

Economic Note

Q2 Terms of Trade

2 September 2021

NZ terms of trade back around record highs

- NZ's terms of trade headed higher at a strong clip over Q2, supported by rising commodity prices.
- There's little sign that constrained shipping capacity is limiting export and import volumes
- We expect NZ's terms of trade to remain well supported over the medium term.

Q2 2021 (qoq)	Actual	ASB	Market
Terms of Trade	3.3%	0.1%	0.3%
Export prices	8.3%	-0.8%	-
Import prices	4.8%	-0.9%	-
Export volumes (sa)	2.9%		
Import volumes (sa)	4.4%		

Summary

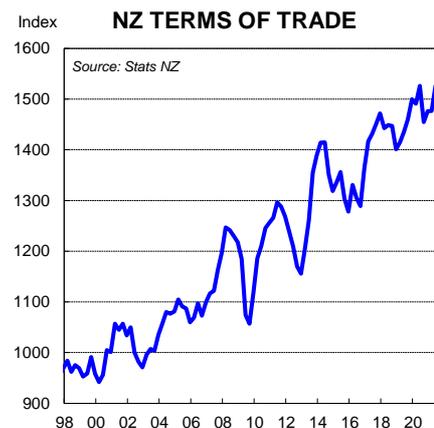
New Zealand's goods terms of trade lifted a marked 3.3% over Q2. A decent lift in import prices was more than offset by a whopping lift in export prices. Our goods terms of trade are now back near record highs.

The lift in the terms of trade was much stronger than either we (or indeed the market) had expected. Based on the monthly trade data from Stats NZ we'd expected both export and import prices to *fall* this quarter, leaving terms of trade broadly unchanged. Still, we'd expected our terms of trade to head back to record highs relatively quickly, so today's result doesn't alter our view, just the timing.

We still don't think the impact of rising commodity prices has been fully reflected in the published data, so expect to see export and import prices advance further. We expect gains for export prices to outstrip those for imports, keeping our terms of trade well supported.

There's not much sign yet that constrained shipping capacity is limiting trade activity in a macro sense, despite widespread anecdotal reports. This quarter's data did indeed show a massive lift in transportation costs, but both export and import volumes were actually higher over the quarter. Still, as we enter the seasonal peak for imports in October and November, we could see things starting to have a bit more of an impact on import volumes.

The implications of today's data are many and varied. NZ's strong export performance should help support the growth outlook, but higher inflation is also set to hit consumers. Increasingly, there's also the risk that NZD could outperform our present currency forecasts.



Higher export and import prices surprise

Both export and import good prices were stronger this quarter. In a sense that isn't surprising – there have been some eye-watering gains for commodity prices over the first half of 2021 that meant last month's surprise dip in export and import prices was always likely to prove temporary. Given there is usually a bit of a lag between lifts in commodity prices and their presence in the trade data, we'd thought it wouldn't be until the Q3 data before we saw a marked lift.

Unsurprisingly given their composition, gains in export prices (+8.3%) were larger than those for import prices (+4.8). Gains in commodity prices over the first half of the year have been widespread, but the strength in agri commodities has been particularly notable. Prices for virtually all of NZ's major agri exports were higher this quarter but gains for dairy (+15.3%) and forestry prices (+12.7%) were particularly strong. By contrast, the big rise in imported commodity prices like fuel (+27.1%) and metals (+12.5%) were offset by only modest gains in manufactured good prices.

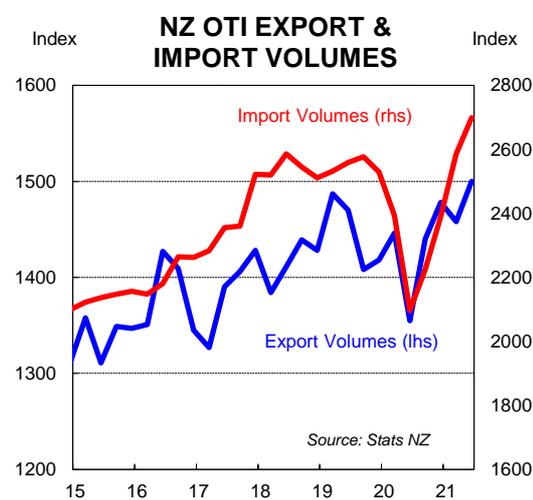
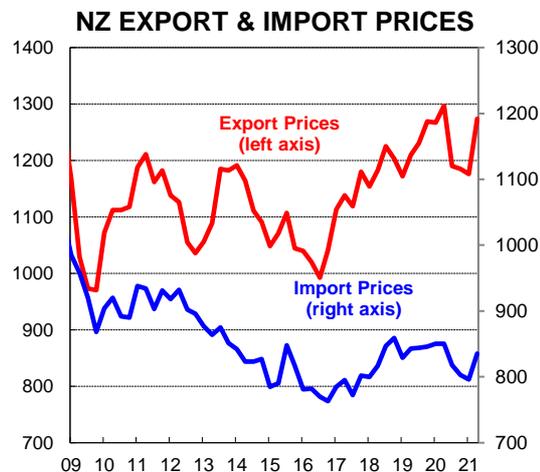
Trade volumes looking resilient

Both export and import volumes notched up some solid increases this quarter. Since the latter half of 2020, anecdotes of constrained shipping capacity and surging freight costs have been a recurring theme. Sure enough, today's data showed a big lift. Still, the last couple of quarters have continued to paint a picture suggesting trade activity is proving highly resilient. We suspect the impact of logistics disruptions are being felt very unevenly across businesses, but at a headline level both export and import volumes look strong. We're cautious about the outlook and wouldn't be surprised to see disruption start to hit harder on the imports side of things as we enter busy season in October and November.

The upshot

We expect NZ's terms of trade to remain strong over the medium term. Both export and import prices look set to head higher off the back of the strength in commodity prices and anxieties around shipping disruption, but we expect export prices to outperform given the current strength in agricultural commodities. While we've seen some commodities start to ease off their peaks (notably for forestry), we think a sharp correction is unlikely, keeping NZ's terms of trade close to record highs. **The NZD and the broader NZ economy are set to retain a crucial support.**

Today's data also affirms our view that CPI inflation is set to head higher over the remainder of the year given the ongoing, large lifts in transportation service costs. Annual CPI inflation is on track to hit 4½% by the end of this year. Higher interest rates beckon.



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