

Overseas Trade Indexes – December 2007 quarter

Key points

- > Terms of trade rises to its highest level since the March 1974 quarter.
- > Dairy prices again led the rise in export prices, but encouragingly, price rises was also recorded in non-food manufacturing.
- > Export volumes were strong, though how much came from inventories and how much was due to timing issues relating to dry weather conditions remain to be seen.
- > A high terms of trade will improve NZ's living standards. But there are signs that the peak is near. In addition, dry weather conditions in some parts of the country, poor productivity performance and persistent inflation mean NZ will not be able to take full advantage of it.

Assessment

The merchandise terms of trade rose by 2.9 percent in the December quarter, in line with market expectations. The level of the terms of trade is at its highest reading since March 1974, and provides a huge income boost to the economy. Strong export prices accounted for the increase in the terms of trade, rising by 5.4 percent, with dairy prices (up 12.8 percent) being the main contributor to the increase. Encouragingly, most of the major export categories recorded increases in their export prices, including non-food manufacturing, whose prices have been under downward pressure over recent quarters. Import prices rose 2.5 percent, led by petroleum and petroleum products (up 7.6 percent) and food and beverages (up 4.7 percent). This highlights that while NZ benefits from higher commodity prices for the products we export, the flipside is that we have to pay more for the commodities we import.

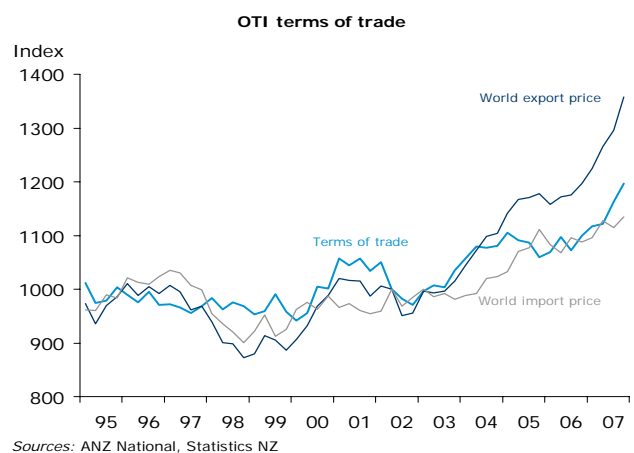
Terms of trade likely close to peaking. While another modest increase in the terms of trade is likely in the March quarter, courtesy of the lagged effect from past commodity price increases, the peak is near. NZ's major export commodity prices, as measured by the ANZ Commodity Price Index, look to have peaked and more timely milk futures data suggest declines are likely over the coming months. In addition, the prices for commodities that NZ imports (oil and non-dairy or non-meat commodities) continue to rise. Although we continue to expect the level to remain high relative to history, nonetheless this means there is less stimulus pending for the economy in the year ahead.

Net external sector to act as a significant contributor to December quarter GDP growth.

Export volumes rose 10.7 percent, led by a surge in dairy (up 27.4 percent) and petroleum exports (first full quarter of contribution from the Tui oilfield). However, how much of the rise in primary exports came out from inventories, and whether part of that was due to timing issues relating to dry weather conditions, remain to be seen. We note that January

merchandise trade data showed a fall in primary export volumes, suggesting that part of the export strength in the December quarter could be unwound in the March quarter. Non-food manufacturing exports managed to unwind the previous quarter's decline, rising 2.5 percent, an encouraging sign given the high level of the NZ dollar.

	Terms of Trade		Export Volumes		Import Volumes	
	QoQ	YoY	QoQ	YoY	QoQ	YoY
Dec 05	-2.5	-1.9	2.8	0.3	-0.6	5.5
Mar 06	0.9	-3.2	-1.7	-0.4	0.2	3.8
Jun 06	2.6	0.5	0.4	0.4	-2.5	-2.0
Sep 06	-2.2	-1.3	6.5	7.5	2.3	-1.1
Dec 06	2.5	3.7	-4.9	0.5	2.1	2.0
Mar 07	1.6	4.5	3.4	5.2	2.4	4.3
Jun 07	0.5	2.3	0.1	5.0	2.9	10.0
Sep 07	3.6	8.4	0.6	-1.1	0.3	7.8
Dec 07	2.9	8.8	10.7	15.6	5.4	11.4
ANZ	2.7	8.5	-	-	-	-
Market	2.9	8.7	-	-	-	-



Import volumes rose 5.4 percent, with all the main broad economic categories recording increases. Capital good imports made the largest contribution, though this was influenced by the importation of aircraft and an oil rig, as opposed to more P&M imports. Consumption good imports continue to rise (up 3.7 percent) despite the slowdown in consumer spending. This could be a sign that the retail sector will be carrying involuntary stock levels which they need to reduce at some stage, possibly at a sharp discount.

On balance, a high terms of trade represents a strong windfall to the economy. It means NZ is wealthier with improved purchasing power globally, improving the nation's living standards. But there are signs that the peak is near. In addition, dry weather conditions in some parts of the country, poor productivity performance and persistent inflation mean NZ will not be able to take full advantage of what the high terms of trade can deliver.

There are limited monetary policy implications from today's data. Strong export growth, and Friday's manufacturing survey data, will no doubt confirm that economic activity ended 2007 on a firm footing. But it is how economic activity will fare over this year that is of more importance for monetary policy. As we have indicated in our past commentary, economic activity appeared to have taken a step change lower in the early part of this year. Indicators for March quarter activity have been soft, and the upcoming data will likely show a continuation of this softness.

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ANZ, Level 7, 1 Victoria Street, Wellington 6011, New Zealand Phone 64-4-802 2000 Fax 64-4-496 8639
<http://www.anz.com/nz> e-mail ecnmcs@anz.com