Economic Note

Q2 Terms of Trade

3 September 2018

Elevated Terms of Trade a major NZ support

- Modest rebound of the Terms of Trade, which are just 1.4% shy of record highs.
- The trade volume split suggests a mildly positive net trade contribution for Q2 GDP. Capital goods imports volumes have remained resilient thus far despite weakening business sentiment.
- We expect the Terms of Trade to remain at historically-high levels, supporting the NZ economy and NZD.

Key Stats (qoq)	Actual	ASB	Market
Terms of Trade	0.6%	1.0%	1.0%
Export prices	2.4%	3.1%	-
Import prices	1.7%	2.1%	-
Export volumes (sa)	1.1%		
Import volumes (sa)	0.9%		

Summary & implications

Today's Terms of Trade data provided a reminder that while negative sentiment has been hogging the headlines, there remain some structural supports to the NZ economic outlook. Today's rise in the Terms of Trade was marginally lower than expected, but the key takeout is that they remain more than one-third above historical averages. We expect the Terms of Trade to remain close to historical peaks over the remainder of 2018. Today's data also pointed to some pipeline pressure on prices. Strong Q2 rises were evident for petroleum and petrol products, which have risen more than 30% in NZD terms over the last 12 months. Higher import prices significantly weigh on the purchasing power of firms and consumers and there remains a risk that they filter through into broader rises in consumer prices. The trade split from today's data is supportive of our Q2 GDP pick (+0.9% qoq) and suggests some upside risk to the RBNZ +0.5% qoq pick. The focus, however, remains on the outlook for GDP in Q3 and beyond, and whether the softness in consumer and business sentiment will result in slowing GDP growth, at which stage an OCR cut will come into RBNZ deliberations. While we acknowledge the clear downward risk profile to the NZ economic outlook, the economy still looks reasonable and it is questionable how much additional support a lower OCR could provide in the current juncture.

Details

The goods Terms of Trade (ToT) rose 0.6% over the June quarter (+1.4% yoy), broadly in line with expectations and our +1% qoq pick. The goods Terms of Trade are just 1.4% shy of late 2017 peaks, and some 36% above historical averages.

Export prices rose 2.4% qoq (+ 2.4% yoy), led by rebounding dairy export prices (up 3.2% qoq). The lower NZD helped lift export prices for other food and beverages, including meat (+3.6% qoq) and seafood (+3.2% qoq).

Mark Smith – Senior Economist (649) 301-5657 mark.smith4@asb.co.nz
Nick Tuffley – Chief Economist (649) 301 5659 nick.tuffley@asb.co.nz

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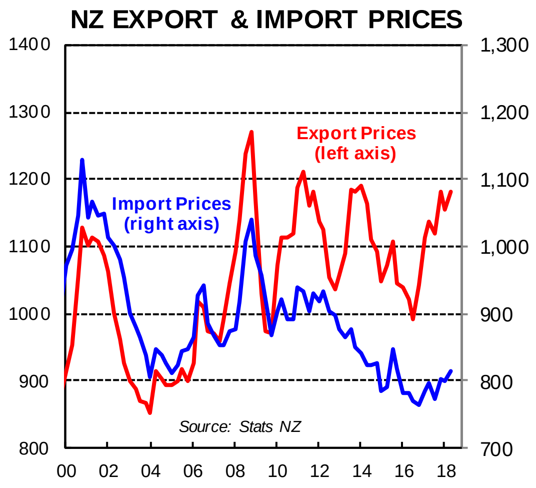
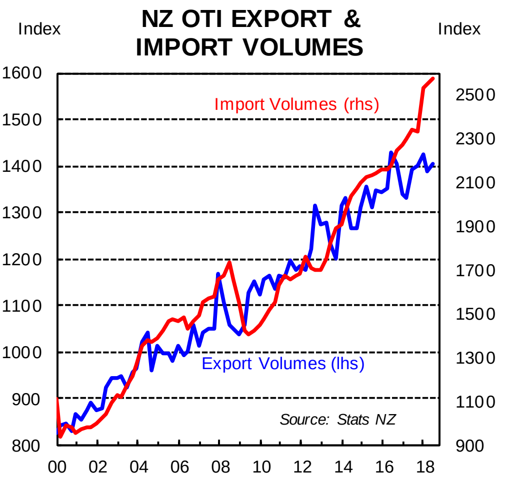
Import prices rose 1.7% qoq (+2.4% yoy). Higher oil prices and the weaker NZD/USD saw prices for petrol and petroleum products prices lift 10.1% qoq, taking the annual rise in prices to just over 30%. Price lifts were more moderate for other imports. Capital goods import prices were up 1.6% qoq, with rising prices for total consumption goods (+2.5% qoq) pointing to a prospective rise in consumer prices. We expect increasing consumer prices to modestly add to consumer price inflation over the coming year.

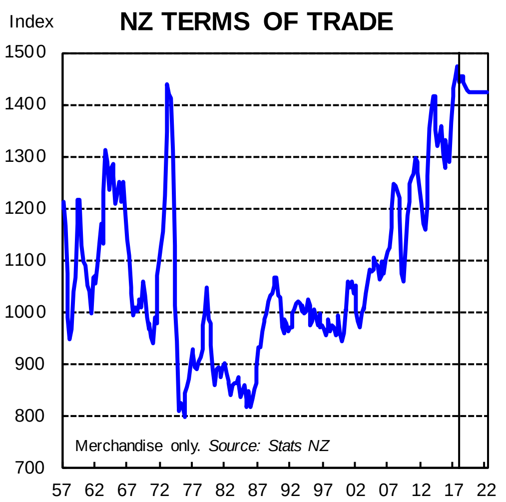
The volume split from the Q2 data points to a marginally positive net trade contribution to Q2 GDP. Export volumes rose 1.1% qoq, supported by a 5.2% qoq increase in dairy export volumes. Rising meat, food & beverage export volumes were partly offset by declining wool and seafood exports. Import volumes rose 0.9% qoq, underpinned by rebounding capital goods imports (+14% qoq). A 31% qoq rebound in transport equipment boosted overall capital imports. While ex-transport capital good import volumes did decline modestly in Q2 (-2.2% qoq, the first fall since March 2016), the level of imports is more than 16% higher than a year ago. Intermediate and consumable import volumes were lower in Q2, with the Marsden Point refinery maintenance shutdown contributing to the sharp fall in primary fuel imports and lower intermediate imports in Q2 (-3.3% in qoq). We expect intermediate import volumes to rebound in Q3. Despite a solid Q2 retail trade print (+1.1% qoq), consumption good imports were lower in Q2.

We will be firming up our Q2 GDP pick over the next week or so, and expect a solid +0.9% qoq print, well above the 0.5% qoq RBNZ pick. The focus, however, is whether deteriorating domestic sentiment will result in slowing NZ GDP growth from Q3 and beyond. If this was to eventuate, the RBNZ are likely to consider an OCR cut, but it is questionable how much support this would provide to the economy in the current juncture.

We remain constructive on the outlook for economic activity. Looking ahead, **we expect the ToT to remain at historically-high levels and a major structural support for the NZ economy.** There is likely to be some slippage to good export prices if global dairy prices fall further, but generally strong demand for other NZ exports should partly offset this. **Recent falls in the NZD should help support export incomes but will add to the import bill, particularly for much-needed capacity-enhancing investment.**







ASB Economics & Research			**Phone**
Chief Economist	Nick Tuffley	nick.tuffley@asb.co.nz	(649) 301 5659
Senior Economist	Mark Smith	mark.smith4@asb.co.nz	(649) 301 5657
Senior Economist	Jane Turner	Jane.turner@asb.co.nz	(649) 301 5957
Senior Rural Economist	Nathan Penny	nathan.penny@asb.co.nz	(649) 448 8778
Senior Economist, Wealth	Chris Tennent-Brown	chris.tennent-brown@asb.co.nz	(649) 301 5915
Economist	Kim Mundy	kim.mundy@asb.co.nz	(649) 301 5661
Data & Publication Manager	Judith Pinto	judith.pinto@asb.co.nz	(649) 301 5660

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