries and more from Australia, who tend to have shorter stays and spend less per day. With the higher spending European and American tourist numbers unlikely to be growing, given challenges in their respective economies and the high NZD, the services trade balance is unlikely to see much of a material improvement in the near-term.



Sources: ANZ, National Bank, Statistics NZ

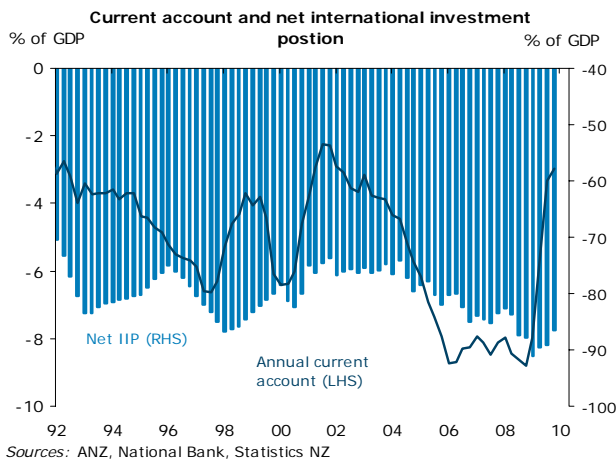
Favourable one-offs helped narrow the invisibles deficit. Re-insurance inflows from the Canterbury earthquakes boosted the 2010Q3 transfers surplus by \$1.7b. With the potential for more insurance inflows to arrive (which will increase the 2010Q3 transfers balance), the likelihood will be a revised improvement.



Sources: ANZ, National Bank, Statistics NZ

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The lower investment income deficit was also influential. 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. **The major influence, however, was a \$548m decline in investment income debits.** **Lower domestic corporate profitability was the major influence.** Earnings from foreign investors on their New Zealand investments fell \$538m in Q3, largely driven by a combined \$607m fall in income earned on foreign direct and portfolio investment in New Zealand companies. This is no doubt reflective of the tough domestic environment.



A decline in net international equity liabilities contributed to a small decline in our net overseas external debt. **However, at \$162.5b (85.2 percent of GDP), it remains very high.** We need to sort out our saving and investment imbalances, lest an adjustment is forced upon us. Improved household saving is a step in the right direction. The intent by the government to move fiscal settings to more sustainable levels will also help. With rating agencies now punishing countries that are not showing commitment to getting their houses in order, a concerted effort at rebuilding our national savings performance cannot come soon enough.

IMPLICATIONS

We expect the current account deficit to move higher from here, but one-offs and low domestic profitability will cap this deterioration in the near-term.

Moreover, we do not expect a return to large current account deficits over the next few years. In the present environment that would be a recipe for a credit rating downgrade. Instead, we see New Zealand's current account deficit remaining in a

2 to 4 percent of GDP range over the next couple of years.

There are limited monetary policy implications from today's release, with the deficit close to the RBNZ's December MPS projection. The RBNZ are cognisant that one-offs have continued to mask the extent of external imbalances within the economy, and will wish to see more progress is being made at rebalancing the economy. The upshot of improving household saving and the intention to tighten fiscal settings from 2011/12, will be that continued monetary policy support will be needed. We see the RBNZ on hold until at least June 2011 and quite possibly later.

The current account deficit was slightly larger than what we had expected (a deficit of \$1.5bn). However, implications for our pick for tomorrow's Q3 GDP release are limited.

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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.

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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.

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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.

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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.

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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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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.

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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.

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.

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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.

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