Records are meant to be broken

- **The Terms of Trade have hit their highest level since June 1973.**
- **With the 5.1% jump over the quarter beating expectations.**
- **We expect the Terms of Trade to set a record high sometime this year.**

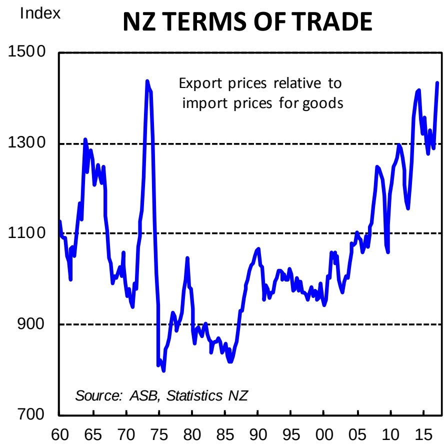
Summary

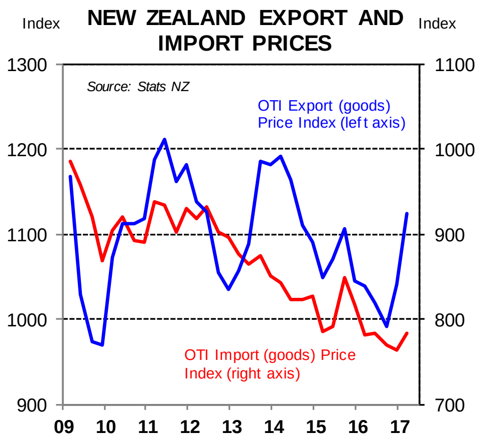
The NZ Terms of Trade (TOT) paint a very healthy picture. Cyclically, the TOT have turned the corner following the dramatic turnaround in dairy prices back in the spring of 2016.

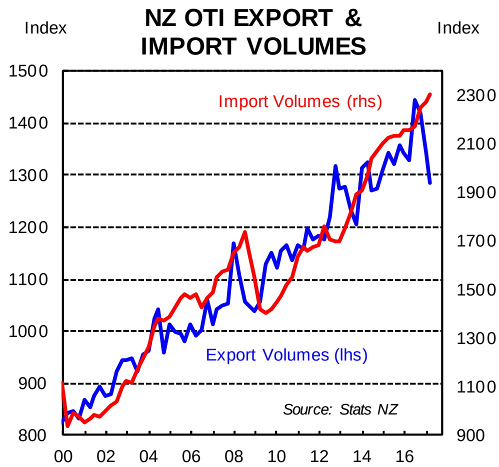
More subtly though, **two other factors are underpinning NZ ToT**. In previous TOT reports, we have highlighted the sustained weakness in global inflation and its flow-through to falling import prices. Indeed, import prices remain relatively subdued, although these latest data do hint at a modest cyclical lift in global inflation on the back of a similarly modest lift in global growth.

The other factor in play is the broad and structural lift in non-dairy agricultural export prices. The sectors doing well include horticulture, viticulture as well as forestry and meat (particularly beef). These sectors are now benefitting from the structural lift in demand from emerging markets (read China et al) in the same way dairy benefitted in years earlier.

All up, these factors point to a sustained lift in NZ's ToT. Moreover, **we expect the June 1973 record high will not last the year.** Indeed, records are meant to be broken.







Comment

The Terms of Trade (ToT) jumped 5.1% over the March quarter, beating our and market expectations. As expected the earlier dairy export price surge accounted for much of the ToT jump. **Over the quarter, dairy export prices spiked 18.0%.**

Moreover, **the export price strength was broad-based**. Forestry prices, for example, jumped 10.7%, while meat prices also lifted 2.6%. In addition, food and beverages prices surged 8.8%.

From here, **we expect the TOT to set a record high this year**. The ToT sit just 0.3% below the record high set back in June 1973. And with export prices still very healthy over recent months, we expect it is only a matter time before a new record is set.

Meanwhile, **rising oil prices drove overall import prices up by 2.7% over the quarter**. Specifically, petroleum and petroleum product prices surged 11.1% over the quarter. However, over recent months oil prices have moderated, which should flow through to flatter import prices over the June quarter.

Turning to export volumes, **these were very weak for a second successive quarter**. Overall volumes fell 4.2%, driven lower by an 11.2% fall in dairy volumes. However, this fall overstates the weakness in dairy production; we expect that this season's production will end around 1% lower than the season prior. **As a result, dairy export volumes will recover over coming quarters.**

On the import volumes side, volume growth was a robust 6.2% and followed on from a 1.4% lift in Q4. The strong import volume growth is in line with similarly robust indicators of domestic demand. As a result, **we expect robust import volume growth to continue over 2017.**

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Important disclosures