

Economic Note

Q3 Terms of Trade

1 December 2017

Records are meant to be broken

- NZ records an all-time high Terms of Trade.
- Breaking the previous record that had stood since June 1973.
- From here, we expect the Terms of Trade to drift lower, but to remain at historically high levels.

Q3 Results

The Terms of Trade (ToT) lifted 0.7% over the September quarter to an all-time high. The previous high had stood since the June quarter of 1973.

Both export and import prices were softer than expected over the quarter. Looking at export prices, both dairy and meat prices posted modest declines, in contrast to our expectations of modest rises.

Meanwhile, import prices dipped 2.5% over the quarter, considerably weaker than our expectations for a flat quarter. In particular, petroleum and petroleum product prices fell 11.9% over the quarter.

From here, we expect the ToT to drift lower, but to remain at historically-high levels over coming quarters. Oil (import) prices have lifted in the months subsequent to this release, while dairy (export) prices have also fallen over the same period.

Record high

The record ToT continues the steady march higher since the early 2000s. Since then, the ToT have nearly doubled.

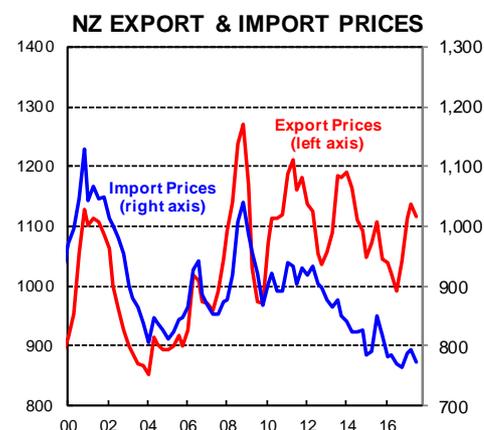
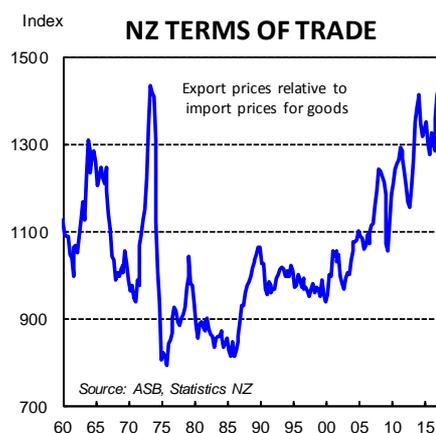
Through to around 2012, a structural lift in export prices (read dairy) dominated the rising ToT trend. More recently, falling import prices have led the way. In particular, a combination of global deflation since around 2012, including lower oil prices, have driven much of the rising NZ ToT. Meanwhile, export (dairy and other food) prices have moved cyclically around their higher level.

These movements highlight how NZ has benefitted from its import-export mix. Basically NZ has benefitted from relatively high food (export) prices, while benefitting from relatively low manufactured (import) goods prices.

Indeed, this also reflects the global over-capacity in the manufacturing

Key Results (quarterly % change)

Terms of Trade	0.7
Export prices	-1.9
Import prices	-2.5
Export volumes (sa)	0.3
Import volumes (sa)	-0.7



sector. At the same time, **these movements also reflect lower global agricultural capacity**, at least in terms of the products that NZ produces.

Looking over a longer horizon (say the next 10 years), we expect global agricultural capacity to increase. In particular, we expect agri-tech to increase productive capacity. As a result, **NZ's food export prices may come under pressure in a similar way to the pressure that manufacturing prices faced earlier in the century.**

However that may be some years away. In the short term, though, **we expect NZ's export (food) prices to remain high and for the ToT to remain similarly high by historical standards.**

ASB Economics & Research

Chief Economist
Senior Economist
Senior Economist
Senior Rural Economist
Senior Economist, Wealth
Economist
Data & Publication Manager

Nick Tuffley
Jane Turner
Mark Smith
Nathan Penny
Chris Tennent-Brown
Kim Mundy
Judith Pinto

nick.tuffley@asb.co.nz
jane.turner@asb.co.nz
mark.smith4@asb.co.nz
nathan.penny@asb.co.nz
chris.tennent-brown@asb.co.nz
kim.mundy@asb.co.nz
judith.pinto@asb.co.nz

Phone

(649) 301 5659
(649) 301 5853
(649) 301 5957
(649) 448 8778
(649) 301 5915
(649) 301 5661
(649) 301 5660

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