

Economic Note

Q1 Terms of Trade

4 June 2019

Comfort food

- Q1 Terms of Trade post modest rise.
- From here, we expect the Terms of Trade to track higher over the remainder of 2019.
- Indeed, despite global trade tensions, NZ is so far benefitting from the combination of strong food export prices and subdued import prices.

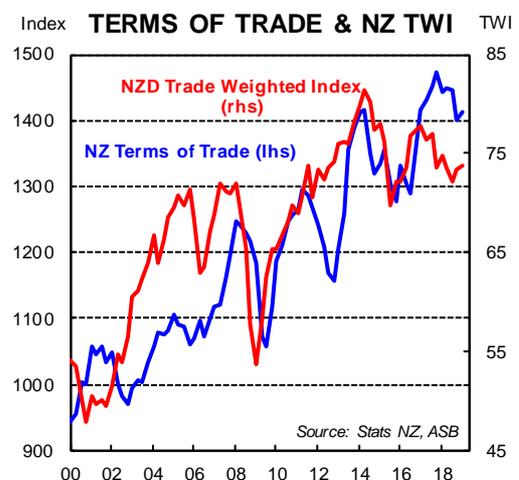
Summary

The NZ Terms of Trade (ToT) rose modestly over Q1. Most of the fall was due to lower dairy prices and higher oil prices.

As is often the case, the ToT data have been superseded by more recent developments. In particular, dairy prices have surged by over 20% since the start of the year, and this move was not captured in the Q1 ToT data.

In addition, we suspect that dairy prices may lift further over the rest of 2019, with the ToT likely to follow. For example, we expect the 2019/20 farmgate milk price to lift to \$7.00/kg of milk solids or above from our forecast of \$6.35/kg for the 2018/19 season.

All up, we expect the ToT to drift towards historical highs and to continue to structurally support the NZ economy. NZ continues to benefit from the combination of strong food export prices and generally subdued import prices. Indeed this combination is so far proving favourable for NZ, particularly at a time when global trade is under pressure from increasing protectionism in some quarters.



Details

The ToT rose 1.0% over the March quarter (-2.0% yoy), with the rise bang on our expectations. The goods ToT sit at a historically high level, 32% above the historical average, and just 3.9% below their 2017 peak.

Both export and import prices fell over the quarter, but it was a case of export prices falling by less. Specifically, falling dairy export prices (down 7.5%) led overall export prices 2.6% lower. Meat and wool prices also fell by 1.6% for the quarter.

Key Results (quarterly % change)

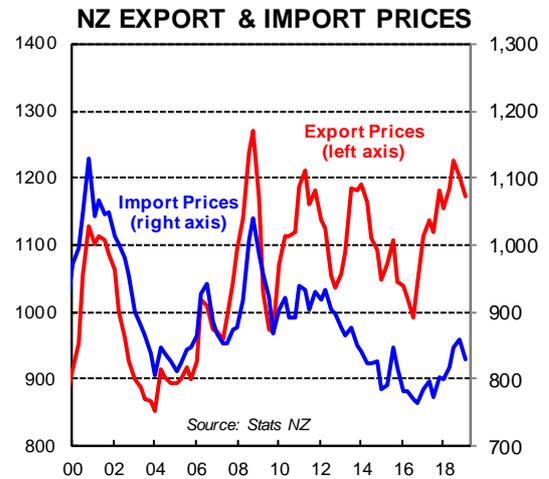
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|-----------------------|------|
| Terms of Trade | 1.0 |
| Export prices | -2.6 |
| Import prices | -3.5 |
| Export volumes (s.a.) | 5.0 |
| Import volumes (s.a.) | 1.3 |

Meanwhile, **import prices were weak over the quarter**. Import prices fell by 3.5%, led lower by a 20.3% fall in petroleum and petroleum products prices. Beyond petroleum, the import price weakness was also broad-based, with the capital, intermediate and consumer goods categories falling by between 1.4% and 5.9% over the quarter.

As noted above, subsequent dairy price moves largely render these data out-of-date. In particular, the global dairy market has tightened significantly over recent months to the point where we anticipate that a new dairy price cycle is underway. Dairy auction prices have lifted around 22% so far this year. In other words, this lift will comfortably cancel out the 7.5% dairy export price fall in the Q1 Terms of Trade data.

The volume split from the Q4 data points to a positive net goods trade contribution to Q3 GDP. Indeed, dairy export volumes hit a record high, jumping a whopping 19% over the quarter. However, this lift will prove temporary as the dry and hot summer slowed production over subsequent months.

Looking ahead, **we expect the ToT to drift higher over the remainder of 2019.** On this front, NZ continues to benefit from the combination of strong food export prices and generally subdued import prices. Indeed this combination is so far proving favourable for NZ, at a time when global trade is under pressure from increasing protectionism in some quarters.



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