24 August 2016

What Does The Slump In Imports Mean?

- July's merchandise trade headlines not that far from market
- But the details provoke some thought
- Especially the slump in imports, ex aircraft/oil
- Is it yet more downward price pressure from offshore?
- Exports a bit mixed; general outlook better
- Current account deficit to narrow further

July's merchandise trade data generally underwhelmed market expectations. Exports (-4.9% y/y) and imports (-10.3%) both undershot market priors. The monthly trade deficit of $433m was wider than the $325m deficit anticipated by the market. But the degree of surprise is relatively small for these often wobbly monthly figures. We wouldn't read too much into that. Perhaps more important is that we think the trade deficit is starting to trend narrower.

Regardless, it is the detail in today's trade data that provokes some thought, especially on the imports side. The large drop in imports needs some explaining. Although the 10% drop on a year ago was close to market expectations, imports were propped up by nearly $400m worth of 'lumpy' items like aircraft. But before you start thinking that this implies the underlying pace of imports was even weaker, raising questions about the strength of domestic growth, or inflation, or both, a quick look back to last July shows there were also large 'lumpy' items imported.

Fundamentally, lower oil prices remain part of weak imports compared to a year ago. Oil prices were recorded as 35% lower in the import statistics, with a 19% decline in crude import volumes compounding the impact on oil import values. But even excluding oil and the 'lumpy' items, the value of imports were still 8% lower than a year earlier (enough to pull the three month average growth rates sharply south). Import values in the month saw widespread declines across products.

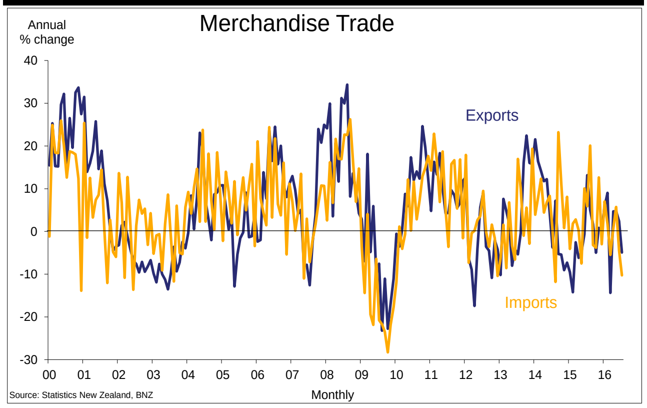
The strength of the NZD continues to have a pervasive influence on both imports and exports. The NZD was 8% higher, on average, in July 2016 compared to a year earlier. After accounting for the influence of the 'lumpy' items and oil, and then adjusting for the exchange rate, underlying annual import growth is about flat.

This weakness is a bit surprising given the general strength of domestic economic indicators. Underlying imports in July were certainly a lot weaker than we had penciled in for the month. Of course, it may just be monthly noise but it is worth monitoring. But, as it stands, we interpret the softness as adding to the view that the downward influence from offshore on domestic inflation remains intense – via both weak international pricing and a firm NZD. That fits with our view that the Q3 CPI will be very subdued and could well print negative.

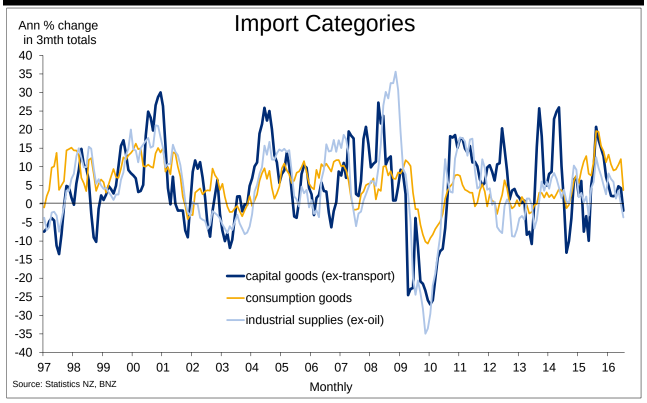
Of course, if the underlying import weakness is not price related then it must be due to volumes which would then ask questions about economic growth heading into the second half of 2016. That line of thought doesn't square with the robustness of other activity indicators. So we will continue to run with the price weakness story for now.

Meanwhile, July exports were a bit of a mixed bag. We had been expecting a large drop in meat exports

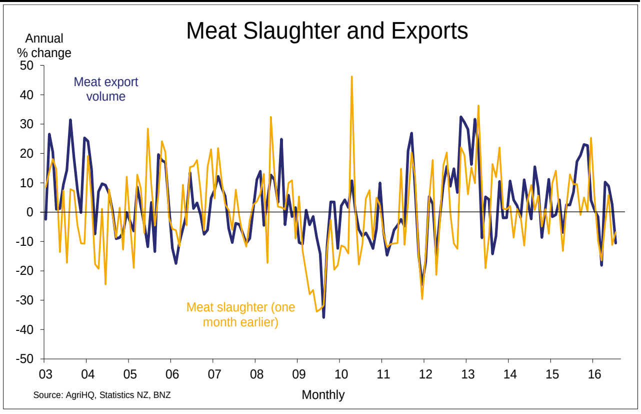
Export and Import Values Down On Year Ago



Import Weakness Widespread



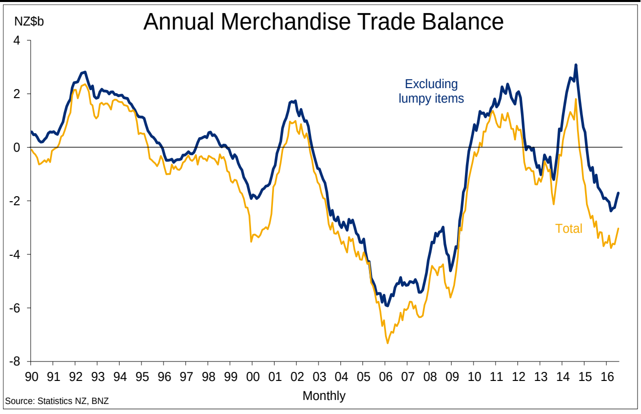
Lower Meat Production Dents Exports



over recent months on the back of the declining slaughter numbers. This occurred in July with meat export values down 19% y/y, although this also reflected strong levels a year ago. Dairy exports were down 10% y/y, on lower prices. But despite the general drag from the strength of the NZD, there were also some areas of strong growth. Log export values were up 19% y/y and wine exports were 10% higher, both boosted by decent volume increases. The dip in fruit exports this month is against what has been a generally very strong upwards trend over recent years (a trend we expect to continue).

While some export weakness may persist for a few months yet, we anticipate a circa 5% gain in exports over the coming year and further growth in the year after that. This is a function of expected gains in both volumes and prices over the period, although the latter would be hampered if the NZD does not drift lower as we expect. Forecast expansion in export volumes will be supported by anticipated further gains in horticulture.

Trade Balance Starting To Trend Narrower



However, we expect overall export volume growth will be dampened to a below average pace over the coming year by anticipated subdued meat and dairy production.

The generally positive outlook for goods exports feeds into our view that New Zealand's merchandise trade deficit will start trending narrower. Indeed, that trend may have already started with the annual trade deficit shrinking to $3,034m in July from $3,331m a month earlier. This will help continue the trend reduction in the current account deficit as a share of the economy which has been coaxed along to date by the tourism boom, interest rate relief and weak import prices including oil. The current account deficit has already reduced to 3% of GDP. We think it is headed towards 2% over the coming year or so, well below the 4% it has averaged over the past 20 years.

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