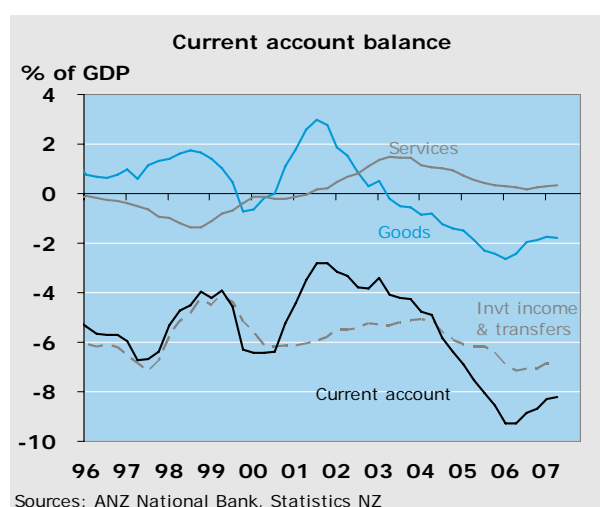


BALANCE OF PAYMENTS – JUNE 2007 QUARTER

Key points

- Current account deficit came in better than market expectations (though in line with ours).
- Both the quarterly trend and seasonally adjusted current account deficits also recorded improvements, helped by a smaller goods and services deficit.
- We expect further improvements in the quarters ahead as the higher commodity prices take effect and import growth slows in line with softening domestic demand.
- Investment income balance will continue to weigh due to higher interest rates and increasing levels of overseas debt.

	Goods Balance \$m	Services Balance \$m	Invt. & Trsf. Balance \$m	CAB \$m	Annual CAB as % of GDP
Jun-05	-142	-188	-2430	-2760	-7.52
Sep-05	-2100	-496	-2583	-5179	-8.04
Dec-05	-1306	163	-2739	-3882	-8.56
Mar-06	-557	967	-3096	-2686	-9.29
Jun-06	169	-207	-2802	-2840	-9.28
Sep-06	-1436	-625	-2562	-4623	-8.84
Dec-06	-1222	281	-2915	-3856	-8.69
Mar-07	-342	1052	-2916	-2206	-8.28
Jun-07	26	-120	-2821	-2915	-8.20
ANZ	-	-	-	-2,825	-8.2
<i>Market</i>	-	-	-	-3,250	-8.5



- **The annual current account deficit improved to an estimated 8.2 percent of GDP in the June 2007 quarter from a revised 8.3 percent in the previous quarter.** The improvement in the current account deficit is a result of an increase in the annual services balance, along with a reduction in the annual invisibles balance as a percentage of GDP. This was offset to a degree by a small deterioration in the annual goods balance. On a quarterly basis, the investment income deficit widened by \$120 million in the June quarter. This was a result of a larger increase in income accruing to foreign investment in New Zealand (\$259 million) than the increase in income earned from New Zealand investment abroad (\$139 million).
- **The quarterly seasonally adjusted and trend deficits also showed some improvement.** The seasonally adjusted current account deficit was \$3,415 million in the June quarter, an improvement of \$162 million from the deficit recorded in the March quarter. A reduction in the seasonally adjusted goods and services deficit, along with higher net inflows of current transfers drove the improvement in the seasonally adjusted current account deficit. Partly offsetting this was the larger deficit on investment income (discussed above). We had expected a small deterioration in the seasonally adjusted current account deficit. It appears stronger export values and the improved transfers balance were the reasons behind the unexpected increase.
- **New Zealand's net international liabilities rose by \$5.5 billion in the quarter to \$149 billion.** As a percent of GDP, we estimate this has deteriorated from 87.6 percent in the March quarter, to 89.8 percent in the June quarter. New Zealand's sizeable and growing external liabilities represent the continual running of large current account deficits. Debt makes up the clear majority of New Zealand's net international liabilities (\$129.1 billion or 86.9 percent of the total).

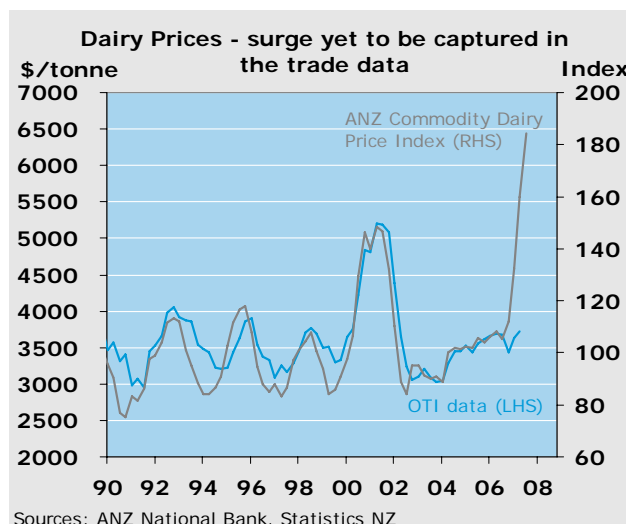
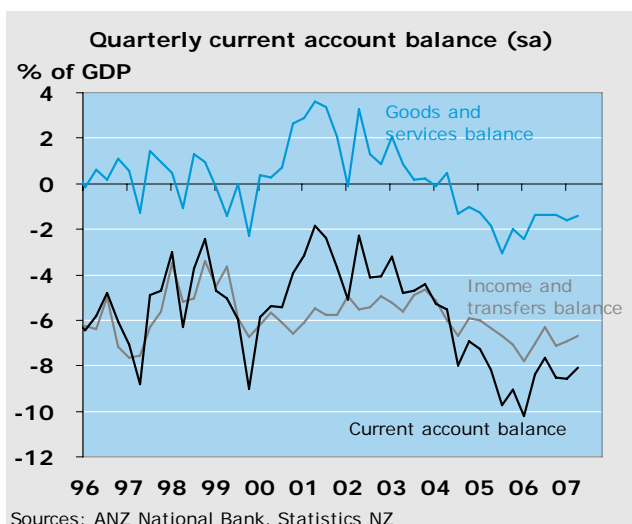
Assessment

The continued improvement in the current account deficit since hitting a peak in March 2006 is encouraging. More so considering the NZD was still rising over the June quarter and we are yet to see the full impact of the recent surge in commodity prices. Granted, some of the better than expected headline number was due to historical revisions (the March 2007 current account deficit was revised from 8.5 percent of GDP to 8.3 percent). But the improving trend since early last year remains. It is also heartening to see that the goods and services balance also managed to show an improvement in both the quarterly seasonally adjusted and trend measures. The monthly trend merchandise trade data had been gradually deteriorating in recent months, but services exports managed to perform despite a high NZD. Not only are tourist numbers still growing, but they are also increasing their expenditure while in New Zealand.

We expect the current account to show further improvements in the quarters ahead once the higher commodity prices are captured in the trade statistics. Recent increases in commodity prices, especially dairy, will start to feed through into the September and December quarter trade numbers. This will continue to improve the goods balance and lead to further declines in the current account deficit. With evidence that domestic demand is waning, this should translate into slower import growth as well. We expect a deficit closer to 7½ percent of GDP by the end of this year.

Investment income deficit remains high and will be slow to improve. At 7.1 percent of GDP, the investment income balance will continue to be the main drag on the current account. Higher interest rates, increased overseas debt and the global re-pricing of risk – which is driving up risk premiums – mean New Zealand will need to pay more to continue borrowing from offshore. And despite an improvement in the current account deficit, New Zealand's net international investment position continues to deteriorate, and is currently close to -90 percent of GDP. With a growing proportion of New Zealand's external liabilities held in the form of debt, the net investment income deficit is becoming unhinged from the corporate profitability cycle. This suggests the investment income deficit will remain elevated even if there is a slowdown in the domestic economy.

There are limited implications for the Reserve Bank from today's data, though they will be heartened by the better than expected outturn (they were forecasting a deficit of 8.5 percent of GDP). While a step in the right direction, the Reserve Bank will want to see further rebalancing of the economy going forward. For credit rating agencies, the ongoing trend improvement in the current account is comforting, but the high level of New Zealand's net external position will continue to concern them. **The better than expected net exports data contained in today's Balance of Payments release suggests a slight upside risk to our view for next week's Q2 GDP, which we expect to print at 0.5 percent.**



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ANZ Bank, Level 7, 1 Victoria Street, Wellington 6011, New Zealand Phone 64-4-802 2000 Fax 64-4-802 2024
<http://www.anz.com/nz> e-mail ecnmcs@anz.com