Economic Review

New Zealand

22 September 2009

Balance of Payments – June 2009 quarter

Key points

> **The current account deficit recorded a considerable improvement in the June quarter courtesy of sharply lower profits of foreign firms operating in NZ and a one-off tax provision.**

> **While encouraging, the improvement does not have a "quality" feel about it.**

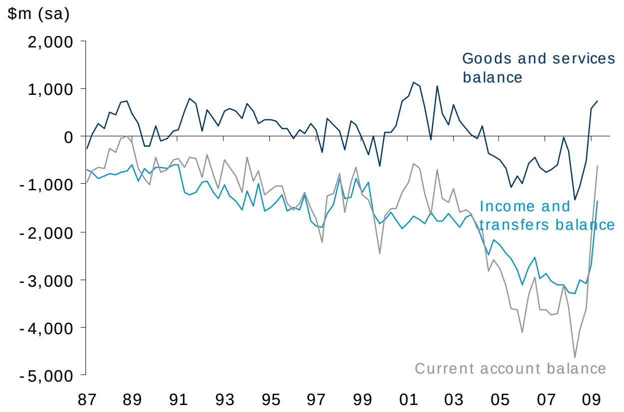
> **We continue to believe a lower currency is a critical (though obviously missing) ingredient if the economy is set to rebalance in a sustainable fashion.**

Assessment

The current account deficit improved sharply in the June quarter, and significantly more than expected. In seasonally adjusted terms, the current account deficit narrowed by $1,508 million to $612 million in the quarter – the smallest (seasonally adjusted) quarterly deficit since June 2001. In annual terms, the deficit now sits at 5.9 percent of GDP – the lowest level since September 2004. In addition, downward historical revisions to the income earned by foreign investors in NZ saw the March quarter current account deficit revised to 8.1 percent of GDP (from 8.5 percent previously).

Lower profits for foreign firms operating in NZ were the big driver of the improvement in the deficit in the June quarter. Foreigners earned $2,068 million on their investments in NZ in the June quarter – the lowest result since March 2001. A $1,094 million decrease in income earned by non-resident direct investors (read banks) was the main contributor to this. A one-off company tax provision by a large NZ bank of $661 million also had a big impact. On top of this, NZ's debt servicing costs (interest paid to foreign investors on debt) fell a combined $214 million, courtesy of falling interest rates during the quarter.

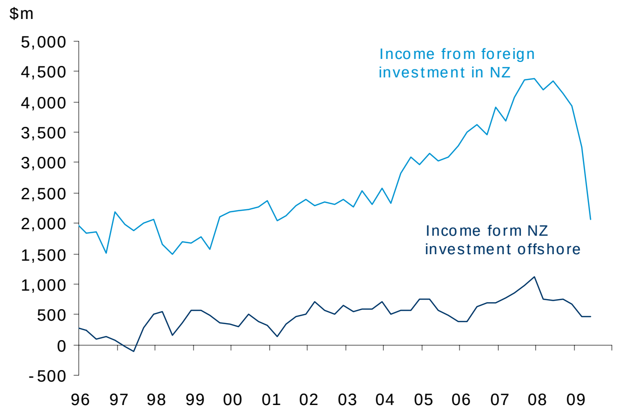
Quarterly current account balance



Sources: ANZ National, Statistics NZ

	Goods Balance $m	Services Balance $m	Invt. & Trsf. Balance $m	Current Account Balance $m	Annual CAB as % of GDP
Jun-07	12	-171	-3,004	-3,163	-8.2
Sep-07	-1,640	-658	-3,121	-5,420	-8.6
Dec-07	-445	80	-3,099	-3,464	-8.1
Mar-08	277	933	-3,291	-2,081	-7.9
Jun-08	-95	-473	-3,263	-3,830	-8.3
Sep-08	-2,063	-966	-3,033	-6,061	-8.6
Dec-08	-501	-403	-3,093	-3,996	-8.9
Mar-09	1,322	723	-2,727	-681	-8.1
Jun-09	**1,768**	**-332**	**-1,313**	**124**	**-5.9**
ANZ	**-**	**-**	**-**	***-783***	***-6.7***
Market	-	-	-	*-1,990*	*-7.4*

Investment income

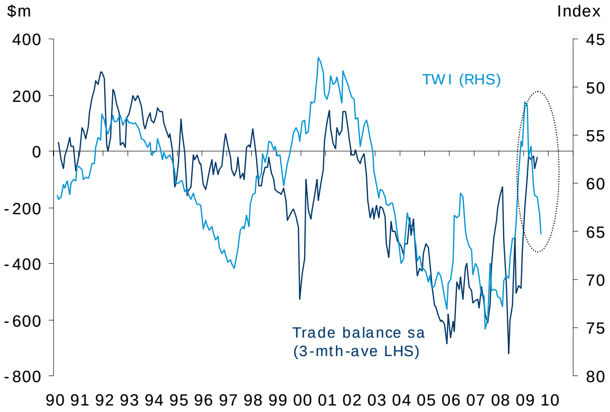


Sources: ANZ National, Statistics NZ

The improvement is obviously encouraging. However, the "quality" and sustainability needs to be questioned. The fact the current account recorded a considerable improvement needs to be acknowledged. The 2.2 percentage point narrowing in the annual deficit as a percent of GDP is the sharpest since at least 1966. Simple arithmetic courtesy of a low Q2 result is likely to see the annual current account deficit fall well below 5 percent of GDP over the coming quarters. However, looking at the main drivers – a capitulation in imports, low interest rates (lowering debt servicing costs) and lower profitability of foreign firms owing to some one-off tax treatment, all look to be cyclical in nature.

Some encouragement can still be taken from the improving trends in net export performance. On a seasonally adjusted basis the trade deficit has been improving for four successive quarters. Signs of improving dairy prices will support this further going forward. However, once again we would question the sustainability of the trade balance improvement given the rotation we are seeing in growth in favour of the domestic economy and strengthening currency. For the NZ economy to truly rebalance, the export and earnings sectors, rather than domestic economy, need to be the drivers of recovery.

NZ trade balance and TWI



Sources: ANZ National, Statistics NZ, Bloomberg

We see little in today's result to alter our expectations for Q2 GDP numbers tomorrow. At the margin, the services deficit was slightly smaller than we had factored in, although this was partly offset by a smaller goods surplus. There could be the interesting dynamic where expenditure GDP does not contract, or is even slightly positive. However, we remain comfortable with our expectation that production GDP (the preferred measure by Statistics NZ) contracted 0.3 percent in the quarter.

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- Associate Member of Investment Savings & Insurance Association of NZ;
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- Adjudicated bankrupt;
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- Subject of an adverse finding by a court in any proceeding that has been taken against them in their professional capacity;
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- Group investment funds;
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