THE TREASURY
Kaitohutohu Kaupapa Rawa

Monthly Economic Indicators

New Zealand Government

June 2017

Executive Summary

- **Real GDP growth remained moderate in the March quarter although nominal GDP continued to grow at a solid pace**
- **The current account deficit widened to 3.1% of GDP despite a 40-year high in the terms of trade**
- **Falling oil prices are leading to declines in global inflation**

Real GDP grew 0.5% in the March 2017 quarter, well below our Budget forecast of 1.1%. Despite the modest gain in real GDP, growth in nominal GDP, which underpins our tax forecasts, exceeded our expectation of a 1.1% rise, rising 1.4% in the quarter. However, downward revisions to growth in prior quarters meant nominal GDP growth in the year ended March, of 5.6%, was a little weaker than the 5.9% forecast in the *Budget Update*. Meanwhile, tax revenue in the fiscal year to April was a little ahead of forecast, as it has been consistently this fiscal year.

There were clearly some temporary factors restraining growth in the March quarter, including disruption from the Kaikōura earthquakes, the sharp fall in non-residential building investment, and the decline in dairy exports.

Weakness in the trade accounts was the main driver of the wider current account deficit revealed in the Balance of Payments release for the March quarter. Export values have recovered in recent months and we expect the current account deficit to track broadly sideways over the remainder of the year.

Indicators of activity in the June quarter point to continued solid growth in domestic demand. Business and consumer sentiment remain buoyant, export commodity prices are high, growth in international visitor arrivals is continuing, and net immigration is at a record high. In contrast, activity in the housing market has eased.

Internationally, the UK elections resulted in a hung parliament and Brexit negotiations have begun. Oil prices continued to ease in the month to be down more than 20% since the start of the year. Falling oil prices are being reflected in lower headline inflation globally and core inflation is also easing, adding to uncertainty about the future course of monetary policy. New Zealand's trade weighted exchange rate TWI has appreciated by around 5% since the middle of May, mostly on US dollar weakness. Lower international oil prices, combined with a higher exchange rate will place downward pressure on domestic inflation over coming months.

Lower oil prices will also provide a boost to New Zealand's terms of trade, which reached a 40-year high in the March 2017 quarter. Our Special Topic looks at the drivers of the current cycle.

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Analysis

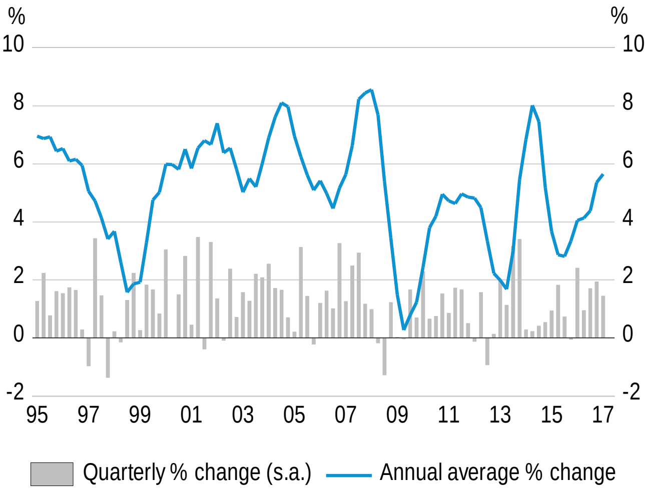
Real GDP growth remained moderate in the March quarter, increasing 0.5%, following growth of 0.4% in the December quarter. Construction-related investment fell in the quarter and net exports also detracted from growth. Nonetheless, domestic demand growth remained solid as private consumption rebounded from a slower December quarter outturn and business investment rose. Strong domestic demand is being reflected in rising import values and a widening current account deficit.

Indicators of activity in the June quarter point to continued solid growth in domestic demand. Business and consumer sentiment remain buoyant, export commodity prices are high, growth in international visitor arrivals is continuing and net immigration is at a record high. In contrast, activity in the housing market is continuing to ease.

Solid growth in nominal GDP as real growth remains moderate…

Real GDP grew 0.5% in the March 2017 quarter, well below our Budget forecast of 1.1%. Partial data, released after our forecasts were finalised, had indicated our Budget forecast was likely to be too strong. Nonetheless, we and most other forecasters did not expect growth to fade to the extent it did. The (more volatile) expenditure measure of GDP was similarly weak, up 0.2% in the quarter following a gain of 0.1% in the December quarter. Compared to the March 2016 quarter real expenditure on GDP was 2.0% higher, the smallest annual rise since the March 2014 quarter.

Figure 1: Nominal GDP growth

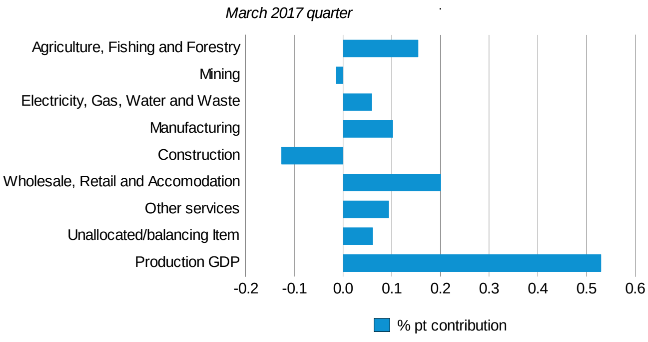


Source: Statistics New Zealand

Despite the modest gain in real GDP, growth in nominal GDP, which underpins our tax forecasts, exceeded our expectation of a 1.1% rise, rising 1.4% in the quarter (Figure 1). However, significant downward revisions to growth in prior quarters meant growth in the year ended March, of 5.6%, was a little weaker than the 5.9% forecast in the *Budget Update*. Meanwhile, tax revenue in the fiscal year to April was a little ahead of forecast, as it has been consistently this fiscal year.

Within the industry breakdown of real GDP, increased dairy production was a key driver of primary sector and manufacturing output (Figure 2). Higher dairy production was also reflected in an increase in inventories, as exports of dairy products fell 10.6%. Wholesale, retail trade and accommodation also made a large contribution to growth, reflecting ongoing strength in tourism, immigration and employment. However, growth in other services, including finance and real estate was subdued, partly reflecting an easing in housing market activity. Construction and transport activity both fell. On the latter, Statistics New Zealand (SNZ) noted that both rail and air transport were down, the former likely reflecting disruptions from the Kaikōura earthquake.

Figure 2: Industry contributions to GDP



Source: Statistics New Zealand

In the expenditure measure of GDP, spending by households continued to grow at a solid pace, up 1.3% in the quarter, driven in equal parts by increased spending on durable goods, including motor vehicles, and services. Investment spending also continued to rise at a reasonable pace, up 1.2% in the quarter, despite falls in residential, non-residential and other construction investment. Investment in plant, machinery and equipment surged 12.6%, although growth had been sluggish in previous quarters.

…as net exports weakened…

Overall, gross domestic demand rose 1.0% in the quarter and 3.9% from the same quarter last year. However, much of that demand was met through imports, which rose 1.3% in the quarter and 7.3% from the same quarter last year. Meanwhile, exports of goods have fallen in each of the last three quarters and services export value growth has slowed, despite continued strong growth in the number of international visitor arrivals. As a consequence, net exports have been a significant drag on growth over the past year.

The national accounts measure of the terms of trade fell 2.1% in the March quarter, driven by a fall in the services terms of trade, although gains in previous quarters meant the terms of trade was up 4.1% from the same quarter a year ago. Real gross national disposable income, which reflects changes in purchasing power arising from the terms of trade, also fell in the quarter but rose 3.4% from a year ago.

On a per-capita basis, growth in real GDP and real disposable income fell in the quarter and annual growth remains below average. The implication is that productivity growth also remains subdued, limiting prospects of a significant acceleration in real wage growth in the short term.

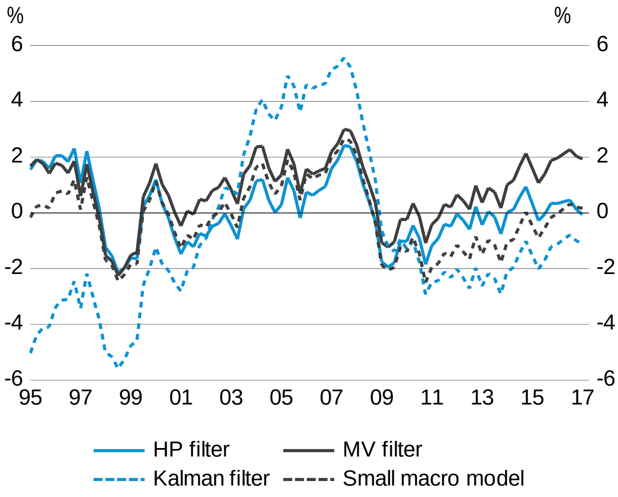
Growth outlook remains positive…

There were clearly some temporary factors restraining growth in the quarter, including disruption from the Kaikōura earthquakes, the sharp fall in non-residential building investment, and the decline in dairy exports. The absence of these temporary drags, and signs of a bounce back in exports, leaves our initial estimate of June quarter growth a little above our Budget forecast of 0.9%. Moreover, the fundamental drivers of recent growth i.e. strong population growth, low interest rates and high terms of trade, remain in place, leaving us comfortable with our forecast of growth increasing at an annual pace of around 3.5% by mid-2018.

…but lower inflation is a risk

Nonetheless, in the shorter term, slower-than-expected GDP growth in the March quarter means our estimates of excess capacity eased rather than tightened as anticipated (Figure 3).

Figure 3: Output gap measures



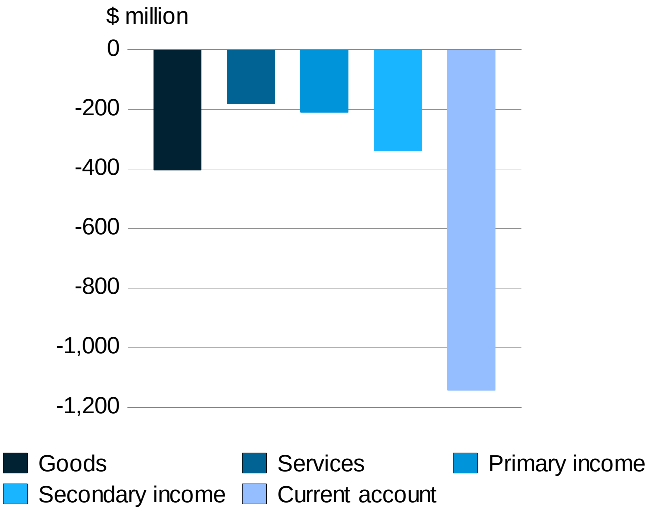
Source: the Treasury

As a consequence it may be a little longer before inflationary pressures build and flow through to higher prices. The risk is that lower inflation spills over to slower growth in company profits, household incomes and, ultimately, tax revenue. This risk is amplified by the recent increase in the exchange rate, which is around 3% higher than forecast.

Current account deficit widens…

Weakness in the external trade accounts was the main driver of the wider current account deficit revealed in the Balance of Payments release for the March quarter. Seasonally adjusted estimates of all the major balances deteriorated (Figure 4), leading to a $1.1 billion increase in the quarterly deficit. The annual deficit widened to 3.1% of GDP from 2.7% in the year ended December 2016.

Figure 4: Current account change by component (seas.adj.)



Source: Statistics New Zealand

The current account deficit was financed by a net investment inflow of $2.0 billion. Nonetheless, New Zealand's net liability position narrowed to 58.5% of GDP (down 1.9% points) as market price and valuation changes to New Zealand's net liability position more than offset the impact of the net investment inflows.

…as terms of trade rise…

The Overseas Trade Indices showed the merchandise terms of trade rose to a 40-year high in the March 2017 quarter, driven by an 18.0% rise in dairy export prices. Unusually, when compared with earlier peaks in the terms of trade, the current peak does not coincide with record high export prices. Rather, the current peak is notable for the weakness in import prices (see Special Topic).

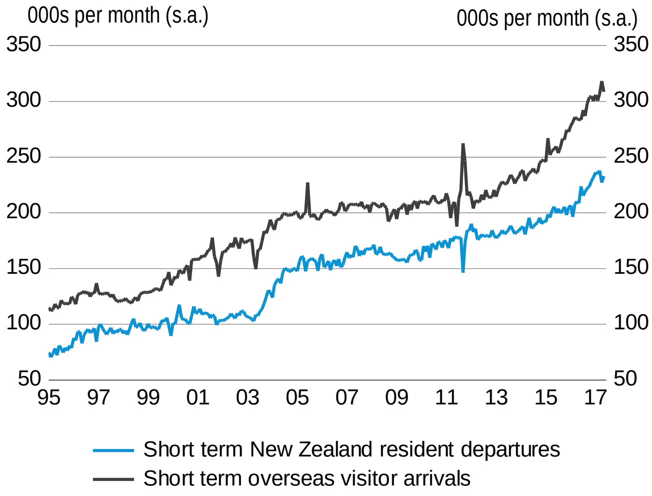
The juxtaposition of the wider current account deficit and the record high terms of trade achieved in the quarter suggests that some of the strength evident in the national accounts measure of household consumption was likely met from lower saving. This view appears to be corroborated by the financial accounts of the balance of payments, which showed a net inflow of foreign investment into New Zealand was driven by banks withdrawing currency and deposits from overseas and increasing other investment liabilities such as loans. However, we do not think this is the start of a trend. May credit data shows household lending growth continued to ease and we expect household incomes continued growing at a reasonable pace. In sum, we anticipate the annual current account deficit will track broadly sideways at around 3.0% of GDP over the rest of the year.

The merchandise trade surplus narrowed to $103 million in May from $536 million in April as export values eased following a large gain in April and import values rose on higher fuel imports, which is likely to reverse in coming months. Export values in the quarter are running well ahead of the March quarter and the trade balance overall has recovered from the weaker March quarter, signalling a reduced drag on GDP from net exports in the June quarter.

Inbound tourism number continue to rise

Tourism inflows continued to rise steadily, up 9.8% in May from a year ago (Figure 5). Australia has overtaken China as the main driver of growth in numbers. However, Australian visitors tend to spend less per visit than their Chinese counterparts, and total visitor spending has fallen slightly over the past year after a period of strong growth. New Zealander departures overseas have also increased sharply over the past year, putting further downward pressure on net tourism exports.

Figure 5: Short-term arrivals and departures

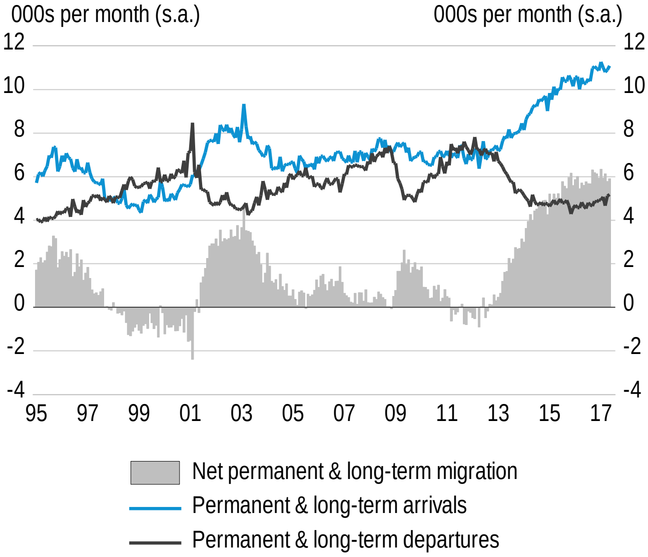


Source: Statistics New Zealand

Positive domestic indicators include migration…

Turning to the domestic economy, indicators over the past month have generally been positive. Migration figures for the 12-months ended May showed the net inflow of migrants rose to a fresh high of 72,000. The pace of increase has levelled off in recent months as departures have stabilised (Figure 6), in keeping with our Budget forecasts. Although past strength in arrivals is likely to continue to add to demand for some time, the supply side impact may begin to wane, helping to create conditions more conducive for a sustained lift in inflationary pressure.

Figure 6: Monthly migration flows



Source: Statistics New Zealand

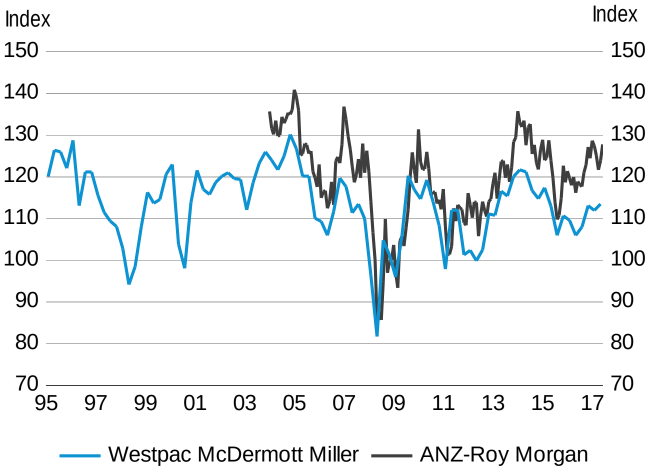
…and business and consumer sentiment…

The BNZ-Business New Zealand manufacturing and services sentiment indices both showed the sectors to be expanding at a solid pace. The combined production value of the two series rose to a record high. Employment intentions also remained high, consistent with ongoing strength in the NZ job ads series, which rose 15.6% in May from the same month a year ago.

Retail spending as measured by Electronic Cards Transactions eased 0.4% in May, following a rise of 0.9% in April, driven by lower fuel sales. Core retail sales also eased 0.4%, following 1.4% in April. On an annual basis, both core and total retail sales continued to grow solidly, up 4.8% and 5.2% respectively. We will be watching to see what, if any, impacts touring supporters of the British and Irish Lions rugby team have on June card spending.

Meanwhile, spending should remain well-supported by consumer confidence, which improved in both the quarterly Westpac McDermott Miller survey and the monthly ANZ-Roy Morgan survey (Figure 7). In both surveys, the rise in confidence was driven by expectations around future conditions, which may reflect expectations of tax cuts next year as proposed in the 2017 Budget and the improved outlook for export incomes evident in the terms of trade.

Figure 7: Consumer confidence



Sources: Westpac McDermott Miller, ANZ-Roy Morgan

…and low interest rates…

Interest rates are expected to remain low consistent with the Statement accompanying the Reserve Bank's Official Cash Rate review that monetary policy will remain accommodative for a considerable period. In our Budget Update, we forecast short-term interest rates to begin rising in the second half of 2018.

…partially offset by rising food prices…

Sharply-rising food prices have been eating into household budgets, with a 1.7% increase in May taking annual food price inflation to 3.1%. Fuel prices have fallen over the June month, providing a partial offset to the higher food prices.

…and an easing in housing market activity

Conditions in the housing market continued to ease in in Auckland where prices slid 0.7% in May, to be up just 1.8% on a year ago, and sales were 27.5% lower than a year ago. Conditions in the rest of the country generally remain firm, with prices up 11.3% on a year ago and sales up 13.6% from a year ago. Nationally house price growth eased to 5.0% from a year ago, down from 11.7% at the start of the year.

In the new dwelling construction sector, residential consent issuance has recovered somewhat over the past three months, but given earlier consent numbers we continue to expect activity to remain around its March levels through the middle of 2017.

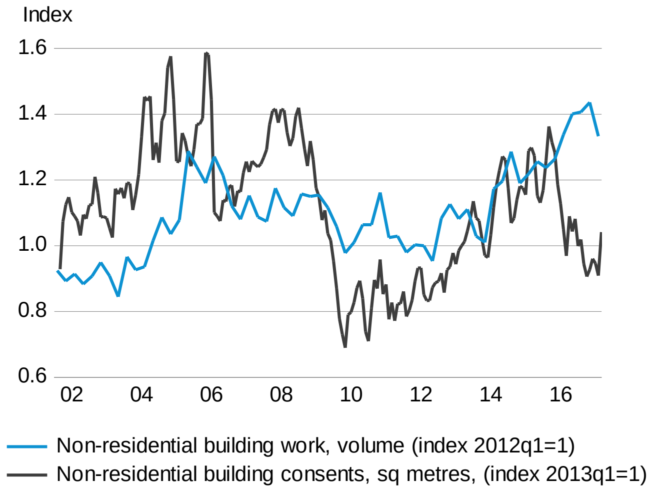
Construction of non-residential construction may be peaking

In the non-residential building construction sector, there are also some signs that activity may have reached a plateau. March's building activity survey showed non-residential building activity declined 7.2% in the March quarter (Figure 8). To some extent, a pull-back in activity was not unexpected given non-residential construction activity has increased 30% over the past three years.

Canterbury has been a big driver of activity, but over the last year or so, activity in the Auckland area has been the major driver of growth. Auckland was the big driver of March's fall in non-residential activity, with data showing the value of activity dipped 24.5% ($172 million) in the quarter, likely a reflection of a number of building projects being concluded or scaled back.

We expect non-residential construction to increase over the year ahead although the level of activity is likely to be close to levels where capacity constraints become increasingly evident. Costs are rising at a relatively fast pace, and there are some indications that consent issuance has slowed, consistent with expectations that the level of activity may be approaching its peak See for example the National Construction Pipeline report[1].

Figure 8: Non-residential building activity and consents



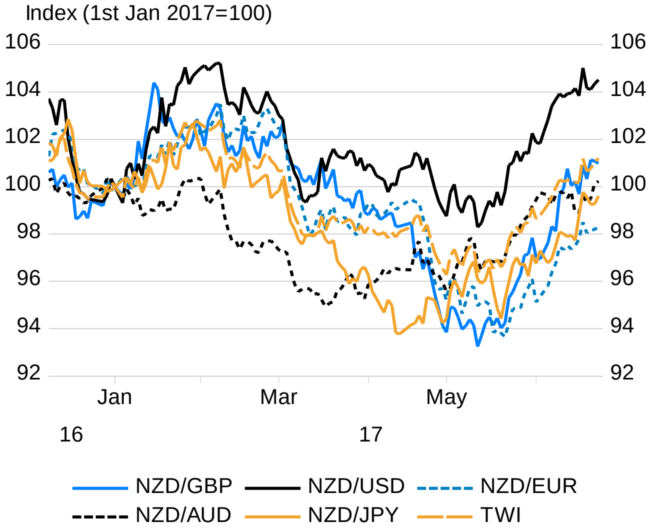
Source: Statistics New Zealand

[1] http://www.mbie.govt.nz/publications-research/research/construction-sector-productivity/national-construction-pipeline-report-2016.pdf

UK election results in a hung parliament

Markets were primarily focused on UK politics and oil prices this month. The UK election resulted in a hung parliament with the Conservative party losing a net 13 seats while the Labour party gained a net 30 seats. However, the Conservative party will remain in government, aided by the support of the Northern Irish Democratic Unionist Party (DUP). Negotiations for Brexit have now officially begun with the UK agreeing to the EU proposition of first negotiating the terms of Brexit before any trade deals are discussed. The UK has also reaffirmed its position that it intends to leave the single market, surprising some analysts who had expected the election to alter this position. The pound is now around 7% lower against the NZD from mid-May. The USD has also fallen in the month and is currently down 5% against the NZD from mid-May, primarily due to market uncertainty about the future track of interest rates (further detail below). Overall the TWI is up around 5% since mid-May and roughly in line with its level at the start of the year (Figure 9).

Figure 9: Exchange rates in 2017



Source: Haver

Oil price falls have continued in June. The WTI oil price fell below $43 a barrel in June, down more than 20% from the start of the year, technically becoming a bear market. Prices remain around a similar level to a year ago. The oil price is being suppressed by doubts about the ability of OPEC to limit global supply, both for member countries and for countries outside the agreement. The decline in oil prices this year is placing downward pressure on headline inflation globally (see Figure 10).

Fed increases interest rates but markets uncertain on outlook from here…

Inflation has stalled in the US with falls in both annual CPI inflation and the annual PCE deflator. Headline CPI inflation fell in May, bringing annual inflation to 1.9%, down from 2.2% in April. Annual core inflation also fell, from 1.9% in April to 1.7% in May. The headline PCE deflator rose 0.2% in April, bringing annual inflation to 1.7%, down from 1.9% in March. Annual core PCE inflation also fell, from 1.6% in March to 1.5% in April.

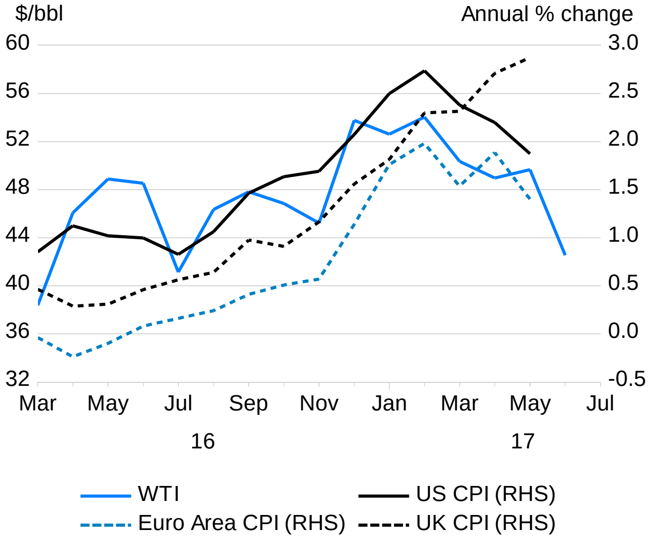
US labour market data was mixed with jobs figures disappointing but the unemployment rate continuing to fall. Nonfarm payrolls showed a net gain of 138,000 new jobs in May, down from a downwardly revised 174,000 in April. The unemployment rate declined to 4.3% from 4.4% in April, below many estimates of full employment, and the lowest rate since 2001.

The US Federal Reserve increased interest rates in June, as widely expected. The Fed noted that recent inflation outturns had been weaker than anticipated but that they expected inflation to return to 2% in the medium term. The Fed's 'dot plot' showed the median member's forecast was for one additional increase this year. Analysts appear sceptical on the likelihood of any future rate rises with current market pricing implying a less than 50% probability of a further interest rate increase by the end of 2017.

…While UK inflation begins to put pressure on the Bank of England

The Bank of England (BoE) decided to leave interest rates on hold in June. While this aligned with market expectations, analysts were surprised by the increased support by committee members for a rate rise, with three of the eight members voting for an increase. This followed CPI data that showed that inflation had increased to 2.9% in May, up from 2.7% in April (Figure 10). Core inflation also lifted to 2.6% from 2.4% in April. The depreciation of the pound surrounding the recent UK election will likely continue to put upward pressure on inflation and may see further pressure for an interest rate increase this year. Brexit is also adding to monetary policy uncertainty. BoE Governor Mark Carney noted that risks surrounding Brexit are one of the reasons he favours keeping interest rates on hold for the time being. Alternatively, Andy Haldane, chief economist of the Bank said this week that risks from overshooting the inflation target are growing and that he had considered voting for a rate increase at the June meeting. Market pricing of a rate rise by the end of the year is less than 50%.

Figure 10: Oil prices and inflation



Source: Haver

ECB remains on hold in June

Inflation for the euro area eased to 1.4%, down from 1.9% in the year to April. Annual core inflation also fell, down 0.3% points to 0.9%. The European Central Bank (ECB) left rates on hold in June as widely expected. The ECB President noted that downside risks had abated and were now broadly balanced. The ECB's forward guidance was altered slightly to remove the reference to lower rates as the most likely policy move. The ECB's growth forecasts were revised up but the inflation forecasts were downgraded. Comments by ECB President, Mario Draghi, later in the month were more hawkish saying "All the signs now point to a strengthening and broadening recovery in the euro area – deflationary forces have been replaced by reflationary ones." Market pricing of a rate increase this year has not increased significantly, though the comments did cause a slight appreciation in the euro.

Australia GDP comes in weak

Australian GDP was subdued increasing 0.3% in the March quarter to be 1.7% higher than the March quarter a year ago. Household consumption growth rose 0.5% in the quarter and 2.3% from the start of 2016, well below its historical average growth rate of 3.3%. A number of one-offs contributed to the softness in the March quarter including weather-related disruptions to exports (-1.6%) and private dwelling investment (-4.4%). Nominal GDP growth was much stronger at 2.2% in the quarter and 7.7% for the year, helped by a strong increase in terms of trade (up 7% in the quarter, 25% annually). The Australian dollar appreciated slightly upon release, reflecting market relief that downside risks were not realised.

Australia experienced another month of strong jobs growth in May with annual employment growth lifting to 2.0%, up from 1.7% in April. The unemployment rate fell to 5.5%, down from 5.7% in April. However, the labour market data are volatile and the Australian Bureau of Statistics measure of trend unemployment was unchanged at 5.7% in the month.

The RBA left rates on hold again as expected. The Bank stated that the current weakness in GDP reflected quarterly variation and growth would return to around 3% in the medium term. Market pricing suggests a cut is slightly more likely than an interest rate rise in the next 12 months, although no change is the most likely outcome for the foreseeable future. During June, Moody's downgraded 12 Australian banks, including the big four ANZ, CBA, NAB and Westpac, which were all downgraded to Aa3 from Aa2. The primary concern highlighted by Moody's was the increased risk in household debt levels, an issue the RBA has also highlighted in recent months. The downgrade was later extended to the New Zealand subsidiaries with ANZ, ASB, BNZ and Westpac all being revised down from A1 to Aa3. This brings Moody's ratings into line with other ratings agencies.

Japan builds momentum

Annual industrial production growth in Japan rose to 5.7% in April from 3.5% in March, though this was still below expectations. Annual CPI inflation remained in positive territory, rising to 0.4% in April, up from 0.2% in March. In the labour market, Japan's seasonally adjusted unemployment rate for April remained at 2.8% for the third consecutive month, the lowest level since the mid 1990's.

Weak data in China and a credit rating downgrade

China's key monthly indicators showed mixed performance in May. Annual industrial production growth remained at 6.5%, proving stronger than markets had anticipated. Retail spending growth remained steady in the year to May, as expected, at 10.7%. Fixed asset investment growth fell to 8.6% from a year ago, down from 8.9% in April. Finally, in line with market expectations, annual CPI inflation was 1.5% in May, down from 1.6% in April.

Special Topic: New Zealand's goods and services trade flows

This Special Topic provides an overview of New Zealand's trade composition and discusses some of the implications for the wider economy.

In the year to March 2017, New Zealand's total trade flows (the value of goods and services exports plus imports) were valued at $137.8 billion, with just two countries, Australia and China, accounting for more than one-third of total trade. New Zealand's top five trading destinations accounted for just under two-thirds of total trade (Table 1). Of the $137.8 billion, 51.1% was exported and 48.9% was imported, resulting in a trade surplus of $3.0 billion.

Table 1: New Zealand's top 5 trading partners

Year to March 2017 $ billions	Imports	Exports	Two-way trade	Two-way trade % of total
Australia	12.9	11.3	24.2	17.6
China, People's Republic of	12.6	10.5	23.1	16.8
European Union	8.3	11.7	20.0	14.5
United States of America	8.0	8.2	16.2	11.8
Japan	3.9	3.7	7.6	5.5
Top 5	45.7	45.5	91.2	66.1
Total	70.4	67.4	137.8	

Statistics NZ

Trade in goods dominates

In the year to March 2017, goods accounted for 71.6% of total trade, while services accounted for 28.4%. Goods exports made up 69.2% of total exports while goods imports made up 74.2% of total imports. Goods as a share of total trade has been relatively stable over the past three decades, averaging 73.1%. However, this decreased slightly in recent quarters, as trade in services increased owing largely to a higher share of services exports, reflecting strong tourism.

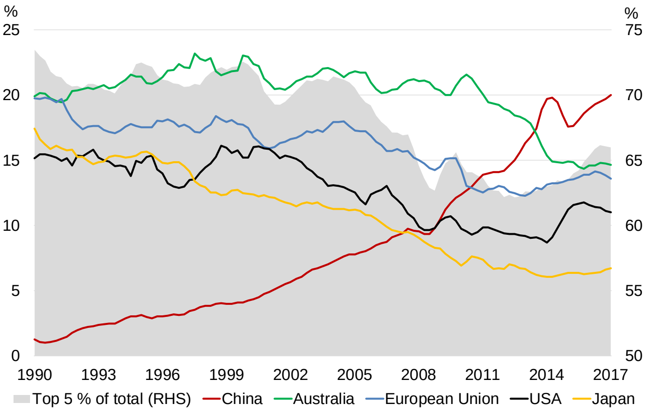
New Zealand's goods exports are concentrated in the primary industries. In the year to March 2017, over half the value of New Zealand's goods exports could be accounted for by four categories: dairy (23.7% of goods exports), meat (12.3%), forestry (8.5%), and fruit (5.7%). Vehicles, parts and accessories accounted for 15.4% of goods imports. Mechanical machinery and equipment, petrol, and electrical machinery and equipment accounted for 13.5%, 8.8% and 8.2% of goods imports respectively.

Services exports are dominated by travel and transportation (63.8% and 12.7% respectively). The former captures spending in New Zealand by short term visitors (mostly holiday makers), the latter includes transportation of passengers, freight and other items though carriers such as ships and aircraft. While travel and transportation dominate imports of services (at 33.8% and 22.5% respectively), other business services – including merchanting (the margin on goods bought and sold offshore) and services, such as legal, accounting and consultancy – accounted for 17.3% of services imports. This compares to 8.8% of exports.

New Zealand's top trading partner

As measured by goods and services two-way trade, Australia is New Zealand's top trading partner. However, for trade in goods, China is ranked first, leading in both exports and imports. In 2008, New Zealand entered into a free trade agreement with China (the first developed country to do so) which contributed to an increase in the pace of trade expansion with China[2] (Figure 1). Since 1990, China's share of two-way trade in goods has increased from less than 1.5% to over 20% in 2017. Prior to this, Australia was New Zealand's top trading partner in goods for more than two decades.

Figure 1: Share of total trade in goods



Source: Statistics NZ

Exports to Australia accounted for 18.3% of total exports in the year to March 2017, with goods accounting for 64.7% of this (Table 2). Of the $2.4 billion in travel services exports, 80.6% of this was other personal travel (holidays) and 19.4% was business travel.

[2] The New Zealand - China agreement is in the process of being upgraded. See https://www.mfat.govt.nz for further information.

Table 2: New Zealand's exports to Australia

Year ended March 2017	$ billion	% of total exports to Australia
Exports of goods	8.3	64.7
Exports of services	4.6	35.3
Major goods exports		**% of goods exports to Australia**
Precious metals, jewellery, and coins	0.6	7.5
Crude oil	0.6	7.0
Miscellaneous edible preparations	0.6	6.9
Mechanical machinery and equipment	0.5	6.4
Milk powder, butter, and cheese	0.5	6.3
Major services exports		**% of services exports to Australia**
Travel services	2.4	52.9
Other business services	0.8	18.4
Transportation services	0.7	15.7

Source: Statistics NZ

Imports from Australia accounted for 16.8% of total imports, with 54.7% of this goods imports (Table 3). Of the $2.2 billion in travel services imports, 72.6% was from holiday makers, 24.8% was business travel and 2.6% was education-related.

Table 3: New Zealand's imports from Australia

Year ended March 2017	$ billion	% of total imports from Australia
Imports of goods	6.2	54.7
Imports of services	5.1	45.3
Major goods imports		**% of goods imports from Australia**
Vehicles, parts, and accessories	0.4	6.9
Mechanical machinery and equipment	0.4	6.5
Miscellaneous edible preparations	0.3	5.2
Electrical machinery and equipment	0.3	5.1
Paper and paperboard, and articles	0.3	5.0
Major services imports		**% of services imports from Australia**
Travel services	2.2	42.4
Other business services	1.1	21.5
Transportation services	0.7	13.3

Source: Statistics NZ

Exports to China accounted for 17.9% of total exports in the year to March 2017, with goods accounting for 78.7% of this (Table 4). Of the $2.4 billion in travel services exports, 59.1% was from holiday makers, 38.8% was education-related and 2.1% was business travel.

Table 4: New Zealand's exports to China[3]

Year ended March 2017	$ billion	% of total exports to China
Exports of goods	9.9	78.7
Exports of services	2.7	21.3
Major goods exports		**% of goods exports to China**
Milk powder, butter, and cheese	2.8	28.7
Logs, wood, and wood articles	2.0	20.1
Meat and edible offal	1.2	11.8
Confidential items	0.8	8.5
Fish, crustaceans, and molluscs	0.5	5.4
Major services exports		**% of services exports to China**
Travel services	2.4	88.1
Transportation services	0.1	5.4

Source: Statistics NZ

Imports from China account for 15.6% of total imports, with 94.5% of this goods imports (Table 5).

Table 5: New Zealand's imports from China

Year ended March 2017	$ billion	% of total imports from China
Imports of goods	10.0	94.5
Imports of services	0.6	5.5
Major goods imports		**% of goods imports from China**
Electrical machinery and equipment	2.0	19.9
Mechanical machinery and equipment	1.7	16.9
Textiles and textile articles	1.4	14.5
Furniture, furnishings, and light fittings	0.7	6.7
Plastic and plastic articles	0.4	4.5
Major services imports		**% of services imports from China**
Travel services	0.3	44.2
Other business services	0.2	27.0
Transportation services	0.1	17.9

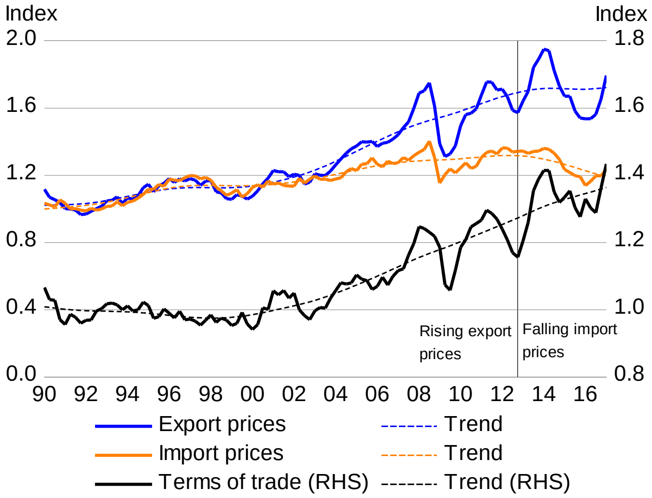
Source: Statistics NZ

Terms of trade implications

The terms of trade is the ratio of New Zealand's export prices to its import prices. A rise in the terms of trade represents a rise in national disposable income, either through lower expenses from cheaper imports or higher revenues from exports. The goods terms of trade has been trending upwards since the early 2000s, and in March 2017, were at their highest level since 1973. Figure 2 shows that between the early 2000s and 2013, the rise in the terms of trade was driven by rising world export prices. From 2013 onwards, the rise was driven by falling import prices. In NZD terms, import prices are currently around the same level as they were almost 30 years ago, driven largely by lower prices for capital and manufactured goods. Conversely, export prices have remained elevated.

[3] Confidential items are suppressed to protect commercially sensitive information. See confidential items – exports for further information.

Figure 2: Falling world import prices drive increase in goods terms of trade from 2013



Source: Statistics NZ

Growth in trade with China has contributed to New Zealand's improving terms of trade, as Chinese urbanisation and ongoing transition towards consumption-led growth has supported demand for New Zealand's primary products and kept export prices elevated. On the imports side, China's ability to produce manufactured products more cheaply than most other countries (due to scale and low labour costs), has kept import price growth muted. However, it is difficult to ascertain the exact "China" impact as other factors, particularly low oil prices, have also kept import prices low. Oil prices declined from over $US100/barrel in mid-2014 to around $US45/barrel currently. This decline followed large-scale investment in shale oil extraction in the US and elsewhere, which increased global supply and reduced prices for oil, and subsequently petrol (New Zealand's third largest import good) along with goods and services with a significant fuel component.

The impact on economic activity from a rise in the terms of trade will vary depending on the drivers of the shift. For example, whether the price change is concentrated in a particular industry or good, or whether it is broad based across many industries or goods. Higher export prices (as seen in the dairy industry in 2013), would generally lead to higher investment (such as farm conversions) which supports domestic activity. In addition, higher export revenues would increase disposable incomes and support growth in consumption. On balance, this additional demand would contribute to inflationary pressures leading to higher interest rates. Moreover, these effects may be more pronounced when a number of export prices rise simultaneously. The New Zealand dollar (NZD) would likely appreciate reflecting the stronger economic outlook and higher interest rates. New Zealanders who do not derive their income from exports (either directly or indirectly) would benefit from lower domestic prices for imported goods and services. In other words, the higher NZD would distribute some of the income gain from higher export prices to the rest of the economy by increasing the purchasing power of households.

On the other hand, the impact of a rise in the terms of trade owing to lower consumer import prices may be less stimulatory for the economy as a whole. While households would benefit through lower import prices, supporting consumption, the relative price shift could also drive higher imports of consumption goods. In addition, the impact on investment is less clear. In general, investment demand will be influenced by the type of import goods experiencing lower prices. Low goods import prices may increase competition in import-competing sectors and discourage investment. On the other hand falls in the price of imported capital goods may encourage investment. Falling import prices will also contribute directly to lower tradables inflation.

Monthly Economic Indicators is a regular report prepared by the Forecasting team of the Treasury.

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New Zealand Key Economic Data

Quarterly Indicators

		2015Q3	2015Q4	2016Q1	2016Q2	2016Q3	2016Q4	2017Q1
Gross Domestic Product (GDP)								
Real production GDP	qtr % chg[1]	0.9	1.1	0.7	0.8	0.8	0.4	0.5
	ann ave % chg	3.0	2.5	2.4	2.7	3.0	3.1	3.0
Real private consumption	qtr % chg[1]	0.6	1.4	0.3	2.0	1.3	0.4	1.2
	ann ave % chg	2.8	2.9	2.8	3.2	3.9	4.1	4.6
Real public consumption	qtr % chg[1]	-0.4	-0.1	1.2	0.2	1.2	1.0	1.0
	ann ave % chg	2.8	2.6	2.7	1.9	1.9	2.4	2.6
Real residential investment	qtr % chg[1]	2.7	1.3	4.8	4.9	0.7	0.1	-1.6
	ann ave % chg	3.2	2.0	2.8	6.3	9.0	11.1	10.2
Real non-residential investment	qtr % chg[1]	2.8	-2.4	1.8	0.9	0.6	1.9	2.3
	ann ave % chg	4.3	2.2	2.4	2.4	1.7	3.2	3.7
Export volumes	qtr % chg[1]	2.2	0.2	-0.5	3.5	-1.1	-3.2	-0.4
	ann ave % chg	7.6	6.8	5.5	4.9	3.3	1.9	1.0
Import volumes	qtr % chg[1]	-2.1	0.5	0.6	2.5	1.5	1.8	1.3
	ann ave % chg	5.7	3.7	2.1	1.1	1.8	3.4	5.1
Nominal GDP - expenditure basis	ann ave % chg	2.8	3.3	4.1	4.1	4.4	5.4	5.6
Real GDP per capita	ann ave % chg	1.2	0.5	0.4	0.7	0.9	1.0	0.9
Real Gross National Disposable Income	ann ave % chg	1.5	1.4	1.9	2.5	3.0	3.9	3.9
External Trade								
Current account balance (annual)	NZ$ millions	-8,529	-8,321	-7,821	-7,371	-7,618	-7,192	-8,132
	% of GDP	-3.5	-3.4	-3.1	-2.9	-3.0	-2.8	-3
Investment income balance (annual)	NZ$ millions	-9,581	-9,207	-8,752	-8,337	-8,221	-7,948	-8,308
Merchandise terms of trade	qtr % chg	-3.8	-2.0	4.2	-2.0	-1.1	5.7	5.1
	ann % chg	-3.6	-3.2	-0.4	-3.8	-1.1	6.7	7.7
Prices								
CPI inflation	qtr % chg	0.3	-0.5	0.2	0.4	0.3	0.4	1.0
	ann % chg	0.4	0.1	0.4	0.4	0.4	1.3	2.2
Tradable inflation	ann % chg	-1.2	-2.1	-1.2	-1.5	-2.1	-0.1	1.6
Non-tradable inflation	ann % chg	1.5	1.8	1.6	1.8	2.4	2.4	2.5
GDP deflator	ann % chg	0.6	0.3	1.0	0.2	1.4	4.2	4.0
Consumption deflator	ann % chg	1.0	0.7	0.8	0.8	0.1	0.7	1.6
Labour Market								
Employment (HLFS)	qtr % chg[1]	-0.3	1.1	1.2	2.3	1.4	0.7	1.2
	ann % chg[1]	1.5	1.4	2.0	4.4	6.1	5.8	5.7
Unemployment rate	%[1]	5.6	4.9	5.2	5.0	4.9	5.2	4.9
Participation rate	%[1]	68.3	68.2	68.8	69.7	70.1	70.5	70.6
LCI salary & wage rates - total (adjusted)[5]	qtr % chg	0.4	0.4	0.4	0.4	0.5	0.4	0.4
	ann % chg	1.6	1.5	1.6	1.5	1.7	1.6	1.6
QES average hourly earnings - total[5]	qtr % chg	1.0	0.3	0.3	0.5	0.5	-0.1	0.5
	ann % chg	2.3	2.1	2.4	2.1	1.7	1.3	1.5
Labour productivity[6]	ann ave % chg	0.8	0.5	0.8	-0.2	-1.2	-2.1	-3.3
Retail Sales								
Core retail sales volume	qtr % chg[1]	1.3	1.5	0.8	2.5	0.2	0.7	1.2
	ann % chg	5.2	5.2	4.8	6.4	5.0	3.8	3.8
Total retail sales volume	qtr % chg[1]	1.6	1.3	0.8	2.2	0.7	0.9	1.5
	ann % chg	5.7	5.3	4.9	6.0	5.1	3.9	4.6
Confidence Indicators/Surveys								
WMM - consumer confidence[3]	Index	106	111	110	106	108	113	112
QSBO - general business situation[4]	net %	-14.5	14.7	1.7	18.6	25.7	28.3	17.1
QSBO - own activity outlook[4]	net %	21.7	21.6	3.8	16.8	39.2	27.0	20.6

Monthly Indicators

		2016M12	2017M01	2017M02	2017M03	2017M04	2017M05	2017M06
External Sector								
Merchandise trade - exports	mth % chg[1]	9.4	1.6	-2.9	-3.5	17.3	-6.6	...
	ann % chg[1]	-0.2	1.0	-5.3	9.5	8.6	8.7	...
Merchandise trade - imports	mth % chg[1]	3.9	3.7	0.9	-3.2	5.7	1.1	...
	ann % chg[1]	-1.1	7.2	4.8	7.9	4.7	15.1	...
Merchandise trade balance (12 month total)	NZ$ million	-3134	-3373	-3782	-3701	-3514	-3754	...
Visitor arrivals	number[1]	300,330	305,880	300,630	306,680	318,300	308,710	...
Visitor departures	number[1]	312,440	301,310	302,530	306,860	315,180	315,440	...
Housing								
Dwelling consents - residential	mth % chg[1]	-8.4	4.1	15.4	-1.2	-7.6	...	...
	ann % chg[1]	-13.1	3.4	1.6	20.0	-10.8	...	...
House sales - dwellings	mth % chg[1]	-1.4	-6.1	1.4	5.6	...	...	...
	ann % chg[1]	-10.7	-14.7	-14.2	-10.7	...	...	...
REINZ - house price index	mth % chg	0.4	-1.1	0.6	2.4	0.8	...	...
	ann % chg	13.5	11.7	10.5	11.1	9.9	...	...
Private Consumption								
Electronic card transactions - total retail	mth % chg[1]	0.1	2.4	-0.4	-0.3	0.9	-0.4	...
	ann % chg	5.8	5.6	2.6	5.6	4.5	5.2	...
New car registrations	mth % chg[1]	-1.8	1.6	0.5	3.6	-2.5	3.8	...
	ann % chg	7.8	12.2	7.3	16.5	3.0	13.7	...
Migration								
Permanent & long-term arrivals	number[1]	10,880	11,280	11,020	10,810	10,910	11,100	...
Permanent & long-term departures	number[1]	4,940	4,930	5,080	4,670	5,120	5,190	...
Net PLT migration (12 month total)	number	70,588	71,305	71,333	71,932	71,885	71,964	...
Commodity Prices								
Brent oil price	US$/Barrel	53.22	54.58	54.87	51.59	52.31	50.33	...
WTI oil price	US$/Barrel	52.06	52.56	53.46	49.48	51.08	48.51	...
ANZ NZ commodity price index	mth % chg	2.0	-1.1	0.6	3.4	0.5	4.0	...
	ann % chg	9.4	8.6	9.2	16.5	20.4	22.3	...
ANZ world commodity price index	mth % chg	0.7	-0.1	2.0	0.4	-0.2	3.2	...
	ann % chg	16.5	19.1	20.9	23.0	23.7	26.3	...
Financial Markets								
NZD/USD	$[2]	0.7049	0.7126	0.7220	0.7009	0.6975	0.6937	*0.7215*
NZD/AUD	$[2]	0.9579	0.9547	0.9428	0.9197	0.9259	0.9334	*0.9562*
Trade weighted index (TWI)	June 1979 = 100[2]	78.12	78.55	78.78	76.54	76.01	75.50	*77.85*
Official cash rate (OCR)	%	1.75	1.75	1.75	1.75	1.75	1.75	1.75
90 day bank bill rate	%[2]	2.03	1.98	2.02	1.98	1.97	1.98	*1.94*
10 year govt bond rate	%[2]	3.33	3.23	3.29	3.28	3.05	2.93	*2.75*
Confidence Indicators/Surveys								
ANZ - business confidence	net %	21.7	...	16.6	11.3	11.0	14.9	...
ANZ - activity outlook	net %	39.6	...	37.2	38.8	37.7	38.3	...
ANZ-Roy Morgan - consumer confidence	net %	124.5	128.7	127.4	125.2	121.7	123.9	127.8
Performance of Manufacturing Index	Index	54.4	53.1	55.7	58.1	56.9	58.5	...
Performance of Services Index	Index	58.4	59.4	58.6	58.8	53.2	58.8	...

qtr % chg	quarterly percent change
mth % chg	monthly percent change
ann % chg	annual percent change
ann ave % chg	annual average percent change

1 Seasonally adjusted
2 Average (11am)
3 Westpac McDermott Miller
4 Quarterly Survey of Business Opinion
5 Ordinary time
6 Production GDP divided by HLFS hours worked

Sources: Statistics New Zealand, Reserve Bank of New Zealand, NZIER, ANZ, Haver, Westpac McDermott Miller, ANZ-Roy Morgan, REINZ, BNZ-Business NZ