1 March 2013

Westpac Institutional Bank

The only way is up

Q4 Terms of Trade

- **New Zealand's terms of trade clocked up its sixth consecutive fall in Q4, decreasing 1.3%.**
- **The Q3 data reflected the last remnants of weak export commodity prices from the first half of last year, with dairy prices (down 3%) headlining the fall. Similarly, the fall in import prices reflected the weak world economy and the strong performance of the NZD.**
- **With export volumes falling by less than we expected, there are upside risks to Q4 GDP.**
- **More timely export commodity price data turned higher mid-2012, suggesting that the terms of trade will improve over the first half of 2013.**

Overseas Trade Indexes (qtr % chge)

	2012Q1	2012Q2	2012Q3	2012Q4
Terms of Trade	-2.3%	-2.6%	-3.2%	-1.3%
Export Prices	-3.7%	-1.0%	-6.3%	-1.9%
Import Prices	-1.5%	1.6%	-3.2%	-0.6%
Export Volumes (s.a.)	-0.4%	-0.7%	9.9%	-0.5%
Import Volumes (s.a.)	5.2%	-3.1%	0.8%	-2.2%

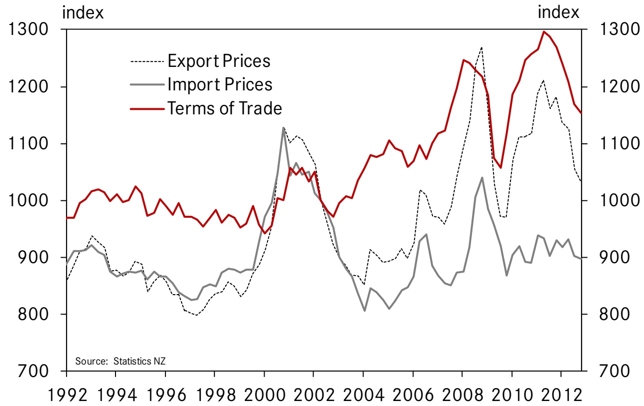
The weakness in the terms of trade data surprised the market, but our own forecast was close to the money. True, dairy auction prices had risen off their May 2012 low by 28% at the end of December. But terms of trade data reflect the prices received by exporters at shipment rather than at auction, between which there is a roughly 3-month delay.

What this all means is that the surge in dairy auction prices over 2012 will show up as a strong rise in the terms of trade over 2013.

That said, it is not all roses for New Zealand's export sector. Export volumes have been strong recently – in Q4 they gave up only a fraction of the nearly 10% gain registered in Q3. But we expect volumes to decline over 2013, as a consequence of current dry weather.

On the imports side, prices and volumes are progressing more uniformly. Import prices reflect the weak global picture from the end of 2012 and the ongoing strength of the Kiwi dollar. Textiles and clothing (down 4.9%) headlined the Q4 fall while the New Zealand dollar rose 1.3% on a trade-weighted basis over the quarter.

Export and Import Prices



Imports of capital goods surged over 8% in the quarter. We have been anticipating an increase in this category on the back of the increasing Canterbury rebuild activity for some time. We expect further increases in import volumes over the year ahead as rebuild activity ramps up. We're going to need a lot of hammers.

Market Implications

Today's terms of trade data were below the market and RBNZ's expectations. The currency fell 15bps immediately following the release. However, with that surprise largely due to timing we don't expect that will put the Reserve Bank off their stride.

The data also imply some upside risk for Q4 GDP. We have 0.8% pencilled in at this stage; the RBNZ has 0.4%. However, this year we expect the impact from drought to weigh on export volumes and business confidence.

That said, there are some prodigious offsetting positives in the Canterbury rebuild and the heating housing market. As a result, we still expect the New Zealand dollar to remain strong and the Reserve Bank to leave the OCR unchanged until December this year. The result will be an imbalanced economy favouring domestic demand at the expense of the export sector and import competing sectors.

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