

Losing altitude

Q1 Terms of Trade

- New Zealand's terms of trade fell 2.3% in the March quarter.
- This is the third consecutive fall from the exceptionally high levels reached last year.
- We think export prices have further to fall yet, but expect the weakness will ultimately prove temporary. By the end of the year the outlook for global growth, and commodity prices should be improving.

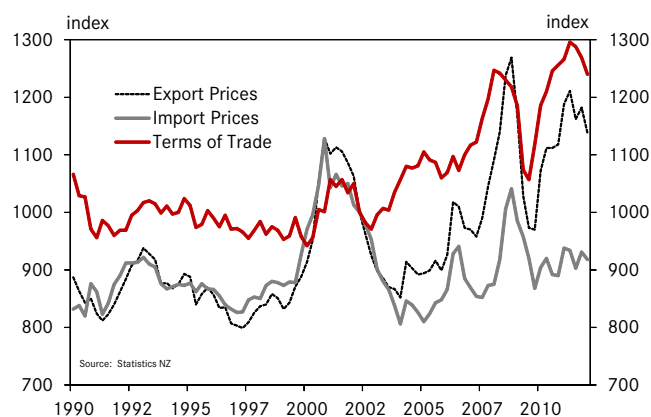
Overseas Trade Indexes (qtr % chge)

	2011Q2	2011Q3	2011Q4	2012Q1
Terms of Trade	2.4%	-0.6%	-1.4%	-2.3%
Export Prices	1.9%	-4.0%	1.7%	-3.8%
Import Prices	-0.5%	-3.4%	3.2%	-1.5%
Export Volumes (s.a.)	0.4%	-0.3%	2.7%	-0.6%
Import Volumes (s.a.)	-1.4%	2.2%	-1.2%	5.4%

New Zealand's terms of trade (the ratio of export prices to import prices) continued its downward slide in the March quarter, falling 2.3%. The terms of trade has now fallen 4.3% from the multi-decade high reached in late 2011. Although the terms of trade remains at relatively high levels, there is no doubt that external conditions have become more challenging for New Zealand exporters. Slower global growth and uncertainty emanating from Europe have been weighing on export prices to a greater extent than import prices.

There were widespread falls in export prices evident in the March quarter. Fruit (in particular apples), meat (especially lamb), wool, and forestry prices all registered significant falls. However it has been falling dairy prices which have probably garnered the most attention of late. While global dairy prices have fallen hard this year, dairy farmer's incomes have been at least partially buffered by strong production growth. While dairy export prices in the terms of trade have fallen 11% over the last 3 quarters, the volume of dairy products exported over the same period has risen 11%. In aggregate there was a small decline in total export volumes in the March quarter, down 0.6% with stronger dairy and meat and forestry export volumes more than offset by weaker export volumes in other sectors.

Export and Import Prices



Import prices fell almost across the board as a stronger NZD in the March quarter pushed down the cost of imports for New Zealanders. The 1.5% fall in import prices included lower prices for iron and steel (-4.8%), plastics (-4.7%) and transport equipment (-2.3%). However higher oil prices in the March quarter meant a much smaller fall in the prices of petroleum products in NZD terms – these fell just 0.2%.

The strong New Zealand dollar has made it attractive for New Zealanders to import goods from offshore and this trend continued in the March quarter as import volumes jumped 5.4%. This took the index to its highest level since the series began. However excluding volatile fuel imports, import volumes rose a more modest 1.8%. Imports of capital equipment rose strongly over most of 2011 but eased over the last couple of quarters while imports of consumption goods were up 2.3% on the back of a strong rebound in durable goods imports following weakness last quarter. Looking ahead we expect imports to be bolstered by the Canterbury rebuild.

Market Implications

Today's data broadly confirms our understanding of the NZ economy and on its own won't change the outlook for the Reserve Bank. Nonetheless export prospects are certainly dimming this year. But while acknowledging the near-term weakness in commodity prices and its impact on the NZ economy, we must keep the recent moves in perspective – the terms of trade remains 10% above its average levels of the last decade. In

addition we expect the current weakness is cyclical rather than structural. By the final quarter of this year, stimulatory policies by authorities in China should be starting to gain traction, boosting growth and demand for commodities. Consequently we expect to see commodity prices stabilise and start to improve. We remain firmly optimistic about prospects for New Zealand export prices over a longer horizon.

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