Reach for the stars
Q4 NZ Terms of Trade

- NZ’s terms of trade remain at a 40 year high after rising further in the December quarter.
- Export prices are lingering at high levels, with the added boost to the terms of trade in the December quarter largely due to softer import prices.
- Export volumes leapt to a record high, reflecting stronger dairy exports as the sector rebounded from the effects of last summer’s drought.
- We think the terms of trade will moderate over the course of 2014, but remain bullish about the outlook for New Zealand’s terms of trade over a medium term horizon.

New Zealand’s terms of trade ventured further into stratospheric territory in the December quarter, rising 2.4%. Over the course of 2013 New Zealand’s terms of trade have climbed 20%, mostly driven by higher export prices. Although strong demand for New Zealand’s commodity exports, particularly from China, has pushed up prices for a broad range of agricultural exports, dairy has undoubtedly been the star performer.

So where to from here? Well we don’t think the terms of trade can continue to head north forever. But, we do suspect a good chunk of the recent strength in the terms of trade will stay around for a while yet. That’s because it reflects structural changes in the drivers of New Zealand’s key exports - in particular, increased demand for New Zealand’s commodity exports from China and other emerging economies. Consequently, while we expect NZ’s terms of trade to ease over the course of 2014, as increased global supply weighs on key export commodity prices, over the medium term we think that sustained strength in the terms of trade will remain a feature of the New Zealand economic landscape.

Detail

Much of the detail in today’s release was in line with expectations. Export prices took a bit of a breather in the December quarter, easing 0.5% in the period but remaining almost 50% above their levels of a year ago. Softer dairy, aluminium and forestry prices in the quarter were partially offset by higher prices for meat, wool and fish products.

Perhaps the most notable (albeit expected) feature of the export data was the 9.7% lift in export volumes driven largely by a rebound in dairy exports. Conditions in the agriculture sector, and dairy sector in particular, improved rapidly after last summer’s drought. The bounce in production actually occurred in Q3 (and contributed a major part of the 1.4% rise in GDP that quarter), but wasn’t shipped until Q4, driving the 23% rise in dairy volumes in today’s release. While such big increases won’t be repeated in the coming quarters, we think
milk production this season could be up 10% on last year’s drought impacted levels.

On the other side of the ledger, import prices fell 2.8%. Reflecting the stronger NZD over the period, import prices fell almost across the board. In aggregate import volumes were flat, with lower imports of capital equipment (following a couple of quarters of very strong growth) offset by a lift in imports of consumption and intermediate goods. With the New Zealand dollar forecast to remain high, and the New Zealand economy set to grow strongly in 2014, we expect to see further import volume growth over the course of this year.

Implications

The very strong terms of trade will have both direct and indirect impacts on the NZ economy. We don’t have to look very hard for evidence of the direct boost to rural incomes high commodity prices are generating. Last week Fonterra announced yet another lift in its payout forecast for farmers for the current season. The current milk price forecast is now sitting at $8.65/KgMs – a 48% lift on last season’s figure.

And while dairy prices have posted the biggest gains, the story doesn’t end there. Log producers are also benefitting from super strong Chinese demand, beef prices are improving and even wool prices are well above where they were a year ago. Such a direct boost to incomes will trickle (or perhaps flood) through the NZ economy in a myriad of ways. A portion will be saved or used to pay down debt, with the remainder expected to flow through to higher consumption and investment spending. We’ve already seen signs of this in surveys of activity and confidence. Last week’s ANZBO survey showed firms in the agriculture sector were the most optimistic about the outlook for their own activity since 2007, with investment intentions in the sector the highest since the survey began.

The indirect impact on the New Zealand economy is via the exchange rate. The high terms of trade is one factor explaining why the NZD has been so strong (with the outlook for the terms of trade a major reason we think the currency will remain elevated over the next year or two). The stronger currency means all New Zealanders benefit from getting more bang for their (New Zealand) buck when importing goods and services from overseas. Of course the flip side is that exporters who are not benefitting from high commodity prices (for example the tourism industry) or which compete with imported products will find the going tougher.

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