

NEW ZEALAND ECONOMICS DATA REVIEW

Balance of Payments – June 2011 quarter

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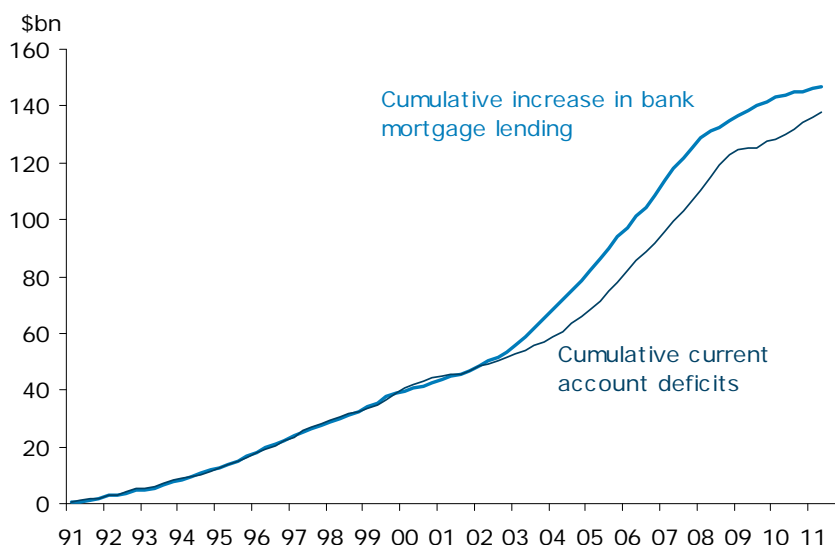
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HELPFUL REVISIONS RESULT IN IMPROVEMENT IN NZ'S EXTERNAL POSITION

KEY POINTS

- Improvements to the way Statistics NZ compile the Balance of Payments has resulted in revisions to the current account balance and the net international investment position. The end result is that the current account deficit is now lower by \$1.1bn and the net international investment position has improved by \$12.2bn. The annual current account deficit stands at 3.7 percent of GDP, with the net international liability position at 70 percent of GDP.
- Other than the revisions, there were no major surprises in the data. High commodity prices are helping things on the goods balance side, while reduced demand for tourism (impacted by recent natural disasters and slowing global growth, alongside a high exchange rate) is weighing on the services balance. An improving economy has also seen increased profits earned by overseas investors, resulting in a larger investment income deficit.
- While the improvements to the Balance of Payments are welcome, NZ's external vulnerability has not been revised away. But it does provide a bit more breathing space, and at the margin should be welcomed by credit rating agencies. However, the economy still needs to rebalance and this will take some time. The lower starting point for the current account deficit will help though.

Current account deficit and bank lending



Sources: ANZ, National Bank, Statistics NZ

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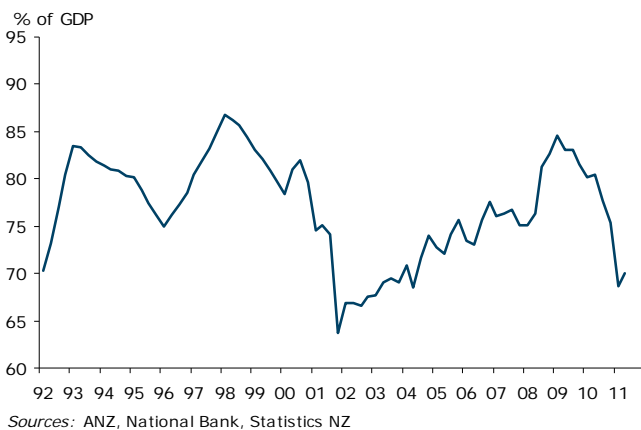
ASSESSMENT

The quarterly current account deficit of \$921m for the June quarter was slightly worse than market expectations, but was in line with our pick. In seasonally adjusted terms a deficit of \$2.0b was recorded. For the June 2011 year, the deficit stands at 3.7 percent of GDP, as compared to the downwardly revised 3.6 percent of GDP in the March 2011 year.

	Goods balance (\$m)	Services balance (\$m)	Invst. & Trsf. Balance (\$m)	Current Account Balance (\$m)	Annual CAB as % of GDP	Net IIP (% GDP)
Mar-09	1,272	847	-2,664	-545	-8.0	-84.6
Jun-09	1,749	-226	-1,056	467	-5.6	-83.0
Sep-09	-355	-487	-554	-1,397	-3.0	-83.0
Dec-09	-250	153	-3,059	-3,156	-2.5	-81.6
Mar-10	1,478	915	-1,894	499	-1.9	-80.2
Jun-10	2,359	-268	-2,734	-644	-2.5	-80.5
Sep-10	-346	-799	-2,175	-3,320	-3.5	-77.7
Dec-10	-145	-263	-2,914	-3,322	-3.5	-75.4
Mar-11	1,563	768	-2,240	91	-3.6	-68.7
Jun-11	2,407	-630	-2,698	-921	-3.7	-70.0
ANZ				-950	-4.1	
Market	-	-	-	-670	-4.0	

As has been the case for the past few quarters, statistical revisions had a substantial impact on the figures. This time around the direction of the revisions was favourable. Downward historical revisions lowered the current account deficit by \$1.1bn over the past year. As announced previously, Statistics New Zealand have managed to find more reliable data on assets held offshore by New Zealand firms and households. This was the major factor contributing factor to the \$12.2bn downward revision to our net international investment position (IIP). At 70 percent of GDP, this remains too high for comfort, but the lower starting position provides us with more room for manoeuvre.

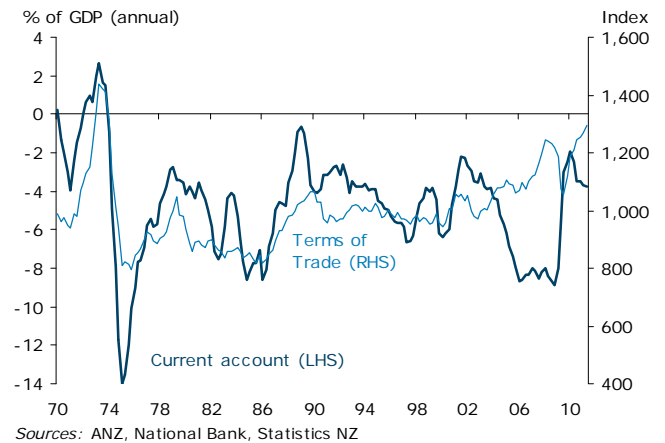
Net international investment position



A slightly higher seasonally adjusted goods balance was recorded in Q2. Having the goods terms of trade at a 37-year high helped. High commodity prices are helping on the goods export

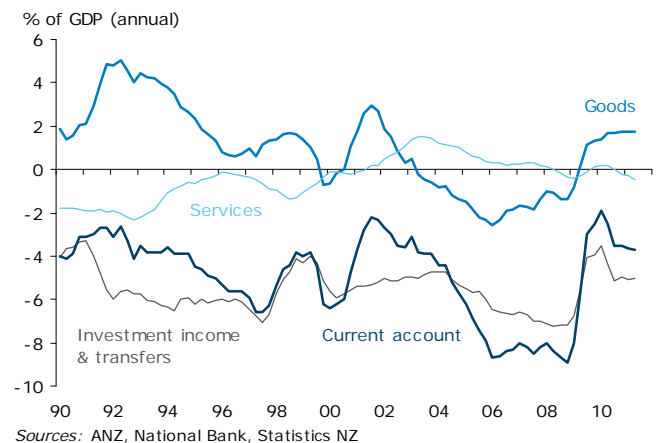
side, but it is pleasing to see that non-food manufacturing exports also rose strongly in the quarter, despite the high NZD. On the goods import side, a higher fuel import bill (mainly from higher prices) was a feature. Despite the strong NZD, we expect goods surpluses to remain until the end of the year.

Current account balance and the terms of trade



One area where the high NZD had more of an impact was in the services balance, with the annual services deficit widening further in the June year. Exports of services (a large component of which includes the proceeds from inbound tourism) appears to have borne the brunt of global weakness, with fewer visitors to New Zealand in the June quarter. NZD strength and natural disasters (both locally and abroad) were also influential. While we expect a services surplus in Q3 and Q4 on account of the 95,000 overseas visitors expected to attend the Rugby World Cup, the outlook beyond that is less upbeat.

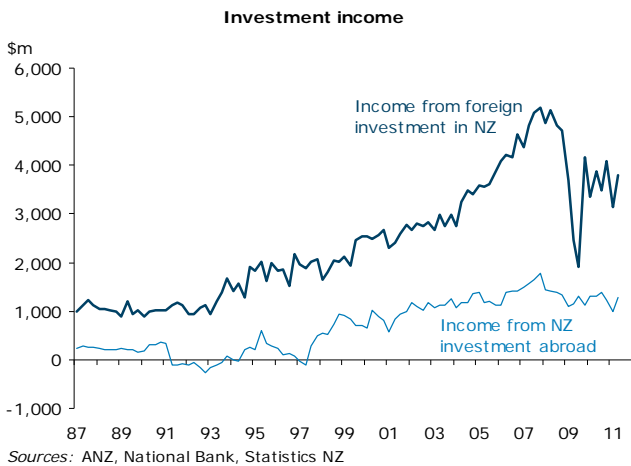
Current account balance



Largely as a legacy of our high indebtedness another large investment income deficit was recorded. Investment income from foreign

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investment increased to \$3.79bn, with the rise from Q1 driven by an increase in equity investment in New Zealand. Part of this turnaround was attributable to foreign owned insurance companies beginning to recover losses from previous quarters. Domestic profitability appeared to remain healthy, with dividends paid out to foreign investors their largest since the June 2009 quarter.



In the June quarter Statistics New Zealand expanded their regular reinsurance survey, asking respondents to provide estimates of total claims, claims settled, and outstanding claims for each of the three major Canterbury earthquakes. Updated estimates of the Canterbury earthquake reinsurance show that at the **at the end of June 2011 the estimate of total claims resulting from the Canterbury earthquakes was \$12bn**. September 2010 quarter claims are now estimated at \$3,297m, with claims for the February 22 event estimated at \$8,541m. Claims from the June earthquake were estimated at \$680m, but this looks set to rise. Reinsurance claims are treated as capital account items, and were the main cause of the capital account being in surplus in the September 2010, March 2011 and June 2011 quarters. These changes also follow through to the financial account and the international investment position. The impact on the current account balance is not as significant, with the impact of the June quarter increase in insurance premiums, boosting imports of services in Q2.

IMPLICATIONS

With the current account deficit at 3.7 percent and net international liability position at 70 percent of GDP, the starting point for NZ's external position is in better shape than seemed the case three months ago. It provides a bit more breathing space, and at the margin

should be welcomed by credit rating agencies. While these changes are helpful, NZ's external vulnerability has not been revised away. The economy still needs to rebalance and this will take some time.

The key focus for the market remains the trajectory of the deficit. We expect that the current account deficit will remain at around the 4 percent of GDP mark throughout the remainder of the year before approaching 5 percent of GDP by the end of 2012. 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 external deficits is not yet in prospect. **The game has changed**, and we expect the ongoing focus on deleveraging and balance sheet repair by households and government to cap the increase in the deficit. 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 are limited. Statistical changes have improved the starting point, but our external debt levels remain high.

Today's Q2 current account numbers provide some insights into tomorrow's Q2 GDP release. Largely on account of the weaker than expected services balance, net exports looks set to make a more negative contribution to GDP than what we estimated. As such, there is a margin of downside risk around our +0.7 percent pick for GDP.

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