Economic Note

Q3 Terms of Trade

2 December 2021

Get on high

- NZ's terms of trade hit a new record high in Q3, but the pace of gains slowed.
- A fall in dairy exports drove overall export volumes lower, while import volumes proved resilient.
- We expect higher import prices to drive NZ's terms of trade lower over the coming quarters but expect it to remain elevated.

Q3 2021 (qoq)	Actual	ASB	Market
Terms of Trade	0.7%	2.5%	2.0%
Export prices	4.6%	3.9%	-
Import prices	3.8%	1.4%	-
Export volumes (sa)	-3.0%		
Import volumes (sa)	3.4%		

Summary

New Zealand's goods terms of trade lifted a modest 0.7% qoq over Q3, reaching a record high. There were decent gains in both export and import prices in line with strong gains in commodity prices over the first half of the year. Both export and import prices rose beyond our already-solid expectations. **The lift in the terms of trade was a bit softer than either we or the market had anticipated, thanks to the strength of the gain in import prices**.

We expect export prices to gain further over the medium term, despite the lofty rise they've already experienced. Strong gains in dairy and meat boosted our ASB Commodities Index to seven high over during October and November and look set to remain high over the medium term. Those gains will filter through into the terms of trade data over the coming quarters and will be more than enough to offset some weakening in prices for other exports, such as forestry products.

Still, import prices are likely to catch-up. Energy prices have surged, while labour shortages and more expensive raw materials are likely to put pressure on manufactured good prices over the near term. All-up, there was little in the import price data to dissuade us of the notion that CPI inflation looks set to remain high over the near term.

In short, there's scope for NZ's terms of trade to ease, while still remaining historically high.

Both export and import volumes continue to prove resilient to logistics disruption and constrained shipping capacity too. Export volumes eased a little this quarter, down a seasonally adjusted 3.0% qoq, but that's coming off the back of a record high in Q2. Import volumes – which we expected to be hit harder by all the disruption – lifted a fifth consecutive quarter, comfortably hitting a new record high. There's a lot of variation by sector, but for now, shipping woes appear to be hurting 'potential' rather than 'actual' growth.'

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Export and import prices keep scaling peaks

Unsurprisingly, both export and import good prices lifted this quarter. Both lifts were a bit larger than our own forecast but are consistent with the broad themes evident in global trade this year. On the export side, strong gains in agri commodity prices over the first half of 2021 continue to flow through into the data. This quarter, the two big behemoths of our goods export sector made sizable gains, with dairy and meat prices up 7.1% and 10.8% qoq respectively. There were signs of softness for some of our other major exports – notably forestry prices were up just 0.9% qoq after a sizable price correction during the quarter – but those dairy and meat prices gains make a lot of impact on their own.

On the imports side, the most notable development was a sizable lift in fuel prices, up by double digits a third consecutive quarter at +14.8% qoq, with prices now back above pre-COVID levels. In line with rising costs for raw materials, iron and steel prices were also up a sizable 15.3% qoq. Prices for manufactured goods were generally more muted in their movement (with mechanical machinery actually recording a 1.1% decline).

Trade volumes looking resilient – mostly

Resilience remains the big theme in both export volumes. Since the latter half of 2020, anecdotes of constrained shipping capacity and surging freight costs have been a recurring theme, yet export and import data continues to go from strength-to-strength. This quarter, export volumes were down a modest 3% off last quarters peak, while import volumes were up another 3.4% to a new record high. So at a national level, the logistical challenges firms are facing appear to be hurting potential rather than actual growth.

The good news for the economy as a whole is that in the big export sectors like meat and dairy, prices gains have been strong enough to more than offset the revenue impact of any hit to volumes.

The bad news is that smaller sectors seem to be being hit a bit harder than the big guys. Comparing this season's merchandise trade data with the last couple of seasons' data, it looks like its seafood, wine and some horticultural produce (like apples) where volumes have been hit the hardest. Prices in these sectors havent gained as much, or have even fallen. After the sharp fall in forestry export volumes this quarter and the price correction during August, it might be a sector worth adding to the list of sectors facing some headwinds.

The upshot

We see further gains for export and import prices in the quarters ahead, but suspect gains for the latter will begin to outpace the former. Further gains in dairy and meat prices will help export prices build on their already-strong lifts over the course of this year. However, with raw material shortages, labour market disruption, and surging power prices all beginning to bite – including in China – we expect to see stronger price gains on the imports side of things. **Still, after their gains over the past year, NZ's terms of trade will remain historically elevated.**

Today's data also showed transport service import prices advancing by a more modest 2.3% qoq, after double digit growth over Q1 and Q2. That suggests tradable inflation may be close to peaking and looks set to moderate somewhat over 2022, consistent with our current CPI view.

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