EXPORT RECEIPTS: REASONS FOR RECENT GROWTH AND NEAR TERM OUTLOOK

In this article, prepared mainly by John Huddleston, recent trends in receipts for the major export categories are examined.

Executive Summary

New Zealand's balance of payments current account deficit improved sharply over 1988, recording its best performance since the early 1970's. This performance was largely due to growth in receipts for exports of goods. Although some export categories, forestry for example, have experienced significant volume growth, much of the growth in receipts has been due to rises in prices.

In part this export price growth can be explained by the general upturn in world commodity prices which was belatedly generated by the long period of growth experienced by the major economies since the early 1980's. However, there have also been structural shifts in the demand, and prices received, for some of New Zealand's exports which mean that part of New Zealand's improved terms of trade is unlikely to be reversed by any cyclical slowdown in the world economy. Thus while the prices received for some primary products may fall over the next eighteen months or so as the growth rate of the international economy slows, only a small decrease in the overall terms of trade is expected.

Export volumes were boosted in 1988/89 by the impact of drought in some regions which meant that lambs and cattle were slaughtered earlier than usual. The reversal of this effect, coupled with the delayed impact of the drought on the productivity of wool farmers, will act as a drag on export volumes in 1989/90. Other sectors are expected to perform reasonably well however, with the result that total goods export volumes should still exhibit positive growth in the current year. In the following year the prospects for export volumes are good for most sectors, with the result that the upward trend in export receipts should continue.

Introduction

New Zealand's balance of payments current account deficit improved sharply over 1988. While higher export prices made a major contribution to the improvement, increased export volumes were also a significant factor. The increased export volumes provided the only source of growth in the real economy during 1988/89.

As it is likely that growth in the New Zealand economy will continue to be export led in the near future this article identifies the sources of the recent growth in merchandise export volumes and provides an assessment of their future prospects. The reasons for the improvement in export prices, and their expected behaviour over the near future, are also examined. The article concludes that while recent trade gains are partly attributable to cyclical conditions, or to special factors which will not recur, more enduring increases in export prices have also contributed and will continue to do so.

Recent Developments

New Zealand's current account deficit improved steadily throughout 1988 to reach a level of $253 million for the year ended March 1989. This deficit represented a 16 year low as a percentage of gross domestic product (around 0.4 per cent). The improving trend continued over the June 1989 quarter, with provisional figures indicating that the current account was in surplus for the year ending June. This is the first annual current account surplus recorded since 1973.

The fall in the current account deficit can be traced to a major improvement in the trade balance. The merchandise trade balance surplus increased by $1613 million to $3107 million in the year ended March 1989. Over the same period the invisibles deficit remained steady at around $3400 million, although it deteriorated up until the December 1988 quarter before improving in the first quarter of 1989. It should be noted, however, that over half of the $272 million improvement in the annual invisibles balance over the March 1989 quarter was due to the one-off sale of property in Tokyo which had been owned by the New Zealand embassy. In year on year terms therefore, and excluding special factors, the invisibles balance continued to deteriorate slightly.

A large rise in export receipts and a fall in import payments both contributed to the trade balance outturn. The import payment reduction was due to a fall in the demand for imports, and in particular imports of investment goods, as the economy weakened.

The export performance was driven partly by an increase in volumes and, to a larger extent, by favourable prices internationally. Due to the buoyant nature of most international commodity markets in 1988, prices for our exports, which are still significantly commodity

Figure 1
Balance of Payments

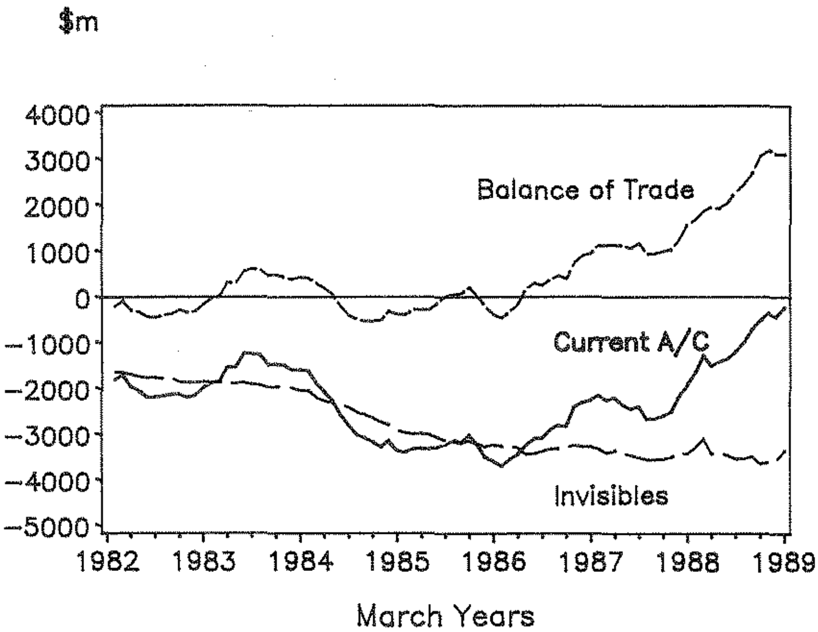
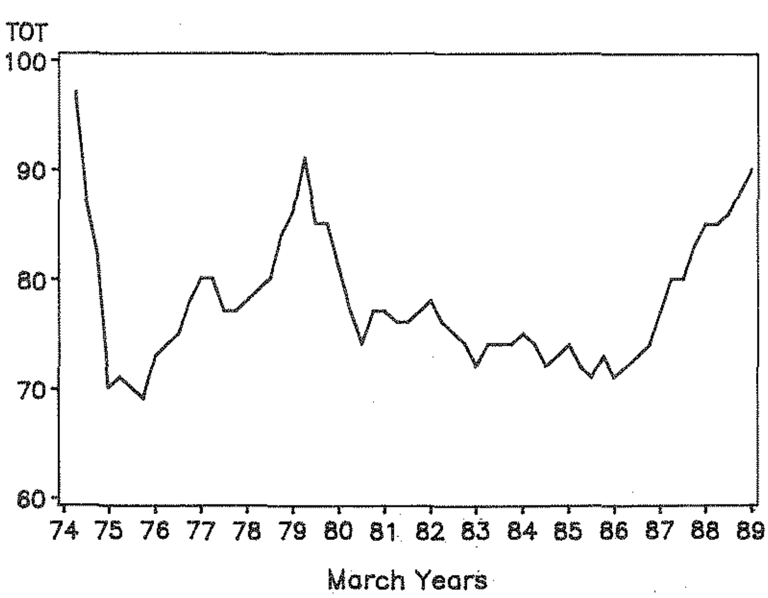


Figure 2
Terms Of Trade



based, rose much more than import prices. As a result New Zealand's terms of trade rose by 6.4 per cent in the year to March 1989 to reach a 10 year high (see figure 2).

The upward trend in most commodity prices over 1988 was partly due to the strength of demand in the major economies as strong growth continued. The current growth cycle has been particularly long in several of these countries. The United States, for example, had by mid 1989 experienced twenty six consecutive quarters of positive growth, its second longest period of uninterrupted growth this century.

What is perhaps surprising is the length of time that it took for demand pressures in the major economies to impact on our terms of trade. 1982 marked the beginning of the upturn in many of the OECD economies but it was not until 1986 that New Zealand's terms of trade began to recover. There are various explanations that might be advanced for this time lag. One of the most likely would seem to be that due to the depth of the previous recession, the amount of restructuring that had taken place, and the increased emphasis on low inflation monetary policies, economies such as the United States had the ability to grow significantly, over a long period, without experiencing inflationary pressures.

A further factor contributing to price increases for New Zealand's primary commodity exports over 1988 was liberalisation of markets for these products by some of our trading partners. Protection for primary producers in some countries had previously led to over production which had had a depressing effect on prices.

While some general statements explaining trends in export volumes and prices over the last year can be made, it is difficult to gain an accurate understanding of the overall results without looking at the various export categories individually. The rest of this article therefore provides a detailed examination of the factors that had, or are expected to have, significant impacts on prices and volumes for specific export categories.

Export Prices

Table 1 provides a breakdown of price increases for various categories of exports for the period 1986/87 to 1988/89 as estimated by the Reserve Bank together with forecasts for 1989/90 and 1990/91. It should be noted that the category definitions are the Bank's and do not necessary match those used by other economic commentators.

Dairy products recorded the largest price increase with dairy prices rising on average by an estimated 32 per cent in the year to March 1989. Lower European Community (EC) milk production, due to a reduction in the amount of subsidisation in the Community, contributed to a substantial reduction in world dairy stocks. This enabled dairy prices to recover from their sharp declines during 1986 and 1987 when markets became over-supplied.

In 1988/89 meat exports experienced a reversal of the trend of static or falling prices that had existed since 1985. This turnaround has resulted from liberalisation of imports in some countries and, in the case of beef, reduced production in the United States as herds were rebuilt after their recent drought.

Other large price increases reflected the favourable impact of rising commodity prices as world economies grew strongly during 1988. Aluminium export prices rose by an estimated 32 per cent in New Zealand dollar terms in the year to March 1989 and have risen by over 50 per cent since late 1985. Methanol, forestry and wool prices also rose significantly during this period. While price rises in the first two export categories reflected strong demand from a range of countries, wool prices have been significantly driven by demand from a single country, China. In the year to March 1989, China was New Zealand's single largest market for wool, buying around 27 per cent (by volume) of our total wool exports.

TABLE 1
MERCHANDISE EXPORT PRICE GROWTH[1]
(annual percentage changes)

Export Sector	*1987*	*1988*	*1989*	*1990[2]*	*1991[2]*
Meat	–6.7	1.3	6.9	9.8	4.2
Wool	6.3	18.1	9.1	0.0	1.9
Dairy	0.5	2.2	32.0	29.8	5.5
Other Animal Products	–5.0	34.1	–6.8	6.3	3.8
Forestry	3.0	3.5	10.9	0.2	–1.1
Other Primary Products	12.3	–11.3	–16.7	–5.6	–1.3
Manufactures	0.2	7.9	14.9	5.1	3.4
Total	1.3	5.0	9.2	7.4	2.7

[1] March Years
[2] Forecast

A strong price rise was recorded in the manufactured exports category as shown in table 1. However it should be noted that this category includes items such as aluminium, iron, steel and methanol which all experienced strong price growth in 1988/89. Prices for manufactured exports, excluding these commodities, are estimated to have risen by just over 7 per cent in 1988/89.

Price declines were recorded in 1988/89 in the 'other primary products' and the 'other animal products' export sectors. The 'other primary products' definition used by the Reserve Bank includes such items as fish and horticultural products. While fish prices did fall somewhat in overseas markets in 1988/89, a major reason for the decline in average prices received in New Zealand was a change in the mix of species exported. Increased production worldwide of some of the other products in this category, particularly kiwifruit, also contributed to the price fall.

The 'other animal products' category consists mainly of animal by-products and is dominated by hides and skins. A world oversupply of hides and pelts during 1988/89, led to falls in price from the highs of the previous year.

Looking to the near future, slowdowns in the major overseas economies, in part due to a natural cyclical slowdown after such a prolonged expansion, as well as their authorities' reactions to inflationary pressures, are expected to lead to softening commodity prices during 1989. Indeed, prices for wool, aluminium and some forestry products have already declined from their 1988/89 peaks. Some further easing in these prices is expected over the next 12 months, although the impact of averaging may mean that price reductions do not immediately show up in annual figures.

In the case of wool, a minor reduction in price is expected. World wool production has been trending up over recent years, but only by 1-2 per cent per annum and so the extra supply has been met by increased demand. In addition wool production in New Zealand is expected to be lower in 1989/90 than in 1988/89 due to the downward trend in sheep numbers and the impact of the drought in parts of New Zealand in 1988. Consequently, New Zealand should not be left with excessive wool stocks due to the expected reduction in purchasing by China. Also the cessation of hostilities between Iran and Iraq could lead to a resumption of Iranian purchases.

Falls in price for aluminium and forestry products are also not expected to be large, as the outlook is only for slower, and not negative, growth in the major world economies over the next year or so.

Over the next 12-18 months price rises are anticipated for manufactures, meat products, dairy products and other animal products. Following the fall in the New Zealand dollar in late 1988 the competitive position of New Zealand manufacturers has increased, particularly in the Australian market which is the largest market for New Zealand's manufactured exports and which now has an inflation rate above New Zealand's.

Meat prices are expected to be supported by the liberalisation of the beef market in Japan and South Korea, the proposed reduction in EC tariff rates, and lower production in North America and New Zealand. The progressive opening of the Japanese and Korean markets to imported beef is expected to lead to a large increase in consumer demand for beef in these markets. The Japanese market has been projected to more than double over the next few years. While New Zealand's beef exports to Japan and Korea are only modest because of those countries' preferences for grain fed beef, their markets will absorb Australian beef which would otherwise be diverted to North America, New Zealand's main market for beef. This diversion of Australian beef supplies, combined with a reduction in US beef production as US herds commence a rebuilding phase after several years of decline, can be expected to help beef prices firm this year.

The reduction in the European community tariff on New Zealand lamb this year from 10 per cent to zero, as compensation for a cut in New Zealand's quota to the European Community, is expected to lead to an increase in lamb prices during 1989/90. Also the lower supplies of New Zealand lamb over this period will mean that less lamb needs to be sold to lower priced markets.

A further decline in EC milk production, along with reduced world dairy product stockpiles, is expected to lead to higher dairy prices for some dairy products this year. Given the removal of protection, prices for other dairy products should maintain their current levels. Because of the lags in price movements which arise from the contract sales which make up a significant proportion of New Zealand's dairy exports, a further increase in average prices will be seen during 1989/90.

The only goods expected to experience a drop in average prices during the next 12 months are other primary products. Higher world kiwifruit production, combined with the loss of kiwifruit's luxury status in world markets, is expected to lead to further price falls. While a lower New Zealand kiwifruit crop this season, coupled with new marketing initiatives by the recently established Kiwifruit Marketing Board, will assist in taking some pressure off prices, a small fall in kiwifruit prices is still expected. Fin fish prices are also expected to decline this year. A lower catch of high valued orange roughy, because of quota reductions, is likely to reduce average fin fish prices during 1989/90. Orange roughy catch quotas have already been reduced by 15 per cent and further cuts are likely because of concerns over orange roughy stocks.

Export Volumes

Table 2 provides a breakdown of volume increases for various categories of exports on the same basis as table 1.

Unusual weather conditions in New Zealand during the past year affected primary product exports. Lamb and beef export volumes were boosted during a period when volumes would have been expected to decline because of lower stock numbers and stock rebuilding. Instead, in the drought affected regions lambs and cattle were slaughtered earlier than in previous years and capital stock was killed off. Beef volumes were boosted also by good pasture growth in some North Island regions. Meat exports in 1989/90 therefore are expected to fall from the unusual high levels seen in 1988/89 before rising slightly in the following year due to an anticipated recovery in meat production.

Increased volumes of dairy exports should partly offset the impact of lower volumes of meat exports on export returns in 1989/90. The

TABLE 2
MERCHANDISE EXPORT VOLUME GROWTH[1]
(annual percentage changes)

Export Sector	*1987*	*1988*	*1989*	*1990*[2]	*1991*[2]
Meat	19.0	–5.1	0.0	–9.6	0.3
Wool	9.5	–9.9	3.6	–9.0	9.6
Dairy	–3.2	2.0	–7.4	7.3	4.7
Other Animal Products	21.1	–6.5	2.7	–4.9	0.4
Forestry	4.0	15.2	16.0	11.6	15.4
Other Primary Products	9.7	17.5	18.9	3.6	5.8
Manufactures	–1.2	3.8	–0.5	5.4	3.2
Total	5.1	2.6	3.5	1.1	4.9

[1] March Years
[2] Forecast

adverse weather conditions in 1988 contributed to a decline in dairy production during 1988/89. Dairy production should therefore rise this year with a further increase in the following year as dairy herds increase and productivity improves in response to increased investment.

Wool export volumes during 1988/89 rose not because of increased production but because of a change in shearing patterns. Farmers are now increasingly shearing their sheep more frequently than once a year. During the 1988/89 March year this had the effect of bringing forward much of the wool clip into the September and December quarters. Shipments during 1989/90 will also be affected by lower sheep numbers and poor seasonal conditions arising from the past season's drought. Consequently, wool export volumes this year are projected to fall before recovering somewhat during 1990/91 due to an expected increase in wool production.

The forecast recovery in meat and wool production during 1990/91 is based mainly on an anticipated commencement of a recovery in stock numbers following the rundown in sheep and beef numbers since 1986 because of farm restructuring and more recently drought. Any recovery however will be limited by the need to rebuild capital stock and by the impact of lower fertiliser usage in recent years which has reduced stock carrying capacities.

Other categories of exports experienced volume increases during 1988/89 that were not due to cyclical or special factors, and are expected to expand further this year. The expansion in forestry volumes is expected to continue as forestry plantations mature but it is less clear what form these exports will take. Much of the current expansion in forestry exports is attributable to log exports but this expansion is likely to slow or even decline in future years as more timber is processed into added value products. Other primary product exports such as pipfruit are also expected to increase further, as plantings mature, but at a much slower rate than in previous years. Horticultural exports this year will be affected by a likely decline in kiwifruit exports. Kiwifruit export volumes had been expected to expand by a further 15-20 per cent during 1989/90 but climatic conditions have reduced this year's kiwifruit export crop. In 1990/91 a resumption of growth in kiwifruit export volumes is expected.

Manufacturing export volumes, after declining slightly during 1988/89, look set to expand this year. New Zealand's manufacturing sector has undergone significant restructuring over recent years, partly as a result of the government's lowering of industry assistance, and this has led to manufacturers concentrating on areas in which they are now internationally competitive. The short term result of this policy has been a fall in production and employment in the manufacturing sector. This has been concentrated primarily in those manufacturing industries which were substantially reliant on the domestic market and import protection, namely the textile, clothing and footwear industries. While further restructuring may still be required in these industries any further effect on exports of manufactured goods will be limited by their now smaller share of total manufacturing exports. This factor coupled with the strong competitive position of the remaining manufacturing industries, should place the manufacturing sector in a good position to take advantage of new trade opportunities. The Australian economy, manufacturers' largest market, while forecast to slow over the next eighteen months, is not expected to experience a recession.

Summary and Concluding Remarks

The recent improvement in goods exports receipts was due in part to cyclical conditions and special factors which will not recur. A slowing in the rate of increase is therefore expected over the next 12 months. Average export volume and price increases are forecast by the Bank to slow to 1.1 and 7.4 per cent respectively during 1989/90 after rising by 3.5 and 9.2 per cent during 1988/89.

Further out the prospects for export volumes are more favourable. A recovery in agricultural sector exports combined with further forestry, manufacturing and horticultural sector growth should see a resumption of earlier export volume gains. The outlook for prices is less certain. The world economy, while entering a more mature phase of its growth cycle, is expected to continue to expand (albeit much slower than in 1988). Commodity prices, while likely to weaken somewhat over the next 12 months, are therefore not expected to fall sharply.