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New Zealand's merchandise trade deficit – situation and outlook

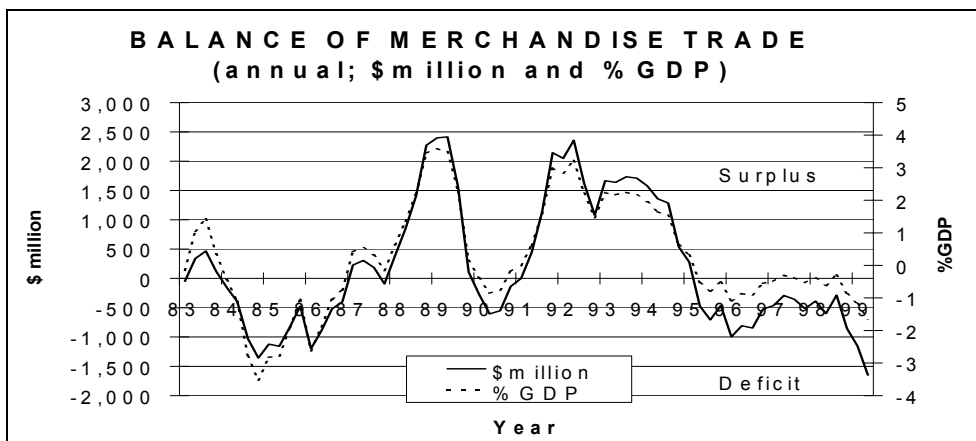
Executive Summary

- The merchandise trade deficit has reached record levels.
- There has been a deficit in New Zealand since 1995.
- Export growth in the mid to late 1990s was reduced by the strengthening New Zealand dollar.
- More recently, drought and the Asian economic crisis have lowered export growth.
- Factors which have kept import volume growth relatively high include exchange rate movements, tax cuts, AMP demutualisation, tariff reduction, and one-off factors such as the purchase of a frigate.
- While the outlook for exports is promising, import growth is likely to remain high due to the cyclical rise of economic growth.

Definitions

“Overseas merchandise trade” refers to the export and import of goods. Services are not included, although the import data used in this note includes the insurance and freight costs of bringing the goods to New Zealand¹. The “balance” of merchandise trade (or trade balance) is equal to the value of exports minus imports. The balance is said to be in “deficit” when the value of exports is less than that of imports, otherwise the balance is in “surplus”.

Situation



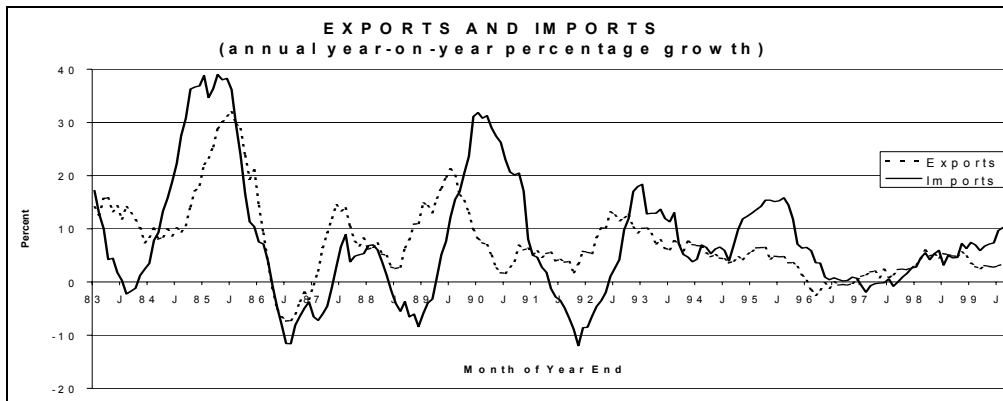
Source: Statistics New Zealand

The main features of the latest trade deficit figures are as follows.

- The deficit is the highest ever in dollar terms (\$1,649 m).
- It is the highest since 1986 as a percentage of GDP (1.7%).
- It contributes to a poor current account balance.

¹ The technical term is c.i.f. (cost, insurance, freight).

Why is the deficit so high?



Source: Statistics New Zealand

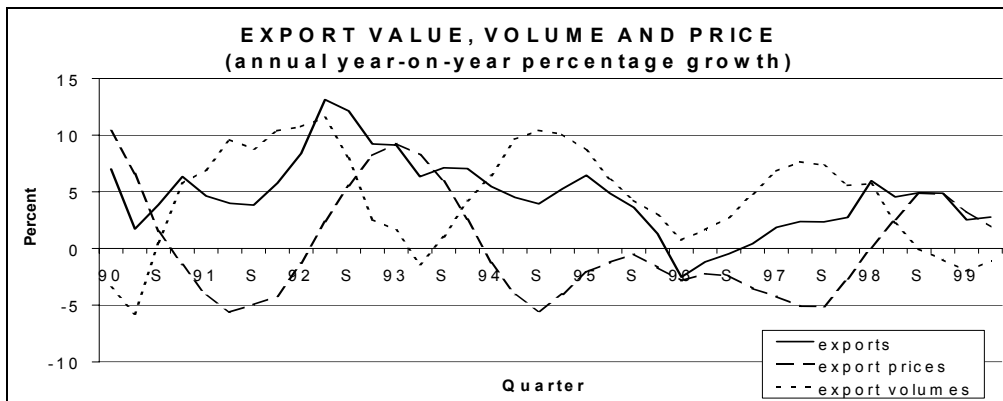
The deficit's rise to record levels is the result of the following factors:

- poor export growth over recent months
- a recent surge in the growth of imports
- import growth outstripping that of exports for much of the period since 1992.

This last point is important. Large swings in the level of exports, imports and the trade balance are not uncommon. Indeed, the recent rise of the trade deficit is not unusual compared with previous years. However, it has reached record levels because it has come off a base which was already high.

The next two sections identify the main factors which have caused the deficit's trend since the mid 1990s. Exports and imports are considered separately.

Exports



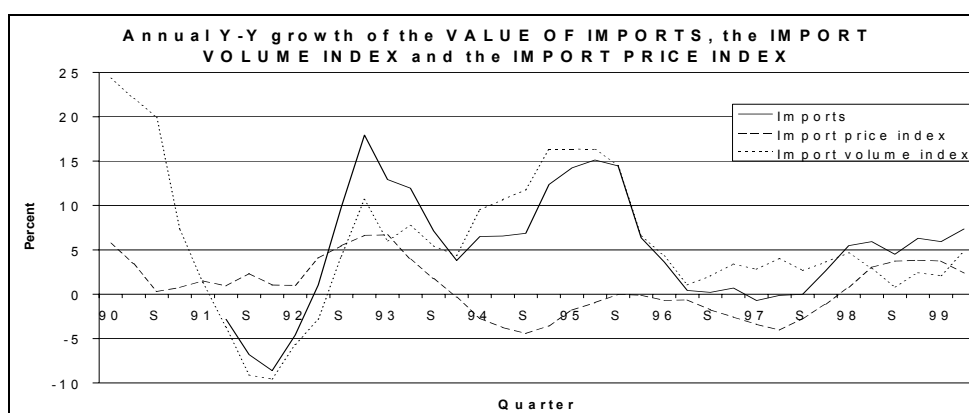
Source: Statistics New Zealand

Annual growth of exports since 1990 is shown in the graph above. The graph also categorises the growth by its two sub-components – price and volume growth. Export price growth was negative from the mid 1990s up to the beginning of 1998. Export volume growth was positive for much of the same period, but with a big dip in early 1996, and negative growth since late 1998.

5. *Exchange rates – volume effects.* By affecting the prices received by exporters, exchange rate movements affect their ability and their incentive to export. The rise in the value of the New Zealand dollar up to late 1996 would have put many exporters under considerable financial pressure, and is likely to have lowered export volumes. However, it is difficult to distinguish this effect graphically because of the other major influences on export volumes over the period.
6. *Other factors.* Government policy and less tangible factors such as exporters' networks overseas are also likely to impact on exports.

In summary, the major reasons for the low export growth rate in recent times are (1) exchange rate movements (at least until recently), (2) world commodity price movements, (3) drought, and (4) the Asian crisis.

Imports

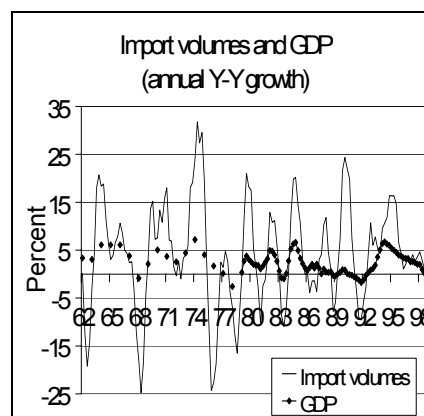


Source: Statistics New Zealand

Annual growth of imports is shown in the graph above. Import prices fell from 1993 to 1998. Import volumes have shown positive growth since 1992.

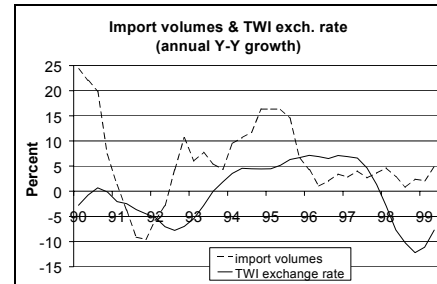
Factors explaining the trend since the mid 1990s include the following.

1. *Exchange rates – price effects.* Exchange rates have a similar effect on import prices as they do on export prices. This is shown clearly in the top graph on page 3.
2. *Economic growth.* Import volume growth tends to be high when the economy is growing strongly. This is because many of the inputs into production are imported, and because consumers and businesses are more confident about spending when times are good. The relationship is seen clearly in the accompanying graph. The long period of recent import growth is consistent with a long period of positive GDP growth. However, whereas in previous years, import volumes fell when GDP growth dipped, this has not happened recently, despite negative GDP growth.



Source: Statistics New Zealand

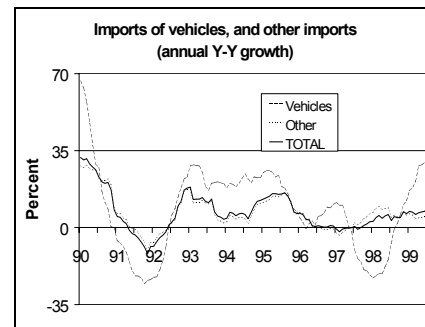
3. *Exchange rates – volume effects.* A stronger New Zealand dollar reduces the price of imports relative to the price of New Zealand products. The rising dollar from 1993 to 1997 would have given New Zealanders a greater incentive to import.



Source: Statistics New Zealand

4. *Tax cuts, AMP demutualisation and immigration.* A number of factors would have kept general expenditure high in New Zealand, and a part of this spending would have been on imported goods. Taxes were cut in July 1996 and again in July 1998. AMP was demutualised in mid 1998 giving New Zealanders shares worth \$2.5 billion, a large proportion of which would have been sold for cash.⁴ New Zealand also experienced strong net migration inflows from 1990 to 1998.
5. *Tariff reductions.* Tariffs are being reduced in New Zealand, making imports relatively less expensive than they were before. This is likely to have contributed to a higher level of imports than before.

The removal of car tariffs in May 1998 has impacted on imports, although a significant part of this may be a timing effect. Due to uncertainty regarding the tariffs and a weak economy, car imports fell markedly just before the tariffs were removed. Subsequent to their removal, car imports have surged.



Source: Statistics New Zealand

6. *Other factors.* There are other factors which would have affected imports, such as the purchase of a frigate in 1997 for about half a billion dollars.

In summary, import volume growth has been positive since 1992, despite a shrinking economy in early 1998. Key factors explaining this are likely to be the strong dollar (at least until recently) and various factors which have put more money into people's pockets, such as tax cuts and the demutualisation of AMP.

⁴ Source: The Dominion. 24.6.98, p.11.

Outlook

The outlook is for export growth to rise. However, further import growth means that New Zealand is likely to continue with a high merchandise trade deficit over the next year or so.

Exports are likely to grow strongly as the factors mentioned above reverse themselves.

- Although the New Zealand dollar is expected to strengthen, it is unlikely to reach the levels of 1996.
- World prices for commodities have bottomed out and are rising. They will rise further as world growth improves from its current levels.
- Assuming a return to more “normal” weather, stock levels on farms will be built up and agricultural exports will no longer be held back by this particular supply constraint.
- International economic growth is forecast to recover, which will increase world demand for our exports.

Import growth is likely to remain strong. A major reason is rising economic growth, which will result in more imports. Added to this will be the purchase of a further frigate later this year. The surge of car imports, however, should soon taper off as stocks are replenished, although they will remain at a higher level than before the tariffs were ended.

The net result is that the merchandise trade deficit will probably continue rising well into the year 2000, with no definite improvement likely until the end of that year.

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