

Economic Note

Q3 Terms of Trade

2 December 2020

Terms of trade ease in Q3, but export activity surges

- There was a sharp fall in NZ terms of trade in Q3, amid a sizable fall in export prices and a smaller fall for import prices.
- Goods export and import volumes posted big lifts, highlighting the ongoing resilience in New Zealand’s international merchandise trade activity.
- All up, NZ’s goods terms of trade remain at historically high levels, and the goods export sector continues to act as a strong support for the NZ economy.

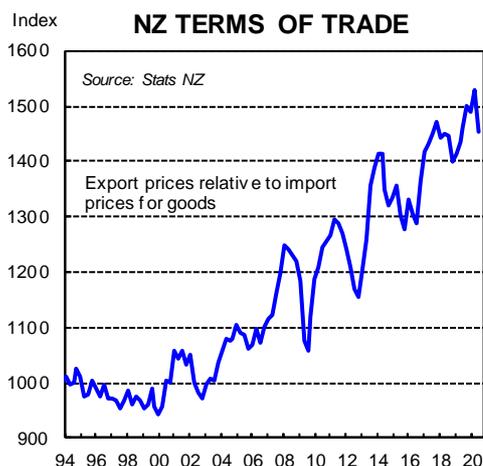
Q3 2020 (qoq)	Actual	ASB	Market
Terms of Trade	-4.7%	-6.1%	-3.8%
Export prices	-8.3%	-7.0%	
Import prices	-3.7%	-1.0%	
Export volumes (sa)	6.5%		
Import volumes (sa)	7.1%		

Summary

New Zealand’s terms of trade fell over Q3, reversing the 2.4% lift we saw in Q2. Prices for both exports and imports fell, but export prices were considerably weaker, as sharp falls in commodity prices earlier in the year filtered through to traded goods.

The release also highlighted the resilience of New Zealand’s international merchandise trade activity with traded goods volumes posting big lifts for both exports and imports as they recovered a Q2 slump.

Despite the fall this quarter, our Terms of trade are still close to historic highs, and we expect to see some recovery in the quarters ahead, providing a key support for the NZ economy.



Terms of trade ease, but remain close to historic highs

The goods terms of trade eased a little in Q3, falling by 4.7% qoq amid a sharp fall in the export prices. Export prices were down a whopping 8.3% over the quarter, whilst the fall in imports was a more ‘modest’ 3.7%. The decline was sharper than the market had expected, but a little bit less dramatic than our forecast. After the record Q2 Terms of trade result, the Q3 fall was one of the sharpest on record, with Stats NZ noting it’s the largest decline since 2009.

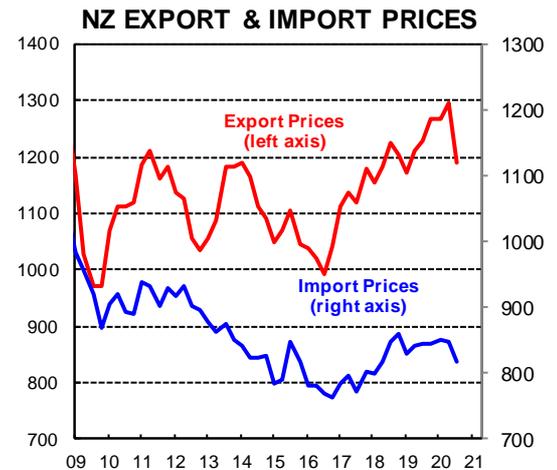
Nonetheless, NZ’s terms of trade remain elevated at historically high levels, and we expect further recovery in the

coming quarters.

The fall in goods export prices was a little bit larger than our expectations (-8.3% vs -7% expected), with broad-based falls in most of NZ's key export commodities, including dairy (-12.3%), meat (-8.8%), wool (-10.9%), fish (-11.3%) and forestry products (-10.5%). Aluminium was one of the few exports to escape the declines, managing a modest 2.9% lift, having fallen sharply earlier in the year. The falls are unsurprising given the volatility in commodity prices we've seen since the pandemic began, with sharp falls earlier in the year, giving way to an uneven recovery more recently. We expect to see that recovery in export commodity prices start to filter through to traded goods over coming quarters.

Goods import prices also fell by more than we expected. Prices for most import categories fell, but fuel imports staged a slight 0.4% recovery after falling to all-time lows in Q2. Still, that's not saying much, with import prices continuing to trundle along historic lows. The pandemic is having an uneven impact on the prices of other imports, with iron/steel (-6.8%), machinery (-6.3%) and clothing (-8.4%) imports registering the largest decline in prices.

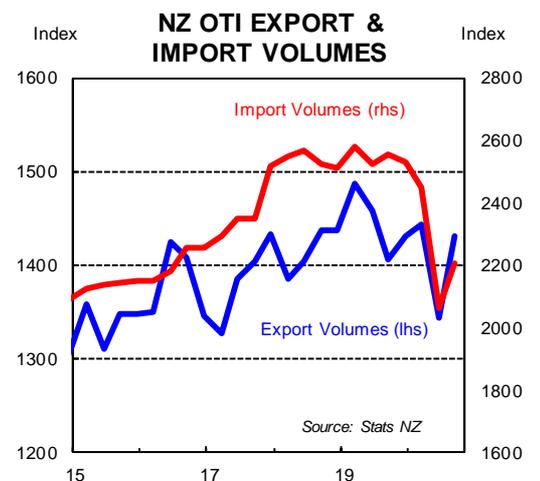
The strength of the NZD was one factor that may have had a significant impact on the result, the NZD/USD lifting 7.2% over the quarter, exacerbating the falls in export and import prices.



Export volumes up sharply

There was a big lift in goods export volumes over the quarter, rising 6.5%.

Export and import activity were disrupted earlier in the year by the imposition of lockdown, but it staged a big comeback in Q3 (despite the brief return to higher Alert Levels in August). Export volumes aren't quite back up above pre-COVID levels, but aren't far off and the high-frequency data released by Stats NZ more recently suggests export activity continues to hold up well. Dairy export volumes fell by about 3.6% over Q3, but volumes for most other major commodities increased. Once again, NZ's status as a food exporter is proving a strength (after all the world still needs to eat, even in a pandemic). Meat export volumes were up 14.3% over the quarter for example, whilst fish export volumes lifted 22.4%. By contrast, non-food manufactured exports lifted a much more modest 7.8%. There was also a massive 29.4% lift in forestry export volumes, recovering from a sharp plunge in Q2 amid strengthening activity in China.



Import volumes up even stronger

Goods import volumes were even stronger, lifting 7.1% over the quarter. Import volumes had fallen dramatically in Q2, and while they are still some way shy of pre-COVID levels, it looks like there was a hive of activity in the aftermath of the first lockdown. There were sharp lifts in oil imports (+25%) and mechanical machinery imports (16%) as economic activity recovered. Lifts in volumes for consumer goods categories were more modest, but we've since the retail trade recover strongly in more recent data. Looking ahead, more recent domestic data suggests the NZ economy is holding up better than expected, which should act as a support for import demand (though ongoing uncertainty might limit capital goods imports as businesses adopt a 'wait-and-see' approach to investment). Still, stories of supply chain and logistics disruption have continued to trickle out over recent months, with reports of a global container shortage, and lengthy delays at ports. Logistical challenges and a cautious approach to business investment may dampen the recovery in import volumes over the rest of 2020 and early 2021.

Despite the fall in terms of trade, goods trade activity remains resilient

All up, today's data suggests the outlook for NZ goods trade is holding up well. Despite the sharp fall over Q3, NZ's

terms of trade remain not too far off historic highs, and we expect some of the decline to be reversed in the quarters ahead. Export and import activity are also proving resilient, as evidenced by the recovery in volumes over Q3 (something we are also seeing reflected in Stats NZ's more high-frequency monthly releases). The strength in international trade is something we are seeing globally too, with the World Trade Organisation revising up its forecast for global merchandise trade over 2020 to a contraction of 9.1%, far better than the fall of up to 32% it predicted earlier in the year. All-up, its good news for a small, exporting nation like New Zealand, and the resilience of NZ exports have contributed to the faster-than-expected economic recovery. **Of course, it's a different story for services trade, and we expect the NZ border to remain largely shut for quite some time yet, until vaccine take-up is widespread.**

ASB Economics & Research			Phone
Chief Economist	Nick Tuffley	nick.tuffley@asb.co.nz	(649) 301 5659
Senior Economist	Jane Turner	jane.turner@asb.co.nz	(649) 301 5853
Senior Economist	Mark Smith	mark.smith4@asb.co.nz	(649) 301 5957
Senior Economist	Mike Jones	Mike.jones@asb.co.nz	(649) 301 5661
Senior Economist, Wealth	Chris Tennent-Brown	chris.tennent-brown@asb.co.nz	(649) 301 5915
Economist	Nat Keall	nathaniel.keall@asb.co.nz	(649) 301 5720
Data & Publication Manager	Judith Pinto	judith.pinto@asb.co.nz	(649) 301 5660

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