

On better terms

Q1 Terms of trade review 2013

- After six consecutive falls, New Zealand's terms of trade sprung back to life in Q1, surging 4.1%.
- The Q1 data shared its headlines evenly between the early stages of the dairy price spike and the strong New Zealand dollar.
- Export volumes held up this quarter. The drought will be more evident next quarter.
- Import volumes are running at a brisk pace as the Kiwi dollar is going a long way for both households and firms.
- We expect the terms of trade to push on towards record highs by the end of 2013.

After six consecutive falls, the terms of Trade perked up in the March quarter, rising 4.1%. And this is just the start. Before we get too excited, however, drought is playing a role here and export price rises will be offset by falling volumes, at least temporarily. But there is another important story here and that is the high NZD and low global inflation combo, which New Zealand households and firms continue to take advantage of.

New Zealand households are cashing in the extra spending power that the high currency affords. Import prices fell 2.1% this quarter or 4.4% in annual terms. Understandably, import volumes are headed in the opposite direction, rising 2.1% in the quarter. Car registrations, of which most are imports, are now at their highest level in 5 years. Add in increasing job security and rising consumer confidence this year and the consumer is poised for a perky 2013.

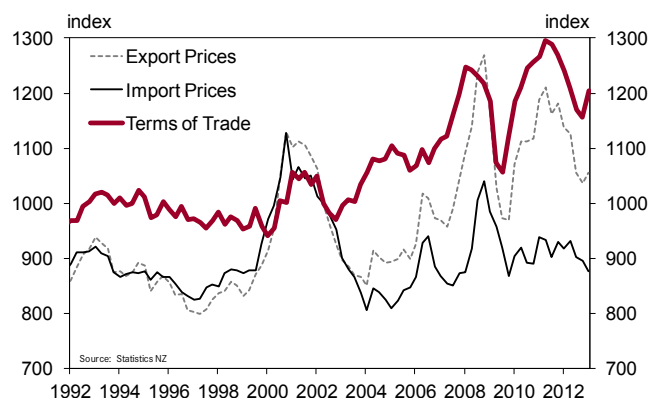
Overseas Trade Indexes (qtr % chge)

	2012Q2	2012Q3	2012Q4	2013Q1
Terms of Trade	-2.6%	-3.2%	-1.2%	4.1%
Export Prices	-1.0%	-6.3%	-1.9%	1.9%
Import Prices	1.6%	-3.2%	-0.7%	-2.1%
Export Volumes (s.a.)	-0.5%	10.0%	-1.1%	0.9%
Import Volumes (s.a.)	-1.7%	0.6%	-1.7%	2.1%

There are also signs that firms are investing more, perhaps on the back of the Canterbury rebuild activity as well as the high currency. Capital goods imports, excluding transport equipment, recorded their second consecutive rise in excess of 5%.

The first stage of the drought was evident this quarter in higher meat exports, reflecting drought-induced slaughtering. We expect production to fall sharply next quarter as farmers begin to rebuild their flocks and herds, thus reducing slaughtering and with it meat exports. Lower dairy production will also become more prominent.

Export and Import Prices



As we have noted previously, the surge in dairy prices is offsetting to lower production (and export) volumes. This quarter dairy prices rose nearly 7%. There's a lot more to come, with larger increases expected over the next couple of quarters

More recently it has become evident that world dairy prices may not fall back as far as previously expected. World dairy supply is tight in most key producers and demand remains strong.

Overall, this report confirms we are on track for the terms of trade to push back towards record highs by the end of 2013. In fact, with ongoing low global inflation and a tight world dairy market keeping dairy export prices high for longer, there may be a tad more momentum in the terms of trade than we thought previously.

Market implications

The 4.1% increase in the terms of trade exceeded both our and the market expectations. The market reacted to the release by pushing the NZD 10 pips higher against the AUD. However, the currency had traced back to its re-release level within the hour as the report detail revealed little in the way of big surprises.

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