

Economic Note

Q4 Terms of Trade

1 March 2019

Zig zag

- Q4 Terms of Trade dip on a combo of lower dairy prices and higher oil prices.
- However, the Q4 data did not capture a more recent dairy price surge and the drift lower in oil prices.
- Both of these moves will lead the Terms of Trade higher over 2019.

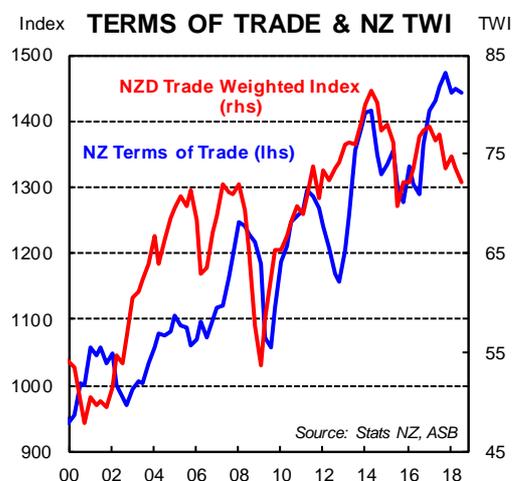
Summary

The NZ Terms of Trade (ToT) fell over Q4. Most of the fall was due to lower dairy prices and higher oil prices.

However, the ToT data have been superseded by more recent developments. In particular, dairy prices have surged by around 20% since November, and this move was not captured in the Q4 ToT data. Moreover, oil prices peaked in October and have since fallen.

In addition, we anticipate that dairy prices will 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 around \$7.00/kg of milk solids from our forecast of \$6.25/kg for the 2018/19 season.

All up, we expect the ToT to remain near historical highs and to continue to structurally support the NZ economy. This view is also a key factor supporting our forecasts for the NZ dollar to remain firm on a trade-weighted basis through 2019.



Details

The ToT fell 3.0% over the December quarter (4.7% yoy), with the fall a little more than expected (our pick was for a 2% fall). Despite this fall, the goods ToT remain historically high at 31% above the historical average, and just 4.7% below their 2017 peak.

Import prices rose over the quarter (1.3% qoq; 7.0% yoy) on the back of higher oil prices and a weaker NZD. Specifically, petrol and

petroleum products prices lifted 7.5% qoq, taking the annual rise to over 36%. Price lifts were more modest for other imports: consumption goods prices rose 1.1% qoq, while capital goods prices rose 1.7% qoq.

Key Results (quarterly % change)

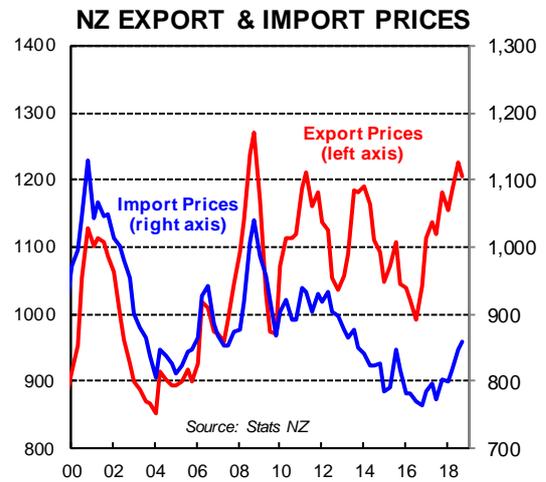
Terms of Trade	-3.0
Export prices	-1.7
Import prices	1.3
Export volumes (s.a.)	0.8
Import volumes (s.a.)	0.2

Meanwhile, export prices fell 1.7% qoq (+2.0% yoy), led by falling dairy export prices (down 5.7% qoq). Other export prices were mixed, with forestry and meat prices moving up and down, respectively.

As noted above, subsequent dairy and oil price moves render these data very 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. Similarly, oil prices have come back from October highs.

The volume split from the Q4 data points to a small positive net goods trade contribution to Q3 GDP. That said, dairy and export volumes fell over the quarter, although we anticipate that export volumes will rebound over coming quarters.

Looking ahead, we expect the ToT to drift higher over the remainder of 2019. As a result, the ToT remain a major structural support for the NZ economy and the NZ dollar. Notably, dairy export incomes are likely to rise over 2019 as the dairy price cycle emerges, with an additional boost from earlier production volume gains.



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

www.asb.co.nz/economics

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