

Balance of Payments – September 2008 quarter

Key points

- > **The annual current account deficit deteriorated in the September quarter.**
- > **Given falling world prices for NZ's major export commodities, prospects for a turnaround in the current account deficit still look some way off.**
- > **The large deficit necessitates an adjustment and given NZ's "twin deficits", we expect the current account position to be given more attention by the foreign exchange market in 2009.**

Assessment

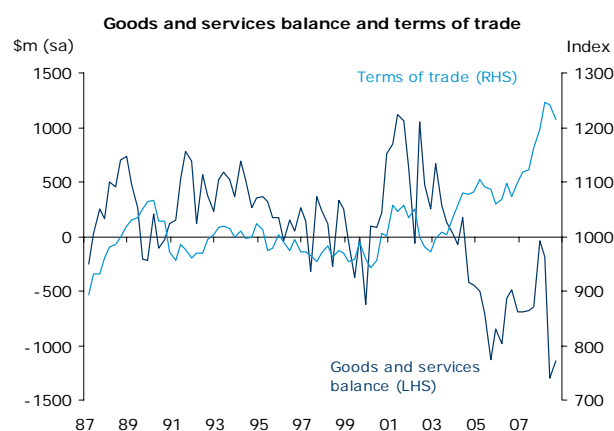
The annual current account deficit widened in the September quarter to 8.6 percent of GDP.

This was in line with market expectations. Nevertheless, this is the second consecutive quarter where the annual deficit has deteriorated, following a deficit of 8.4 percent of GDP in the June quarter and 8.0 percent in the March quarter. Given the credit-centric nature of the shock facing the global economy, NZ's current account cannot continue its current trajectory. An adjustment is imminent, either undertaken voluntarily or forced upon it externally. The deterioration in the annual balance was entirely due to a growing goods and services deficit, which rose (in annual terms) from \$2.0 billion to \$2.7 billion. The investment income balance improved slightly courtesy of a fall in profitability of foreign firms operating in NZ.

The seasonally adjusted deficit did improve slightly, but we expect this to unwind. In seasonally adjusted terms, the current account deficit improved from \$4,650 million to \$4,079 million. While at first glance this is encouraging, and was driven by a smaller seasonally adjusted trade deficit, a lot of this improvement can be put down to the lagged effect of high commodity prices. With New Zealand's main commodity prices falling, and not helped by a falloff in external demand for NZ's exports given the deteriorating global environment, it is reliant on a sharp falloff in import volumes to drive any improvement in the trade balance. In the near-term, we see the current account deficit deteriorating further, approaching 9 percent of GDP before any improvement is seen.

There are limited GDP implications from today's data. Today's data suggests export volumes were a lot weaker than we had expected, not only on the goods side but for services as well. However, this was offset by a larger decline in import volumes. On balance, we remain comfortable sticking with our forecast of a 0.5 percent contraction in Q3 GDP.

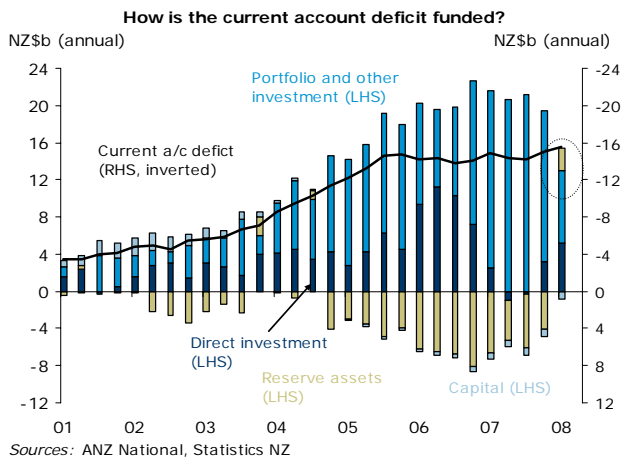
	Goods Balance \$m	Services Balance \$m	Invnt. & Trsf. Balance \$m	Current Account Balance \$m	Annual CAB as % of GDP
Sep-06	-1,435	-658	-2,578	-4,671	-8.9
Dec-06	-1,221	239	-3,019	-4,001	-8.8
Mar-07	-342	1,032	-2,960	-2,270	-8.3
Jun-07	21	-192	-2,983	-3,154	-8.4
Sep-07	-1,631	-649	-3,187	-5,467	-8.7
Dec-07	-428	97	-3,150	-3,481	-8.2
Mar-08	294	932	-3,335	-2,109	-8.0
Jun-08	-79	-518	-3,328	-3,925	-8.4
Sep-08	-2,049	-982	-2,963	-5,994	-8.6
ANZ National	-	-	-	-6,273	-8.7
<i>Market</i>	-	-	-	-6,010	-8.6



Sources: ANZ National, Statistics NZ

Probably the most interesting aspect in today's release was how the current account deficit was funded in the quarter. For the second consecutive quarter, the deficit was not funded via more borrowing (which has been a theme over recent years). Instead it was primarily through the selling of New Zealand's assets abroad, with a rundown of Reserve assets (particularly foreign exchange reserves) the big factor in the September quarter. New Zealand's Reserve assets were reduced to the tune of \$5.5 billion, primarily through a \$7.5 billion reduction in foreign exchange reserves. In the June quarter, the bulk of the current account deficit was funded via sales of "other investment" of around \$6.3 billion. These means of funding the current account deficit can

obviously not continue for too long, and highlights the vulnerability the New Zealand economy faces heading into 2009.



The large current account deficit necessitates a rebalancing process. Years of imbalanced growth have resulted in a ballooning current account deficit, which by definition means we are spending much more than we save as a nation. The cumulated current account deficits have led to a large net external liability position, which rose to close to 92 percent of GDP in the September quarter. Running large current account deficits was not an issue in an environment where credit was cheap and abundant, as was the case over the first

part of this decade. However, the current global environment is no longer as tolerant towards economies with large external imbalances. With credit much more expensive and difficult to come by, this leaves the economy in a more vulnerable position, and suggests that the net external liability position may not just have to stabilise (something that hasn't happened yet), but will in fact have to reduce. This will require a period of much lower current account deficits in future – an adjustment which will shape the economic outlook over 2009. Typically, a current account adjustment has two distinct dynamics. First, the domestic economy will go through a period of weak activity. Second, the currency depreciates. Both of these dynamics have already begun, but considering the large starting position for the external balance, and the worst credit shock in 80 years, there is still some way to go yet.

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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.

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.

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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.

The insurer is ANZcover Insurance Pty Limited.

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- 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.

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- 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.

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

- Providing cash;
- 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

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