

Economic Note

Q4 Terms of Trade and Overseas Trade Indexes

Terms of Trade lift on lower import prices

- Merchandise Terms of Trade increased 5.7%, stronger than expected.
- Merchandise export prices fell 0.3%, while import prices fell 5.8% on the higher NZD.
- Export volumes disappoint with 1.2% fall, but import volumes surprisingly robust, up 1.6%.

Terms of trade lift 5.7%

Terms of Trade: Merchandise

The terms of trade improvement was stronger than forecast, printing at 5.7%. Our expectation was for a 2% lift. The stronger than expected lift was driven by import prices falling more than export prices.

Export prices remain broadly flat

Merchandise Export Prices

We expected the recent recovery in dairy prices would help boost export prices over Q4. The NZD lifted over Q4, with the TWI lifting 4.6%, negatively impacting export prices. The export price index fell 0.3% in the quarter (we expected a 1% rise). Higher prices for dairy products (+5% in Q4) were recorded, but were more than offset by lower prices for meat (-8.3%) and fish (-8.2%). A 16.3% quarterly lift in fruit prices also cushioned the fall in the export price index. Higher kiwifruit prices during the quarter were behind this lift.

Further improvement in dairy prices to come

We see some upside to the Q1 outlook, as Q4's export index did not capture the full lift observed in dairy prices in late 2009.

Import prices held lower by stronger NZD

Merchandise Import prices

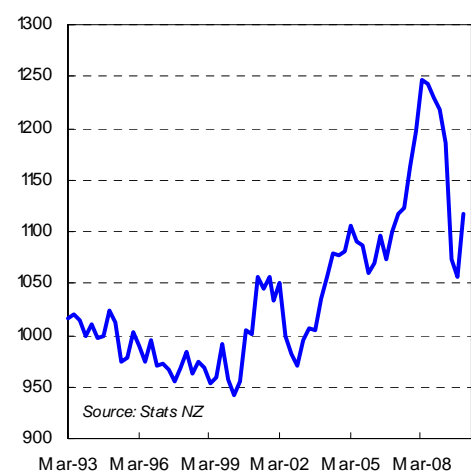
The NZD appreciation helped hold down import prices during the quarter. The merchandise import price index fell 5.8% in Q4, after dropping in the two preceding quarters. The mechanical machinery index (-8.6%) and electrical machinery and apparatus index (-10%) were the main contributors to the overall fall. Other import categories recording significant falls included petroleum and petroleum products (-4.3%), and food and beverages (-6.9%). The TWI has eased slightly in Q1, but is expected to remain relatively strong over 2010, which will help restrain import prices. As global growth recovers, some of the price falls in NZ imports recorded over 2009 will likely reverse.

Import prices likely to lift as the global economy recovers

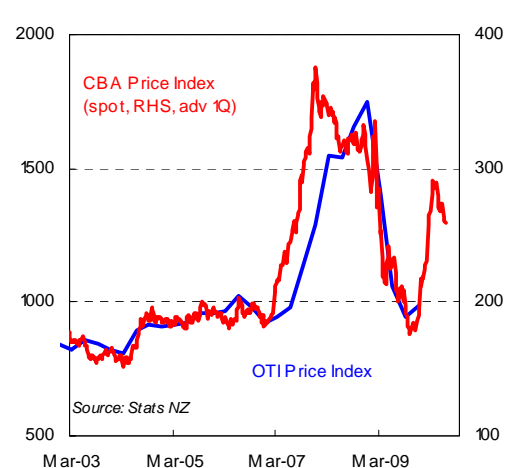
Key Stats (qoq)

Terms of Trade	5.7%
Export prices	-0.3%
Import prices	-5.8%
Export volumes (s.a.)	-1.2%
Import volumes (s.a.)	+1.6%

NZ TERMS OF TRADE



NZ DAIRY EXPORT PRICES



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General Advice Warning

As this report was prepared without taking into account your objectives, financial situation or particular needs, you should not take any action in reliance of this report without considering your particular circumstances and, if necessary, obtaining professional advice.

Services Terms of Trade also increase

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The services terms of trade also increased, up 0.8%, following strong increase of 9.8% and 3.8% in Q3 and Q2 respectively. The lift was also largely due to a sharp fall in services prices (down 1.8%). The main contribution to the fall was a decline in the personal travel sub index. Services export prices fell 1%, with the fall driven by declines in the transportation index and other services.

Export volumes down on lower oil production

Export volumes down on oil and dairy

The decline in export volumes was led by an 18% fall in oil exports, following a lift in the prior quarters as Maari oil production ramped up to full capacity. It is fairly typical for oil production to taper off after production peaks at full capacity.

Dairy volumes also weak

Dairy volumes also fell 4%, weaker than suggested by the monthly trade figures. The declines were relatively broad-based (milk powder and butter), with the exception of cheese (up 46.1%). Fruit exports were also weak, led by a large decline in kiwifruit. StatsNZ noted that the cheese and kiwifruit sub-categories are not seasonally adjusted.

Partially offsetting the declines in dairy and oil were increases in smaller export categories, including a 12.3% increase in meat exports. Fish exports also increased strongly.

Non-food manufactured exports continue to recover

Non-food manufactured exports increased for the second consecutive quarter. A strong increase in this category was also evident in the manufacturing survey. A large share of manufactured exports are sent to Australia and this sector has benefited from Australian growth remaining firm, and further supported by the low NZD/AUD cross rate.

Import volumes

Stronger capital goods imports encouraging for economic recovery

Capital goods and passenger cars were the main contributors to the increase in import volumes. The stabilisation in capital goods imports (excluding transport related goods) is encouraging, and points to a slightly more robust plant and machinery investment outlook.

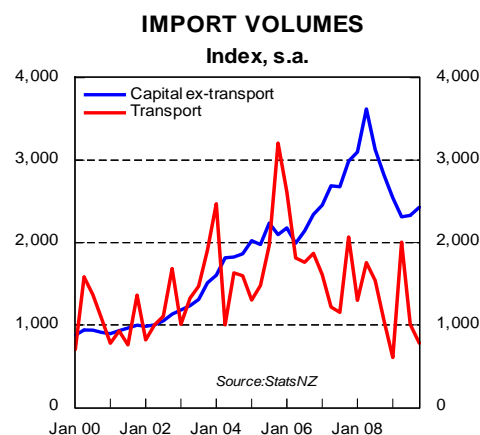
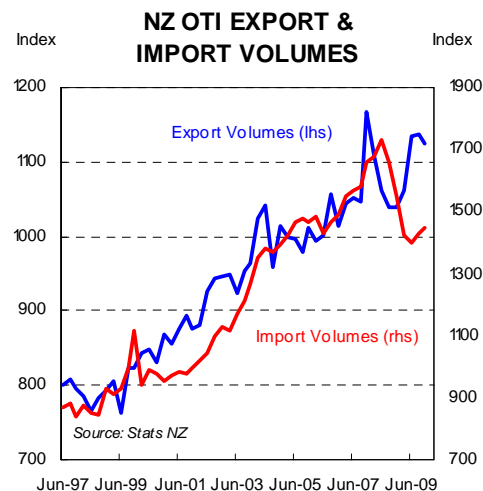
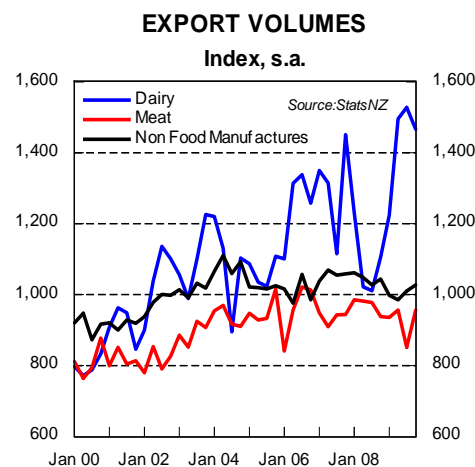
Car imports also recovery

Passenger car import volumes increased 32.2%, following the robust lift in vehicle registrations. Nonetheless, car imports are rising off a very low base and remain below 2007 levels. Consumer credit growth figures point to ongoing reluctance by households to invest in big ticket items, and further improvement in this category may be limited.

Recovery in consumer imports remains subdued

Consumer goods lifted 1.1%, with the recovery remaining relatively sluggish. While retail trade figures recorded a recovery in spending over the final quarter of 2009, more recent electronic card transaction data point to very subdued consumer spending. High levels of caution appear to remain in the retail environment.

Intermediate goods were slightly weaker than expected, down 1.3%, although were weighed down by falls in volatile items (such as aircraft parts and processed fuels).



Implications

Further gains in Terms of Trade likely in Q1, but further recovery may be limited.

The 5.7% lift in the merchandise terms of trade reflects an improvement in the purchasing power of New Zealand's exports relative to imports. On the surface this is a positive, but hidden by the improvement is weakness in some key New Zealand export products. Ongoing recovery in New Zealand's trading partners is key to an improvement in export prices in the future. A fall in the NZD would also help export prices, but would be offset by a corresponding increase in import prices. We expect some improvement in the export index in the short term, given Q4's result did not capture the full lift observed in dairy prices in late 2009. However, after that we expect the terms of trade to track sideways. Supporting this, the CBA NZ commodity price index suggests New Zealand's commodity prices have at best gone sideways over recent months.

Recovering import volumes suggest trade balance to widen over 2010

Over the past year the trade balance, and current account balance, have narrowed on the back of weak import demand and ongoing robust agricultural export volumes. Today's numbers point to early signs of this trend reversing, in particular the lift in capital goods was encouraging. As the economic recovery gains momentum, we expect import demand to improve and for the trade balance to begin widening over 2010.

Q4 GDP implications:

Q4 GDP growth likely to be soft

Weaker export volumes and stronger import volumes both reduce our GDP forecast (on an expenditure basis), and increases our confidence in our relatively soft pick for Q4 GDP of 0.4% (production basis).

Background to the data

The Overseas Trade Price and Volume Indexes measure changes in the levels of prices and volumes of imports and exports of merchandise trade to and from New Zealand. There is also some limited services price data included in the release.

The indexes are compiled from information gathered by New Zealand Customs from importers and exporters, and Statistics New Zealand's overseas trade statistics.

The Terms of Trade is a measure of the "purchasing power" of New Zealand's exports. An increase in the terms of trade implies that more goods can be imported for each dollar of exports and is a net income boost for the country.

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