

Brief detour

NZ Terms of Trade, March quarter 2015

- The terms of trade rose by 1.5% in the March quarter, similar to market forecasts.
- Cheaper imported oil outweighed the fall in export commodity prices over the quarter. This will likely prove to be a temporary detour.
- New Zealand's terms of trade remains in a cyclical downturn. Even so, it is on track to settle at a high level relative even to recent history.

New Zealand's terms of trade, the ratio of export prices to import prices, rose by 1.5% in the March quarter. The result was broadly in line with the market's forecast (and our own) of a 1.7% rise, and the New Zealand dollar was unmoved after the release.

The terms of trade are currently in a cyclical decline. Having reached a four-decade high in the first half of last year, the terms of trade fell by nearly 7% over the second half of the year as world dairy prices plunged. While the fall in export prices continued into this year, the March quarter figures were dominated by a steep drop in the price of imported fuel.

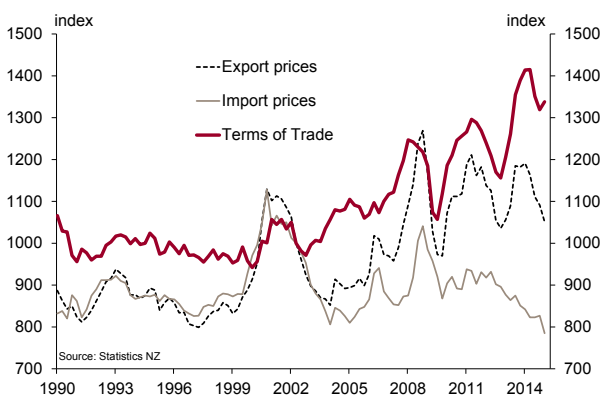
This bounce in the terms of trade is likely to prove temporary. Global oil prices have subsequently regained some of their lost ground, whereas export prices – particularly dairy – have come under renewed downward pressure in the last few months. We expect the terms of trade's cyclical decline to resume next quarter, reaching its low point later in the year.

This cyclical downturn shouldn't detract from the fact that New Zealand's terms of trade remain at very high levels relative to history. Indeed, our forecasts suggest that the trough in this cycle is still likely to be higher than the previous peak seen in 2011. That's quite a contrast with Australia for example, whose terms of trade have been in a steady decline since 2011, down to levels last seen during the Global Financial Crisis. The emergence of the Chinese consumer has had a profound impact on New Zealand's export performance in the last decade, and this effect looks likely to persist.

Turning to the details, the rise in the terms of trade consisted of a 3.7% fall in export prices, more than offset by a 5.1% fall in import prices. The latter figure was dominated by a 29% fall in the price of petroleum products, which account for about 15% of New Zealand's imports. World oil prices have subsequently reclaimed some of the losses they incurred over late 2014 and early 2015, and the decline in the New Zealand dollar has further added to the price of imported fuel.

	Jun-14	Sep-14	Dec-14	Mar-15
Terms of Trade	0.1%	-4.5%	-2.3%	1.5%
Export prices	-2.2%	-4.6%	-1.8%	-3.7%
Import prices	-2.3%	0.0%	0.5%	-5.1%
Export volumes	-3.8%	1.5%	1.9%	1.4%
Import volumes	3.0%	2.4%	1.2%	0.1%

New Zealand's terms of trade



On that matter, it's worth noting that other import prices weren't quite as benign as the headline figure suggests. Prices of non-food manufactures rose 0.4%, the second quarterly increase in a row, following a steady string of declines in the last few years. With the NZD in decline its disinflationary effects are now waning, though it remains to be seen when and how much of this will flow through into consumer prices.

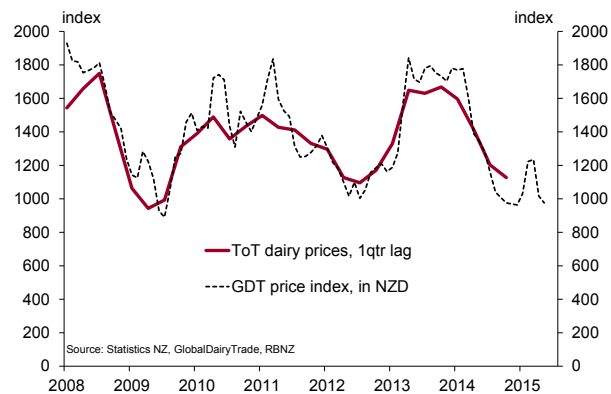
In contrast, the downturn in export prices was fairly widespread. Dairy export prices fell by 6.3%, a less drastic pace compared to the double-digit declines in the two previous quarters. A temporary drought-related spike in world dairy prices early this year would have helped to some degree, and given the typical three-month lag between world prices and the terms of trade, some of this will be captured in the June quarter as well.

There was also a fall in export prices for meat (down 4.5%, albeit reversing only a small part of last year's surge in beef prices), wool and manufactured goods. Prices of wood exports rose by 1.4%, but this is likely to be short-lived as global log prices have turned sharply lower again in the last few months.

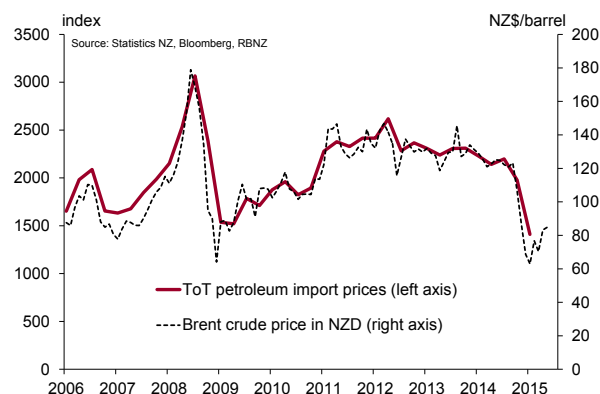
The terms of trade also provides some detail about trade volumes for the quarter. Import volumes were about flat, while export volumes grew by 1.4%. The latter figure appears to include the re-export of an oil drilling platform that was imported in 2008; it's not clear whether this will be included in the national accounts when they're published later this month. But it looks likely that net exports made at least a small positive contribution to GDP growth over the quarter.

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Dairy export prices



Oil import prices



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