NEW ZEALAND'S TRADE WITH AUSTRALIA

REPORT PREPARED BY:

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JULY 2013

PART I – MERCHANDISE GOODS TRADE

All figures are for calendar years unless otherwise stated.

OVERVIEW – NZ EXPORT TRENDS

- Over the past 20 years (i.e. 1992-2002), the value of NZ's exports to Australia have grown at an annual average rate of 5.2%.

- This compares with our exports to the rest of the world, which have grown by 2.8% per year on average over the same time period.

- In the years following the global financial crisis (GFC) (i.e. 2008 onward), the Australian economy slowed but did not fall into recession. Australia's resilience (along with China's) during this period, greatly assisted NZ weathering the global recession.

- NZ's merchandise exports to Australia held up relatively well during the GFC. In 2009 – the year immediately following the onset of the GFC – goods exports to Australia declined by 8.6% compared to a year earlier. However, merchandise exports to Australia rebounded in 2010 and continued to rise steadily through to 2011.

- In 2012, NZ's merchandise exports to Australia declined sharply despite a continuing exchange-rate tail wind. Merchandise exports to Australia fell by $940 million, an annual decrease of 8.7%. This was driven by declines in the exports of our top two commodities to Australia: crude oil and gold.

- Crude oil is our largest export commodity to Australia, comprising 18% of total exports by value. Most of NZ's crude oil is exported to Australia for refining. NZ's high quality oil is more suited to the Australian refineries than to NZ's only major refinery at Marsden Point – which is configured to process lower-quality oil. Once it has been refined, crude oil is primarily consumed in Australia. In 2012, our export of crude oil to Australia declined by $456 million (or 21%) and this was the key driver of the overall decline in merchandise exports. For the 2012 year, our total crude oil exports to the world were down (an annual decrease of $383 million or 17%).

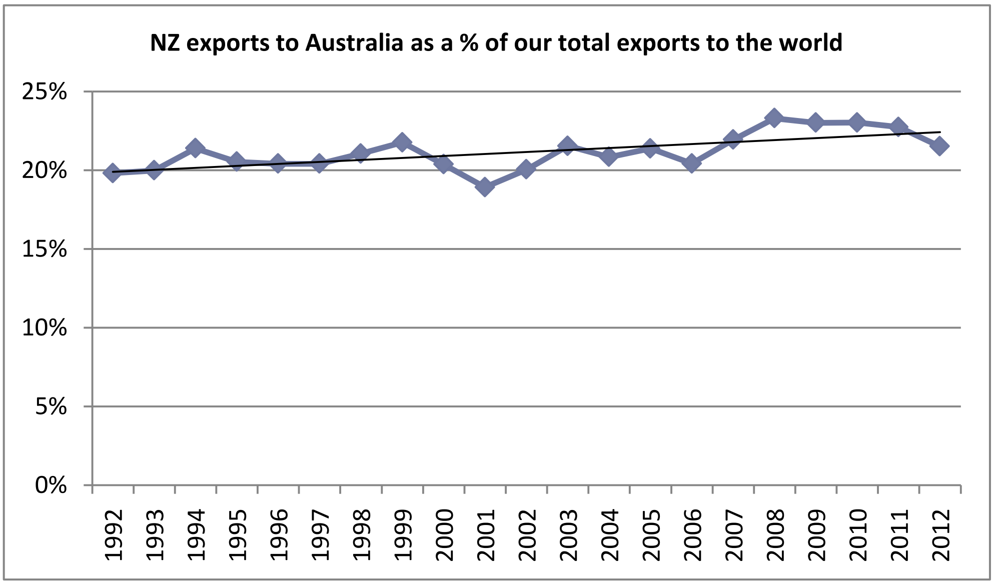
- Gold – our second largest export commodity to Australia – decreased by $32 million (or 5.3%) in 2012.

- Furthermore, even after the drop in mineral fuels and precious metals, our merchandise exports to Australia still fell by $451 million or 5.6%.

- The following table shows the annual change for our top 5 exports to Australia in 2012:

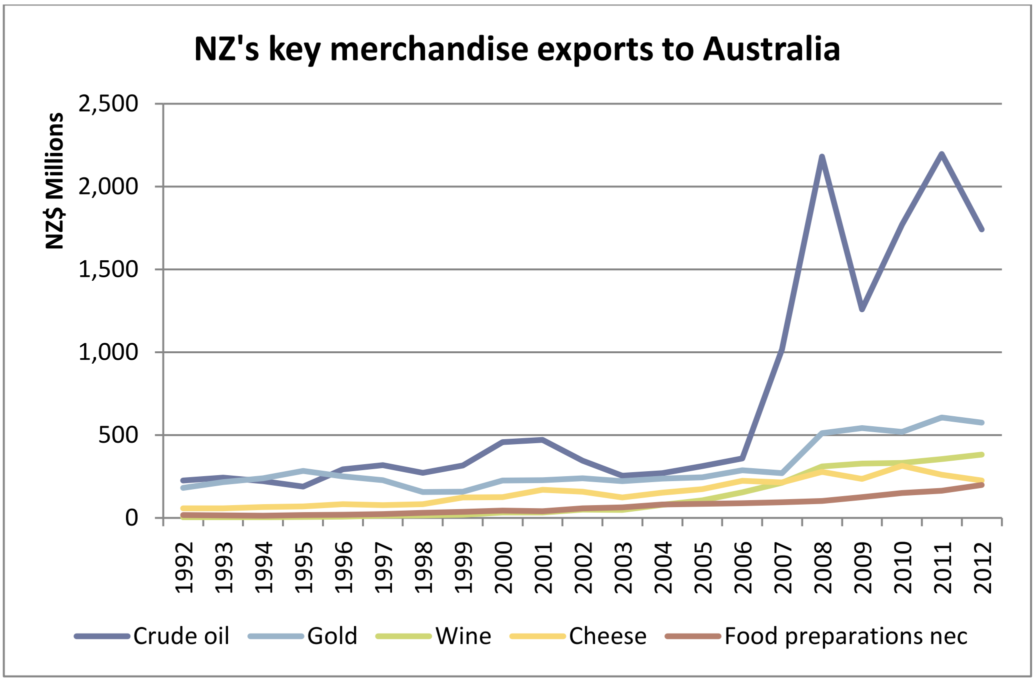
Commodity	2011 (NZ$m)	2012 (NZ$m)	Annual change (NZ$m)	Annual percentage change (%)
1. Crude petroleum oils	2,197	1,741	-456	-21%
2. Gold	607	574	-32	-5%
3. Wine	356	382	26	7%
4. Cheese	261	226	-35	-13%
5. Food preparations nec	164	198	35	21%
Top 5 export commodities	**3,584**	**3,122**	**-462**	**-13%**
Total all commodities	**10,848**	**9,908**	**-940**	**-9%**

- Over the past 20 years, Australia's share of our total merchandise exports has remained relatively flat (ranging from 19% to 23%). For the year ended December 2012, approximately 22% of NZ's total goods exports were destined for Australia.



CRUDE OIL

The minerals and petroleum sectors make a significant contribution to NZ's economy. In fact, over the past 20 years, exports of mineral fuels have consistently remained as NZ's fourth largest export commodity – behind dairy, meat and wood. For the year ended December 2012, exports of mineral fuels contributed 5% to our total export earnings.



The majority (over 80%) of NZ's mineral fuel exports are exports of crude oil (HS2709) – nearly all of which is destined for Australia. Since 1996, crude oil has been NZ's largest export commodity to Australia, and over this 16 year period, our crude oil exports to Australia have grown at approximately 12% per year on average, in value terms.

In 2012, NZ exported $1.8 billion worth of crude oil to the world with $1.7 billion going to Australia. However, during this year, NZ's exports of crude oil fell by $456 million (or down 21%) compared to the previous year – driving the overall decline in our total merchandise exports to Australia. The steep decline in NZ's crude oil exports to Australia reflects a fall in the quantity of crude oil exported – which decreased at a significant rate (down 20.5% annually) in 2012. The unit price of crude oil remained relatively flat over the year, declining by only 0.4%. This suggests that the decline in the value of our crude oil exports to Australia in 2012 was by and large, a supply-side story. In 2012, NZ exported around 1.6 million tonnes of crude oil to Australia (cf. 2 million tonnes in 2011). Indigenous production of crude, condensate, naphtha and NGL in NZ was down 259,000 tonnes (a decrease of 12%) compared to the 2011[1], due to decreased production across most oil fields during the year.

It is also important to note that exports of crude oil can be irregular, mainly affected by the timing of shipments and the amount of crude oil that is kept in NZ to be refined locally.

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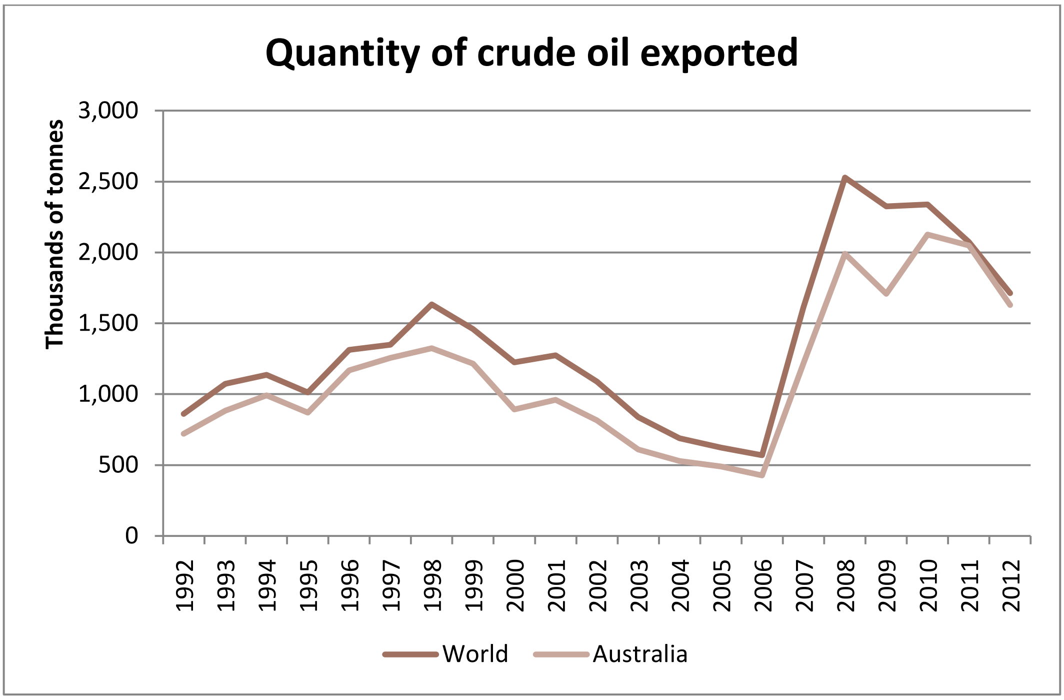
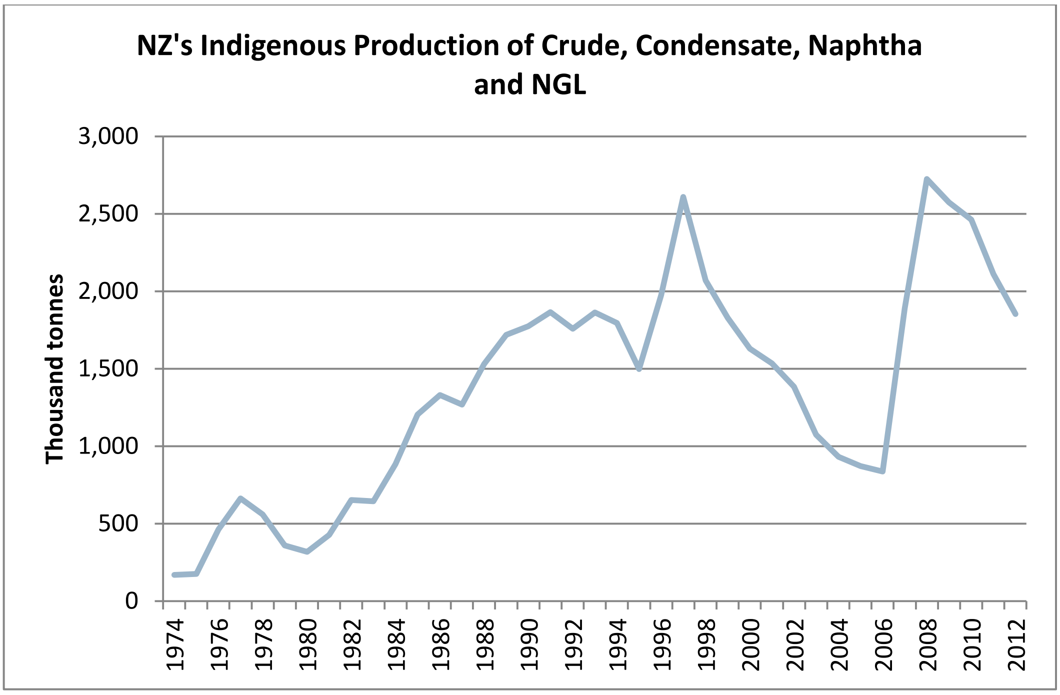
[1] Source: "Oil supply, transformation and consumption statistics", Ministry of Business, Innovation and Employment.

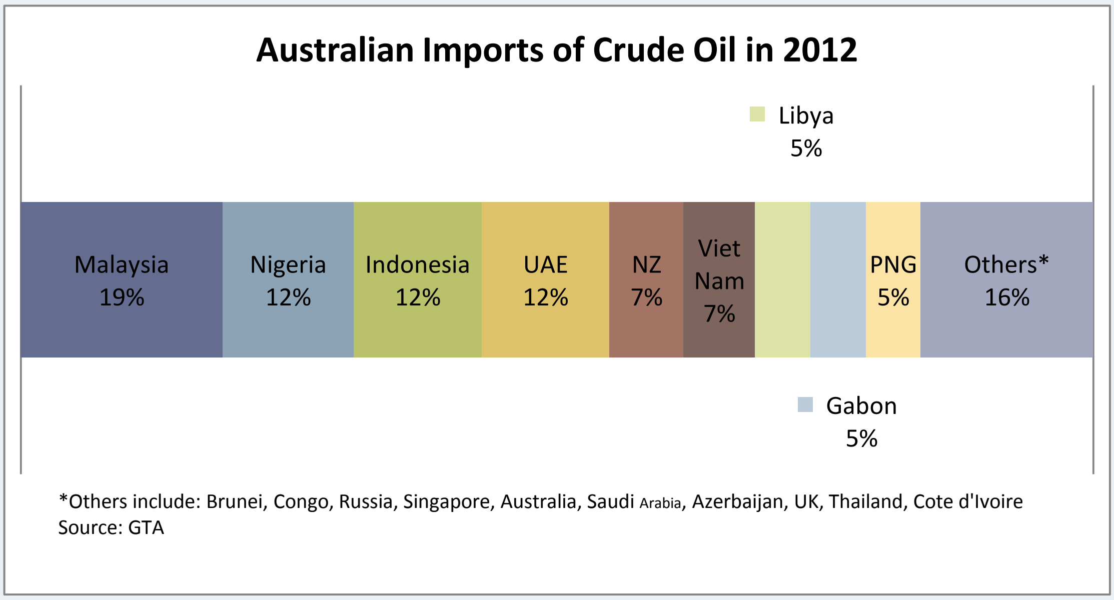

Quantity of crude oil exported
Thousands of tonnes
3,000
2,500
2,000
1,500
1,000
500
0
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
World
Australia


NZ's Indigenous Production of Crude, Condensate, Naphtha and NGL
Thousand tonnes
3,000
2,500
2,000
1,500
1,000
500
0
1974
1976
1978
1980
1982
1984
1986
1988
1990
1992
1994
1996
1998
2000
2002
2004
2006
2008
2010
2012

Box 1 – SPOTLIGHT ON CRUDE OIL

Crude oil production in NZ increased dramatically after the Tui Area Oil Fields (located in the offshore Taranaki basin), began production in the middle of 2007. Production was further boosted in late 2008 as Maari – also located off the Taranaki coast – started production. The Maari field reached full production in June 2009 – around the same time that production from the Tui fields began to decline.

Most of NZ's crude oil is exported to Australia for refining. This is because NZ's high quality oil is more suited to the Australian refineries than to NZ's only major refinery at Marsden Point – which is configured to process lower quality oil. For this reason, we export almost all of our domestically-produced crude oil and import nearly all the crude oil that is refined and used domestically. Once it has been refined, NZ's crude oil is primarily consumed in Australia. Australian refineries import crude oil from a range of countries, with NZ accounting for 7% of imports. 98% of the refineries' production is then consumed within Australia, and supplemented with imports of refined petroleum products.[2]



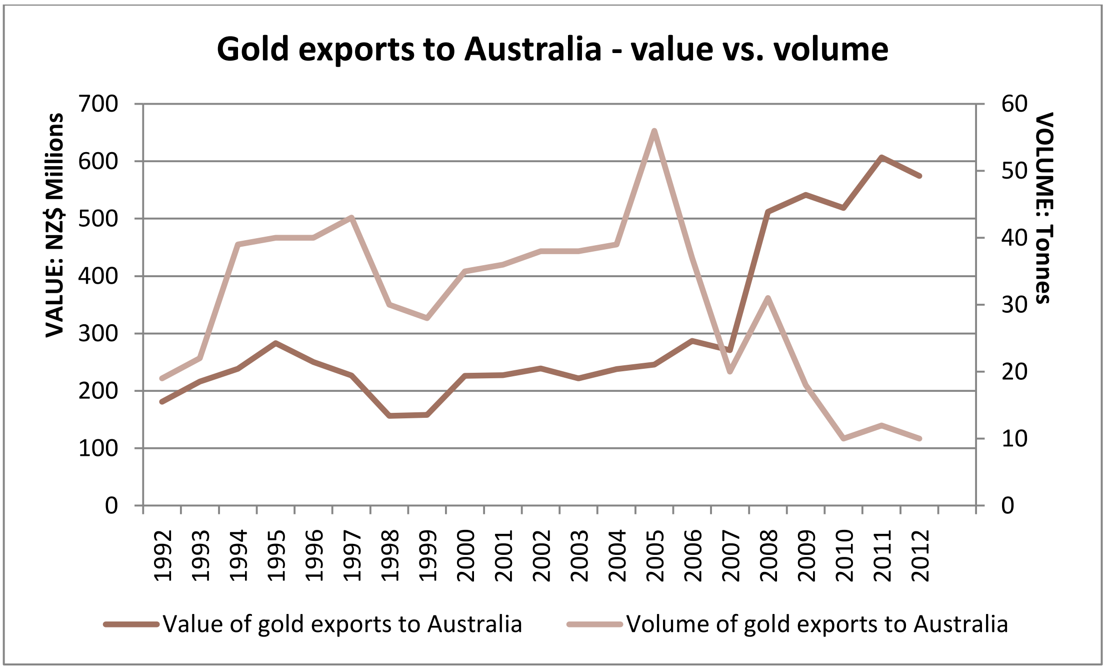
Sources: "New Zealand Economic and Financial Overview 2012", The NZ Treasury.
"Economic contribution and potential of New Zealand's oil and gas industry", Economic Development Group.
"Oil, gold and silver exports to Australia: the story behind the statistics", MFAT.
"Downstream Petroleum 2011", Australian Institute of Petroleum.

[2] Imports of refined oil account for 27% of total consumption within Australia. Australia does have substantial crude oil production, but 70% of this production was exported in 2010-11 (Source: "Downstream Production 2011", Australian Institute of Petroleum).

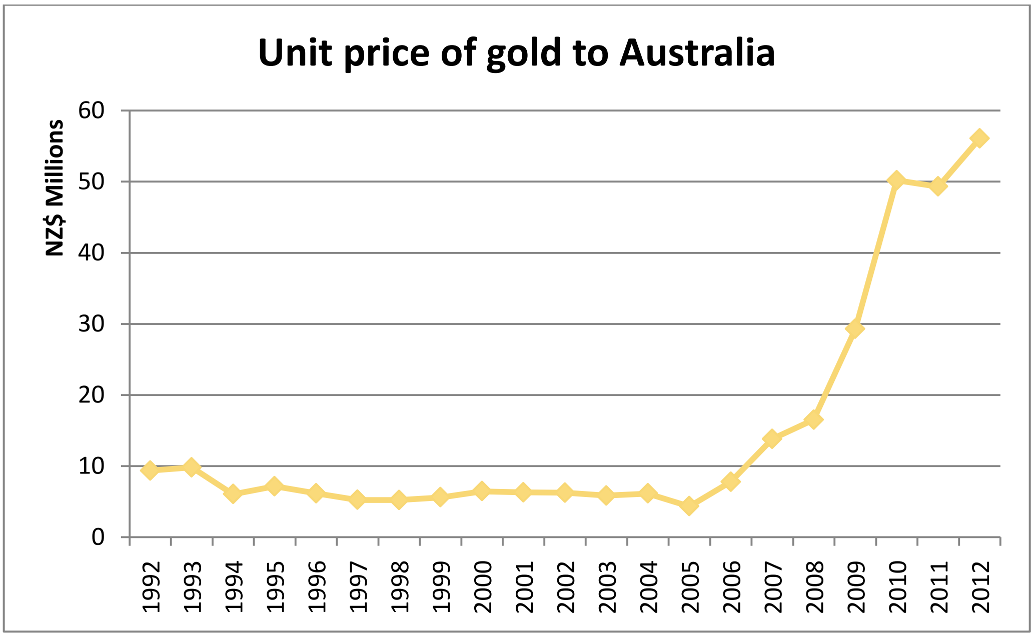
GOLD

Since the mid-1990s, gold (HS7108) has been our second largest export commodity to Australia in terms of value. Australia is NZ's most important destination for gold exports, with approximately 98% of our total exports of gold destined for Australia. NZ sends gold to Australia (Perth) in the form of doré bars to be refined. The doré bars are a mix of gold and silver, with gold making up only 10-25% of these bars by volume but remaining as the more valuable component.

In general, the value of our gold exports to Australia has been trending upwards since 1999, whilst volumes of gold exported have been declining rapidly (see graph below).[3] In 2012, NZ exported $574 million worth of gold to Australia – an annual decline of $32 million or 5%. Volumes of gold exported were also down in 2012, with NZ exporting approximately 10 tonnes to Australia (an annual decline of 17%). In 2012, the unit price (i.e. value per tonne of gold exported) of NZ's gold exports to Australia rose by 14% compared to the previous year – reaching $56 million. Given that volumes exported fell over the year, the rising per unit value indicates that the price of gold rose during the year, in NZ dollar terms. The upward trend in the value of gold exported by NZ has been driven almost entirely by the rising global price of gold in recent years. Since the early 2000s the price of gold rose steadily for about a decade – peaking in September 2011. The price increases for gold slowed in 2012, yet continued to remain at a relatively high level.



[3] Prior MFAT analysis on NZ's gold exports to Australia found that NZ's gold export volume statistics should be interpreted with caution, as the figures conflict with both production data and anecdotal evidence from Newmont (large gold operation in Waihi). There has also been a classification issue with gold and silver during 2009-2011, with the actual value of gold exports being higher than shown in official statistics during this period.



However, it is important to note that the high price of gold throughout 2012 did not translate into increased production for NZ miners. This is because the NZD/USD exchange rate also rose during the year, meaning that the relatively stronger NZ dollar only enabled NZ miners to gain a small price rise, in local currency terms. Therefore, whilst miners in NZ continued operations in 2012, little new production came on stream during the year. For a more detailed explanation as to why the rising price of gold did not translate into real gains for NZ gold miners, please refer to Box 2.

WHAT DOES THIS MEAN? The export value of a commodity is computed as the product of the quantity exported and it's per unit price. As the price of gold (and unit value) rose over the 2012 year, the fall in the value of our gold exports to Australia can be wholly attributed to the reduction in the volume of gold exported over this year. The lowered export volume of gold during 2012 is most likely a result of reduced gold production domestically.[4] For more information on gold production in NZ please refer to Box 3.

[4] Note: Whilst total NZ gold production for the 2012 year is not yet available, OceanaGold's combined gold production statistics for the year ended December 2012 shows that their gold production declined by approximately 20,000 ounces compared to the 2011 year. Combined gold production refers to gold production at both Macraes and Reefton.

Box 2 SPOTLIGHT ON THE PRICE OF GOLD

In general, the international price of gold is inversely correlated to the US dollar, meaning that a weaker US dollar is likely to drive the price of gold higher. This is because, during times of uncertainty – when the dollar is weak – people prefer to invest in gold as it offers protection from inflation.

Since the end of December 2009 to June 2011, the price of gold soared as the US Federal Reserve announced the first two rounds of quantitative easing (QE) – essentially devaluing the US currency and increasing inflationary pressures. After the announcement of the launch of QE3 in September 2012, the price of gold climbed further. The devaluation of the US dollar (as a result of QE) also caused the relative 'price' of the NZ dollar to rise. That is, the NZ dollar strengthened relative to the US dollar. For kiwi miners, this was not very beneficial.

WHY IS THAT? It is more easily explained when looking at the reverse situation. For instance, if you are selling gold, you ideally want the price of gold to be high and for your local currency to be worth less in US dollar terms. A falling local currency relative to the USD means that – as a seller – you will receive 'more' local dollars when you sell your gold. The converse is also true. Therefore, in 2012, the strong NZ dollar meant that NZ gold miners essentially received a reduced price for their output in NZ dollar terms.

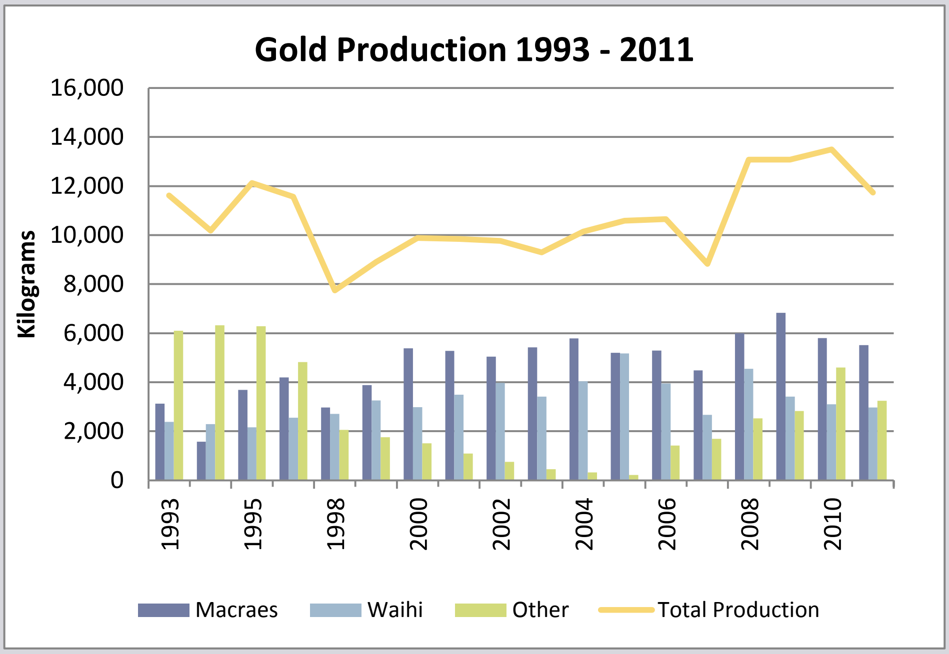
The correlation between the US dollar and the price of gold has also been evident in more recent months, as the price of gold has been tumbling – reaching two-year lows through much of 2013 – at the same time the US dollar has started to recover/strengthen.

Box 3 – SPOTLIGHT ON GOLD PRODUCTION

80-90% of all gold produced in NZ is mined by two companies: OceanaGold (at Macraes and Reefton); and Newmont Waihi Gold (Waihi). The remaining 10-20% of NZ's gold production is alluvial.

NZ's gold production surged with the opening of the Waihi and Otago opencast mines in the 1990s and 2000s. These mines opened after the removal of the fixed international gold price led to a rapid increase in gold prices in the 1970s.

Between 2008 and 2010, gold production in NZ reached (and continued) at a 20 year high. For instance, in 2010, over 13,400 tonnes of gold was produced in NZ (cf. 11,614 tonnes in 1993). Since 1998, the majority of gold in NZ has been produced at Macraes – our largest gold operation – owned and run by OceanaGold (a publicly listed company).



In general, gold production experiences relatively long lead times as it takes several years for new mines to come on stream. Mining output (or production) is relatively inelastic – unable to respond quickly to a change in price outlook.[5]

[5] Source: http://www.gold.org/investment/why_and_how/why_invest/demand_and_supply/

KEY NON-OIL/GOLD SECTORS

The profile of NZ exports to Australia is considerably more diverse than our export product profile to any other trading partner. However, once you take out our oil and gold exports to Australia (already discussed), residual export growth to Australia over the last 10 years – at around 3% per annum – has tailed our exports globally – at 4% per annum. For this reason, one of the goals in the recently launched NZ Inc Australia Strategy[6] is to: double the annual growth rate of non-oil/gold exports to 8% p.a. by 2016.

The following sub-sections analyse which of our export products have grown at a faster rate (or slower decline) – over the past 10 years – to Australia relative to the world; and which have grown at a slower rate (faster decline). These product lines comprised a share of 2% or more of our total non-oil/gold exports to the world in 2012 and are termed 'emerging' and 'contracting', respectively.

Of the 13 product lines NZ exported to the world in 2012 that comprised a share of 2% or greater of our total non-oil/gold exports – six of these were identified as 'emerging' to Australia, whilst the remaining seven have been 'contracting' to Australia, relative to the world.[7] Identifying the 'contracting' product lines allows us to evaluate which of our export sectors are underperforming to Australia relative to the world, and where (if possible) additional non-oil/gold export growth to Australia may come from.

[6] Available here: http://www.mfat.govt.nz/NZ-Inc/9-NZ-Inc-Australia/index.php. The Strategy focuses on positioning our economic relationship with Australia in order to best support export growth in target sectors such as food and beverage, mining and health – among other initiatives.

[7] A product line identified as comprising a high share of our total non-oil/gold exports to the world in 2012 was HS9808 – Confidential Items. However, this has been excluded from our analysis as it contains country-specific detail that would make comparisons between Australia and the world difficult.

EMERGING PRODUCT LINES

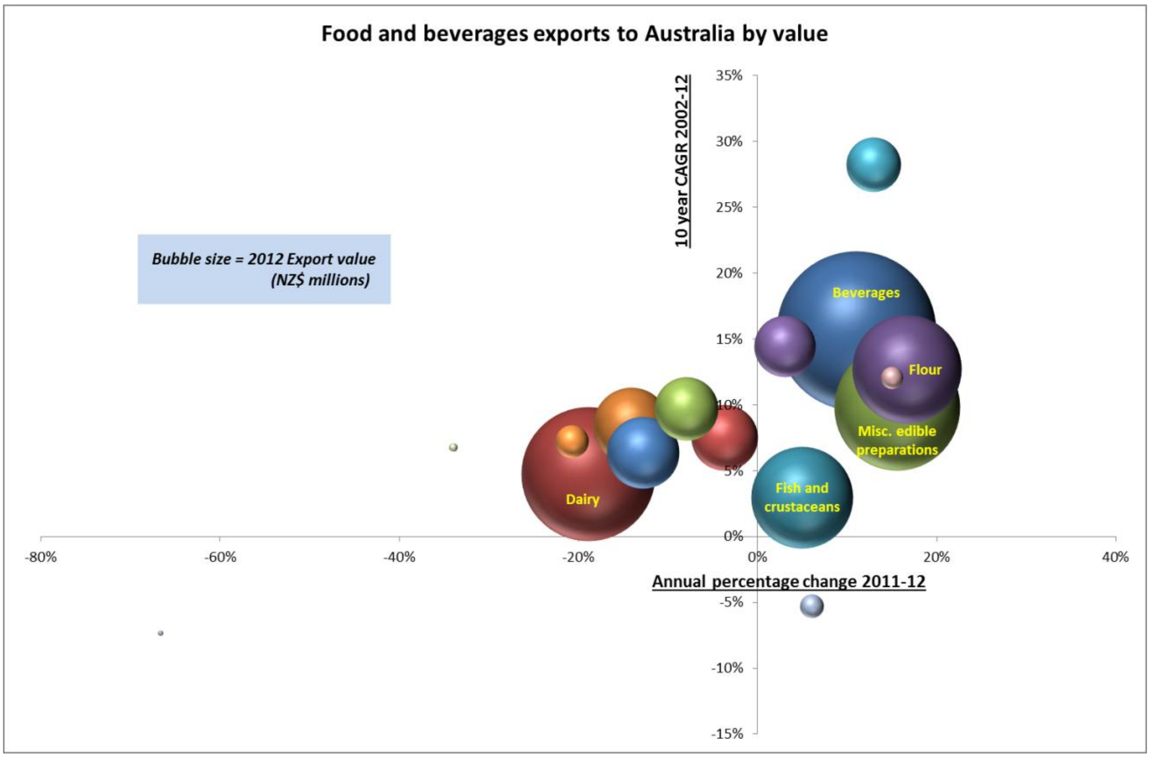
The six export products that have grown at a faster rate to Australia than to the world over the past decade are:

- Frozen beef meat
- Sheep meat
- Butter and dairy spreads
- Cheese
- Fruit
- Wine

i.e. food and beverages

FOOD AND BEVERAGES

Australia is NZ's second largest destination (behind China) for our exports of food and beverages – with our exports of this product group to Australia growing at an annual average rate of 9% over the past decade (cf. 6% export growth to the world). In 2012, we exported approximately $2.4 billion worth of food and beverages to Australia (an annual increase of 0.6%). Our most significant commodities sent to Australia, in value terms, are beverages ($565m), dairy ($402m); miscellaneous edible preparations ($354m); flour ($264m); and fish and crustaceans ($230m). In 2012, the decline in our dairy exports to Australia (down $94 million) was offset by large increases in our exports of beverages, miscellaneous edible preparations, and flour (see graph below).



PROCESSED FOODS

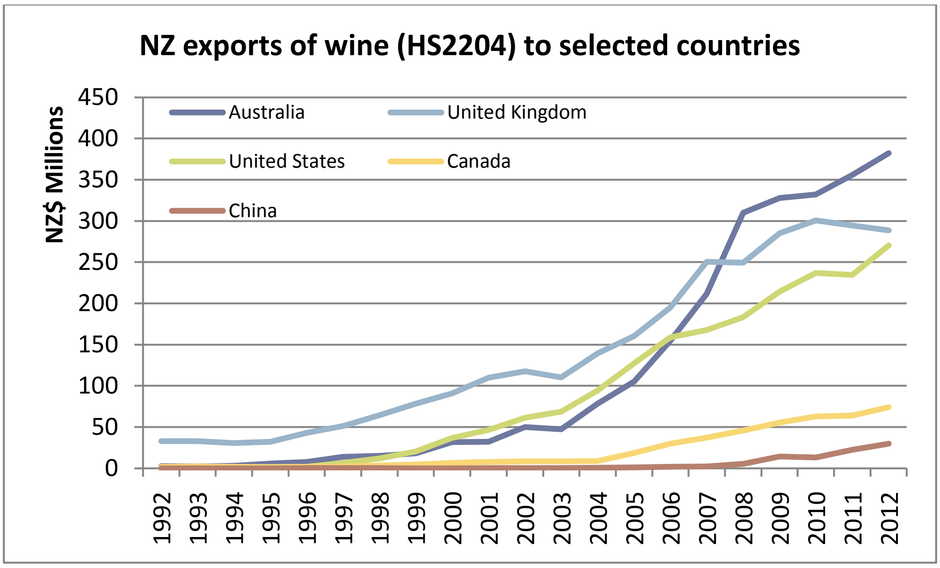
NZ is also the largest supplier of **processed food** and beverage products[8] to Australia, sending over 18% of all Australia's imported processed food in 2012. During this year, NZ exported around $744 million worth of processed food to Australia – an annual increase of 4%. Over the past 10 years, our exports of processed food to Australia have outpaced exports of this product group to the world (i.e. 10% annual average growth vs. 7%, respectively). However, the strong increase in our exports of this product group during 2012 was not enough to offset the declines in crude oil and gold exports. Moreover, NZ is starting to face competition in the Australian market from Asian competitors such as China and Thailand – as well as from the US.

"The main reason that we export most processed foods to Australia is that **most Australian's eat similar food to us**. We have grown up with the same foods. We eat cereal for breakfast, snack on muesli bars, use similar soup flavours, sauces, and jams."

-CEO, mid-sized, NZ owned
Sourced from December 2012 Coriolis report

WINE

Wine has emerged as a significant export to Australia – with NZ exporting $382 million worth of wine in 2012. Over the past decade, NZ's wine exports to Australia have grown at a stellar rate of 23% each year on average (cf. 16% to the world). In general, NZ wine exporters have benefitted from Australian consumers' preference for light, crisp wines (such as NZ's Sauvignon Blanc). In 2012, NZ supplied over half of all Australia's imported wine and is Australia's largest wine supplier.[9]



[8] Processed foods are foods made from a combination of ingredients, rather than one single or predominant ingredient. Please refer to the Appendix for detailed HS codes included in the processed foods category.

[9] Source: GTA and http://www.nzte.govt.nz/en/export/market-research/food-and-beverage/food-and-beverage-market-in-australia/

CONTRACTING PRODUCT LINES

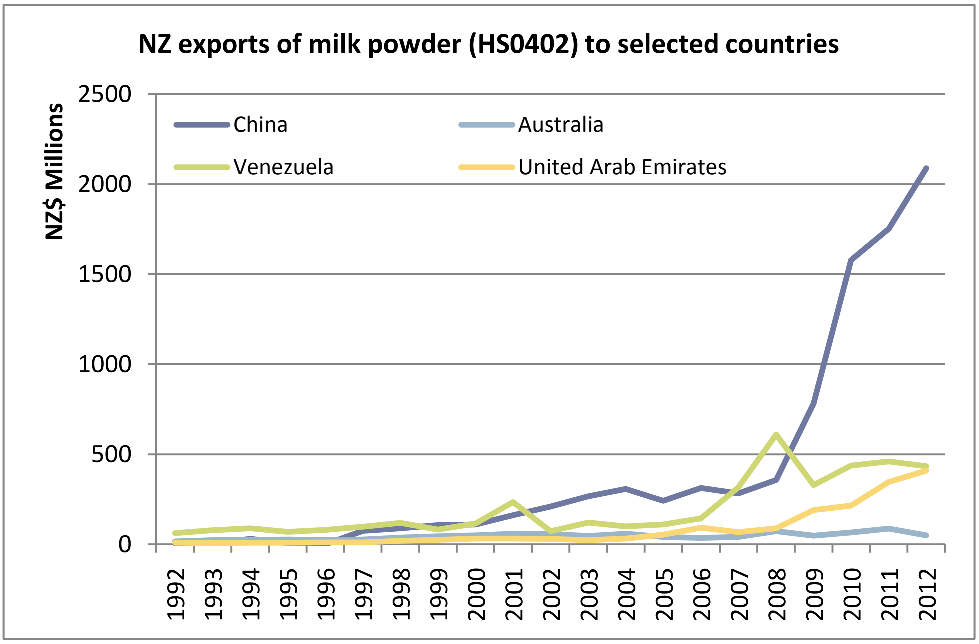
Product lines that have experienced slower growth (or faster decline) to Australia compared to exports to the world has occurred in the following product groups:

- Milk powder
- Whey and milk constituents
- Casein
- Logs
- Sawn or chipped wood (of thickness 6mm and over)
- Wool not carded or combed
- Unwrought aluminium (albeit there isn't a significant negative difference between the export CAGR of this product to Australia compared to the world).

We consider a selection of these export products below.

MILK POWDER

Since 1993, **milk powder** has been NZ's largest export product to the world, with exports of this product group benefiting from the expansion in large, emerging infant formula markets – particularly in East Asia. Over the past 10 years, our exports of milk powder to the world have grown at a rate of 10% per year on average. In comparison, exports of this product group to Australia have declined by around 1% over the same period; with NZ exporting around $49 million worth of milk powder across the Tasman in 2012. China is currently our largest market for milk powder and was the destination for 30% of our total milk powder exports in 2012. It is followed by Venezuela and the United Arab Emirates (each of which took around 6% of our total milk powder exports). In the same year, we exported just under 1% of our total milk powder exports to Australia.

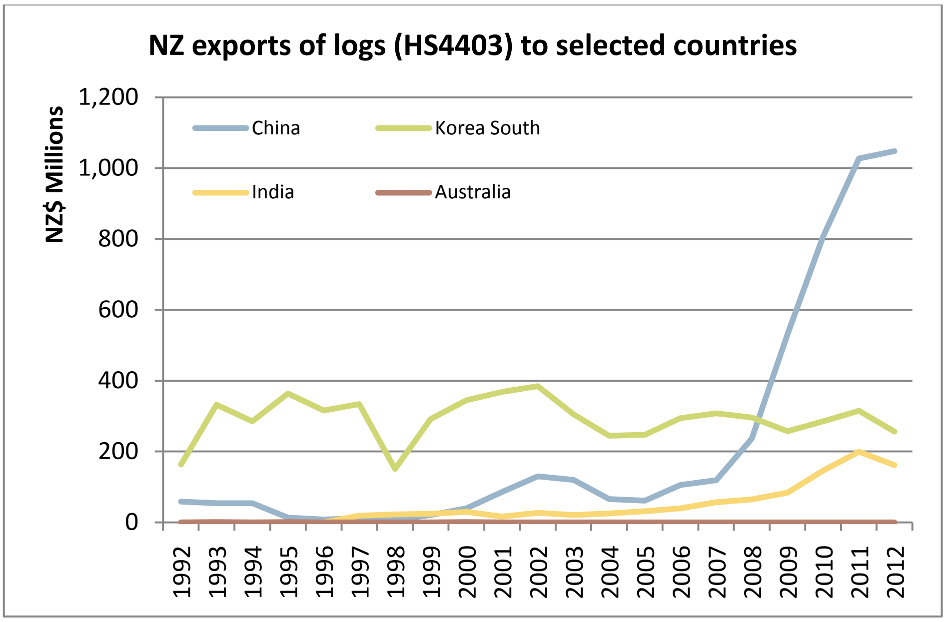


LOGS

Over the past 10 years, exports of NZ **logs** to the world have grown by 7% per year on average, compared with an annual average decline of 11% to Australia. In 2012, logs were NZ's sixth largest export product, with a negligible amount (close to 0%) destined for Australia.

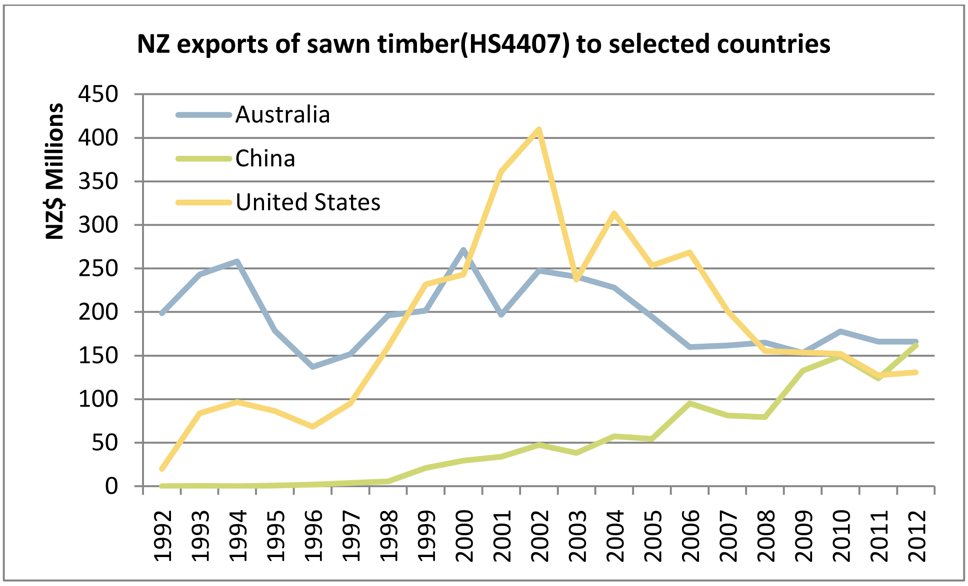
Strong economic growth in China (our largest export market for logs) and a reduction in the availability of logs from China's traditional supplier – Russia – have pushed up demand for NZ's logs (mainly radiata pine) in recent years. Furthermore, India has also emerged as a significant destination for NZ logs – with its demand now approaching that of Korea's – our second largest log export market.

As with milk powder, Australia is also a global supplier of logs – substantially reducing their need to import logs from NZ.



SAWN TIMBER

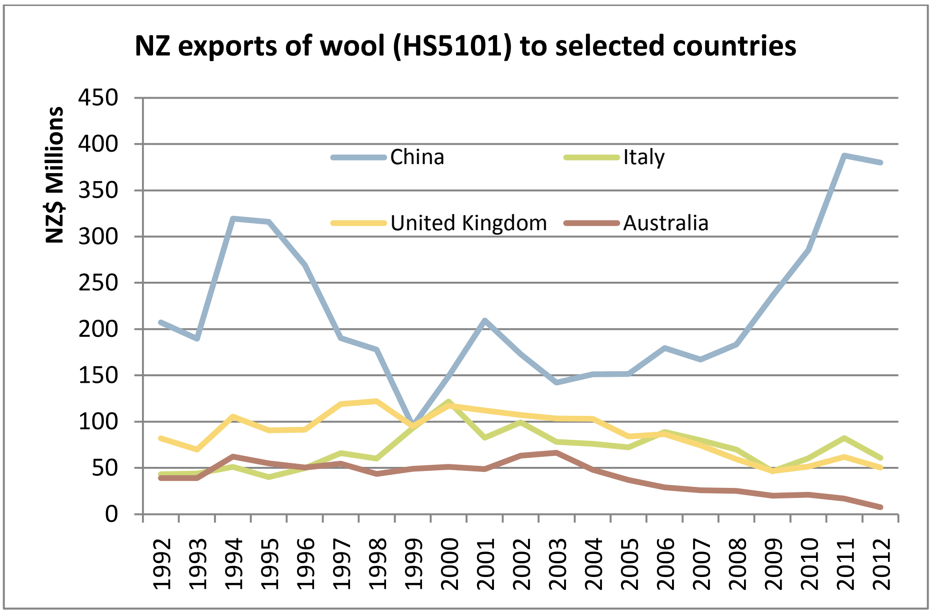
Exports of **sawn or chipped wood** to Australia have declined at an annual average rate of 4% over the past decade (cf. exports of this product group to the world declining by 2%). Exports of this product group to the US have fallen since the early 2000s (albeit, the US has consistently imported the majority – around 85% - of its timber from Canada). The further decline in sawn timber to the US in recent years has been due to weak housing markets. However, this has been offset by increased volumes of timber going to Asia.



From a historical perspective, exports of sawn timber as a share of our total merchandise exports to Australia have been declining over the past 20 years. In 1992, sawn timber was our second largest export to Australia – ahead of gold and behind crude oil. During this year, exports of this product comprised around 6% of total exports to Australia. By 2002, this share had declined to 4% (albeit sawn timber yet remained as our second largest export to Australia). And in 2012, NZ exported $166 million worth of sawn timber (our sixth largest export product) across the Tasman – approximately 2% of our total exports to Australia.

WOOL

Our **wool** exports to Australia have always been quite small as a share of total exports across the Tasman. For instance, in 1992, NZ exported around $39 million – or 1% of our total exports to Australia – of wool to Australia. This share remained unchanged in 2002, and in 2012 it had declined to approximately 0.1%. Over the past decade, NZ's exports of wool to Australia have declined at an annual average rate of 19%.

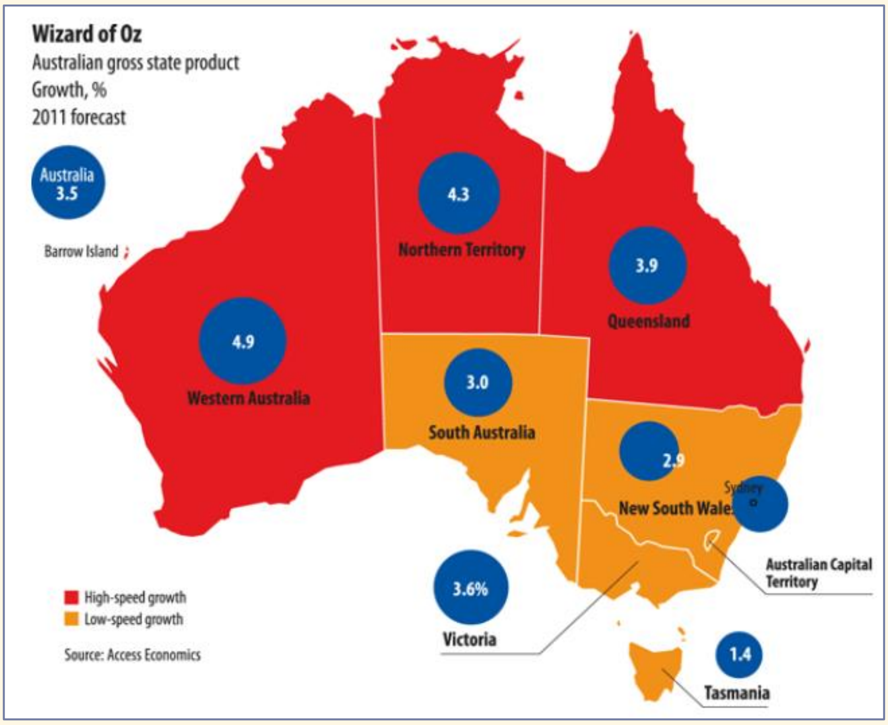


In general, the destination for NZ's wool exports has shifted – with the debt problems in the Eurozone and the growing strength of China as a textile producer – swinging wool exports towards the Asian market. For instance, in 2012, China took over half of our total wool exports. As a result (and in comparison to wool exports to Australia), our exports of wool to the world have only fallen by 1% each year over the past 10 years.

WHERE ARE OUR MERCHANDISE EXPORTS GOING?

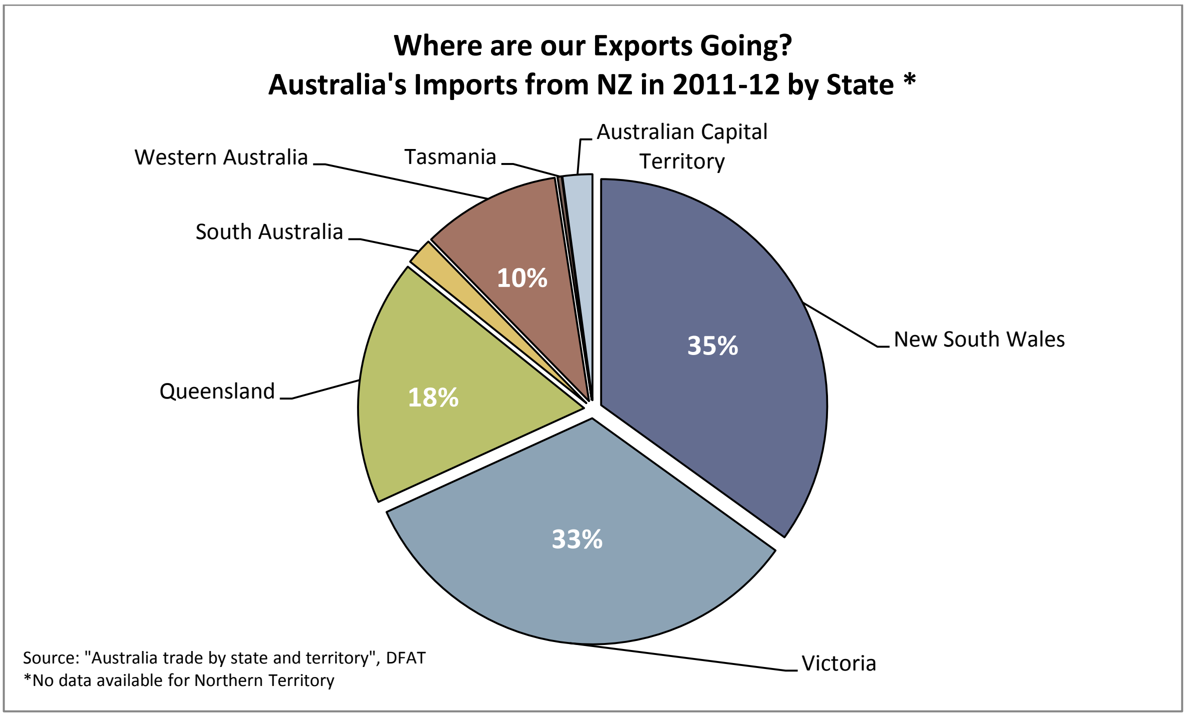
Since the mid-2000s, Australia has been amidst a mining investment boom, and in 2012, mining investment generated half the economy's growth.[10] The boom has by and large been fuelled by China's rise and its demand for iron ore and coal – Australia's two main exports. However, economic activity and prosperity associated with the mining boom has been significantly concentrated within the mining-related sectors and the states in which mining is occurring.

Box 4 Fast Growing States in Australia



Source: The Economist, http://www.economist.com/node/17493357

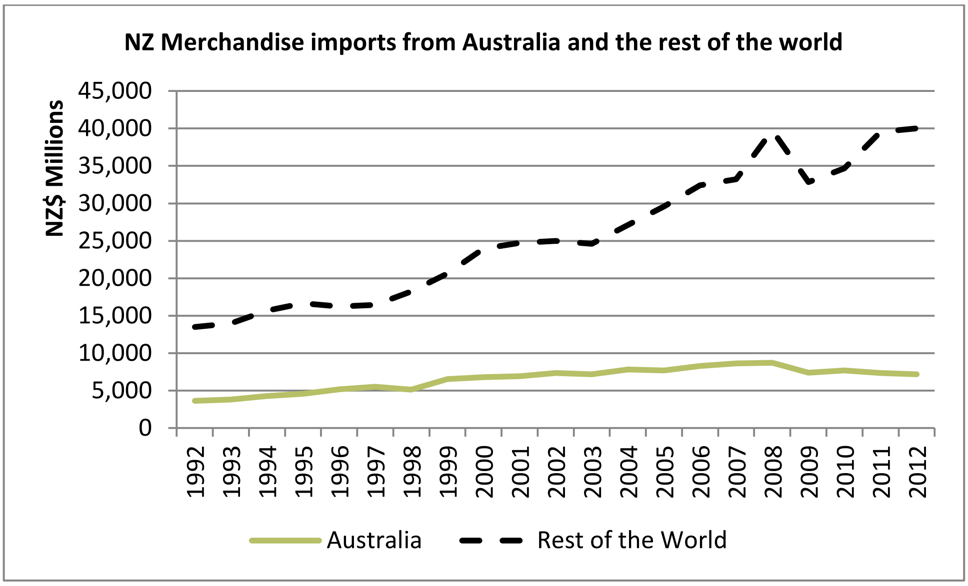
[10] Source: http://www.smh.com.au/business/some-fear-the-mining-boom-will-turn-to-bust-20130329-2gz2o.html


Where are our Exports Going?
Australia's Imports from NZ in 2011-12 by State *
Western Australia
Tasmania
Australian Capital Territory
South Australia
10%
35%
New South Wales
Queensland
18%
33%
Victoria
Source: "Australia trade by state and territory", DFAT
*No data available for Northern Territory

OVERVIEW – NZ IMPORT TRENDS

- Over the past 20 years (1992-2012) NZ's merchandise imports from Australia have grown at approximately 3.5% per year on average.

- This compares with our total imports from the rest of the world which have grown at an annual average rate of 5.6% over the same 20 year period.



- In 2012, NZ imported $7.2 billion worth of goods from Australia – an annual decline of 2.5%. The main driver of this decline was a reduction of imported aluminium oxide from Australia, which was down 25.5% (or $88 million) compared to the previous year.

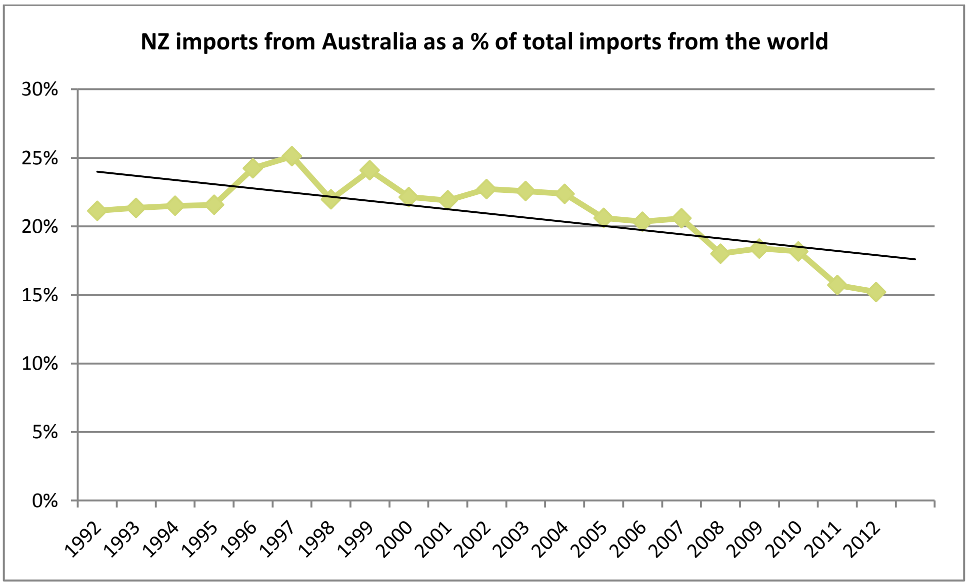
- The following table shows the annual change for our top 5 imports from Australia in 2012:

Commodity	2011 (NZ$m)	2012 (NZ$m)	Annual change (NZ$m)	Annual percentage change (%)
1. Motor Vehicles	259	323	64	25%
2. Aluminium Oxide	346	257	-88	-26%
3. Crude petroleum oils	0	245	245	-
4. Retail medicines	212	212	0	0%
5. Wheat	210	187	-23	-11%
Top 5 import commodities	**1,027**	**1,225**	**199**	**19%**
Total all import commodities	**7,369**	**7,184**	**-185**	**-3%**

Note: Crude oil imports can be quite volatile and varies considerably between periods. The annual percentage change for our imports of crude oil from Australia is too big to be expressed for this reason.

- Over the past 20 years, NZ imports from Australia have been declining as a share of our total imports from the world. This is predominantly due to the rise of China. In 2011, China surpassed Australia as our number one market for imports – with 15.9% of our imports being sourced from China and 15.7% from Australia.

- In 2012, around 15% of our total imports were sourced from Australia (cf. 16% from China).

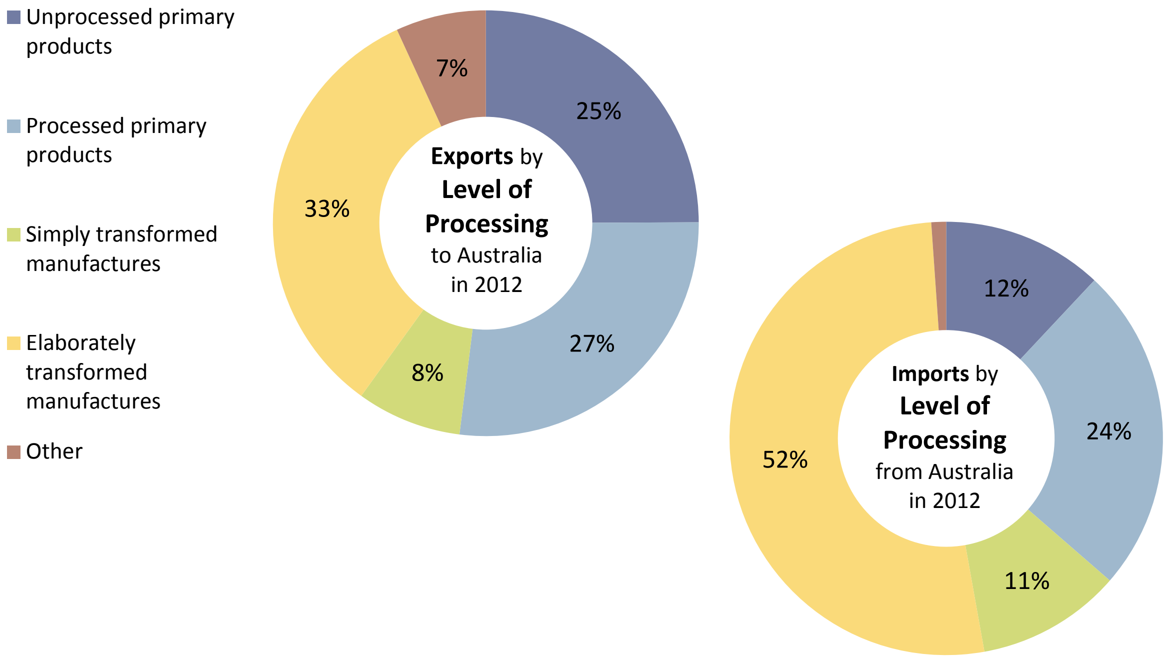


- Looking at the other side of the coin, i.e. Australia's merchandise exports to NZ, the story is largely the same. The share of Australia's exports destined for NZ has declined from between 5-8% in the late 1990s/early 2000s to around 3% in 2011/12. The decrease comes despite the value of Australia's exports to NZ currently being at historically high levels.[11] According to the Australian-NZ Joint

[11] Source: Australian/NZ Joint Productivity Commissions report http://transtasman-review.pc.gov.au/study/final-report-0

Productivity Commissions report, the decline in the proportion of Australia's exports to NZ is largely due to the rising share of mineral energy exports to Asia. In 2012, 29% of Australia's total merchandise exports were destined for China, 19% to Japan and 8% to South Korea.

LEVEL OF PROCESSING



- In 2012, 52% of our exports to Australia were primary products (unprocessed and processed), compared with 41% being manufactures (simply transformed and elaborately transformed). However, our single largest export by level of processing (LOP) category in 2012 was elaborately transformed manufactures (ETMs). During the year, 33% ($3.3 billion) of our total exports to Australia were ETMs – with the majority being machinery and equipment. This compares to our total exports to the world of which only 16% were ETMs.[12]

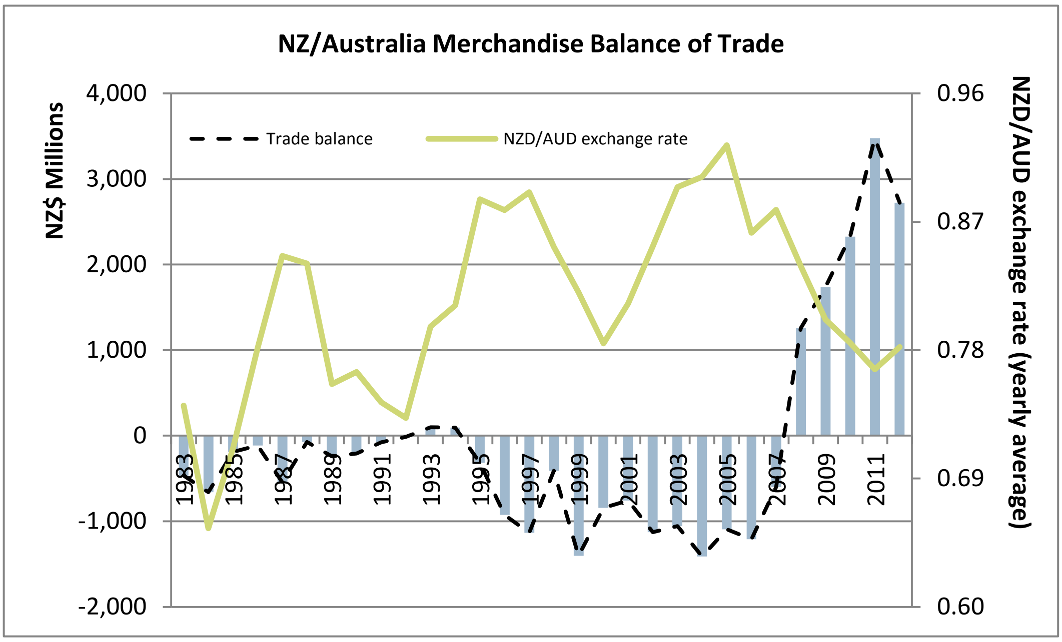
- Australia has traditionally been the most important market for NZ's manufacturing sector with barriers to trade of manufactures being substantially reduced under CER.

- Today, Australia's average tariff rate for manufactures is around 3%.[13]

- NZ mainly imports manufactured products from Australia, with the bulk (over 50%) being ETMs. NZ is a major market for Australia's manufactured goods particularly, mechanical and electrical machinery and equipment. We imported $3.7 billion worth of ETMs from Australia in 2012. However, only 13% of our total imports of ETMs are sourced from Australia – with the majority originating from Asian countries.

[12] Our exports destined for Asian countries largely comprise of processed primary food products such as milk powder.
[13] Source: World Bank.

BILATERAL TRADE BALANCE



- At the time the NZ-Australia Free Trade Agreement[14] was signed (in August 1965) the balance of trade was in Australia's favour, to the extent of almost four to one. Since then, NZ steadily increased its share of trans-Tasman trade so that the ratio in in the year to March 1984 was about three to two in Australia's favour.[15] The growth in NZ's manufacturing exports to Australia has been identified as one of the factors which assisted the upturn during these years – most likely driven by the buoyant Australian economy and the implementation of CER.

- In 1993, NZ recorded its first bilateral trade surplus (of NZ$101 million) with Australia. However, this surplus was short-lived as NZ-Australia bilateral trade grew increasingly imbalanced over the years 1995 to 2007 – with the bilateral trade ratio increasing to 5:4 in Australia's favour.

- Since 2008, the balance of trade with Australia has swung greatly in NZ's favour. From 2008 onward, NZ has consistently posted a bilateral trade surplus with Australia – meaning that over this period, our exports across the Tasman have been greater than our imports from Australia in value terms.

- For the year ended December 2012, NZ's bilateral trade surplus with Australia was NZ$2.7 billion. Our positive trade balance with Australia in recent years has largely been driven by increases in our oil exports (whilst our imports of oil (not crude) from Australia have been on the decline).

- The exchange rate is also a crucial factor in determining bilateral trade balances. A strong local currency (relative to a foreign currency) often results in increased imports as domestic consumers now have 'more foreign dollars' to purchase goods from overseas. As reflected in the graph above, the NZD/AUD exchange rate is inversely correlated to the NZ-Australia bilateral trade balance. This

[14] The so called NZ-Australia Free Trade Agreement grew out of renewed interest by Australia and NZ in each other's markets. However, it had various shortcomings and was replaced by CER which is far more comprehensive.
[15] Source: "Manufactured exports to Australia", RBNZ, August 1984.

suggests that the falling NZ dollar relative to the Australian dollar in recent years has contributed to our bilateral trade surplus. However, it is important to note that despite the continuing exchange-rate tail wind over the past year, our merchandise exports to Australia still fell in 2012 – implying that the exchange rate provides us with an informative, yet partial explanation.

- Moreover, we must be careful about highlighting a bilateral trade surplus with a country as a good thing (vs. a bilateral trade deficit as something negative). There is no reason why trade should be completely balanced between countries, and it is not necessarily inefficient or inequitable to have bilateral imbalances. This is particularly true given that countries often have a comparative advantage in producing different products, and will therefore occupy different parts of the supply chain. For further information on the role of imports in supporting the production of exports, please refer to the Trade in Value-Added section. The balance of trade time series between NZ and Australia can be found in the Appendix.

PART II - TRADE IN SERVICES

Trade in services is playing an increasingly important role in international trade. Services are an important driver of growth as it is difficult for economic activity to take place without services such as freight, banking and telecommunications. Therefore, when analysing bilateral (or global) trade flows it is important to consider both merchandise goods trade and trade in services together.

For the year ended December 2012, Australia was NZ's largest merchandise goods export destination, whilst China was our largest source of merchandise imports. However, when looking at trade in both goods and services, Australia is our number one market – by a comfortable margin (see table below).

Therefore, unlike in goods trade, where Asia is increasingly becoming a primary destination and source market, the pattern of NZ's trade in services is dominated by our 'traditional' trading partners. This is due to the link between investment and services trade, where commonalities in laws, standards and culture makes setting up a business and trading services easier (see following section on Investment).

2012	Exports (NZ$ millions)			Imports (NZ$ millions)			Total trade (NZ$ millions)
	Goods	Services	Total	Goods	Services	Total	Goods and services
Australia	9,908	3,823	13,731	6,872	4,911	11,783	**25,514**
China	6,859	1,232	8,091	7,325	360	7,685	**15,776**

EXPORTS OF SERVICES

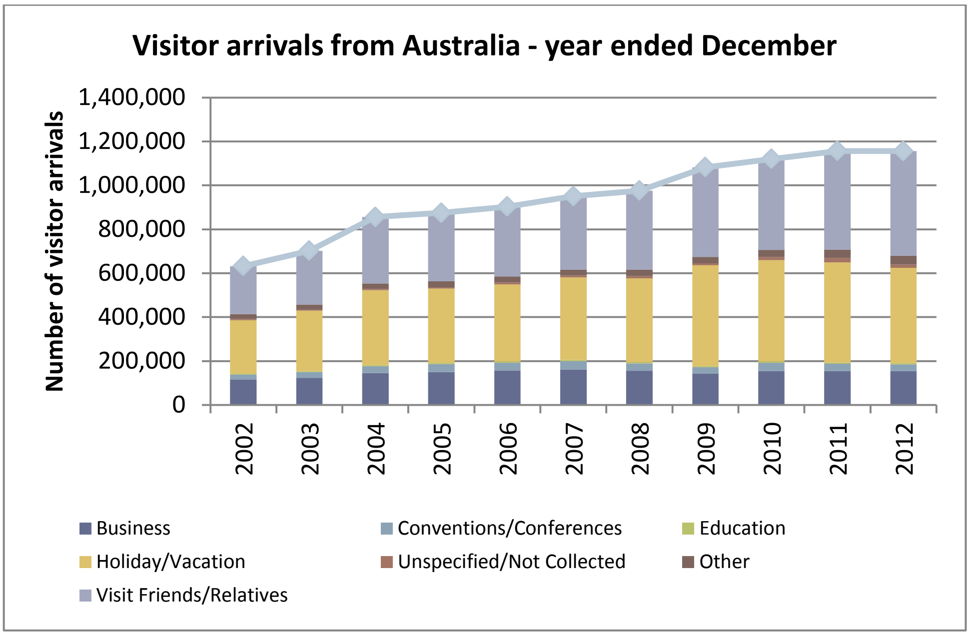
Total exports of services to Australia were worth $3.8 billion for the year ended December 2012, an annual decline of 2.4%. However, despite the annual decline, services exports to Australia were still worth considerably more than the value of our merchandise goods exports to Japan – ranked as our fourth largest goods export market. During 2012, Australia represented nearly 30% of our total services exports.

The following sub-sections contain analysis on exports of our key services to Australia for the year ended June 2012 (due to data availability). For a complete breakdown of services export categories to Australia, please refer to the appendix.

TRAVEL

Our main services exports to Australia are travel services (tourism and education) comprising 50% of total services exported to Australia in the year ended June 2012. Within this category, tourism is our largest export (42% of total services exports to Australia). For the year ended June 2012, NZ exported $1.9 billion worth of tourism to Australia and $0.4 billion worth of education related travel services.

Over the past 10 years, visitor arrivals from Australia have increased at an annual average rate of 6.2%, with around 1.2 million Australian's visiting NZ in 2012 (see graph below). Australian visitors travel to NZ mainly for the purpose of visiting friends and relatives or for holidaying. Whilst the upward trend in Australian visitors is welcome in relative terms (due to time in country and frequent 'staying with friends'), their spend per visit is considerably lower than visitor arrivals from Europe – where numbers are on the decline (e.g. for the year ended December 2012, Australian tourists to NZ spent NZ$1500 on average per trip; whilst visitors from the UK spent NZ$2700 on average; and those from Germany spent $3200 on average).



COMMERCIAL SERVICES

Commercial services (aka professional services) comprise 30% of our total services exports to Australia. The bulk of this is from management fees to related parties as many Australian companies have subsidiaries or branches in NZ (e.g. banks). Other significant commercial services exported to Australia are: computer services, engineering and technical services, and merchanting.[16] For the year ended June 2012, NZ exported $1.3 billion worth of commercial services to Australia – an annual increase of $62 million.

[16]Merchanting refers to the situation where a NZ enterprise buys goods abroad and then on-sells them to another overseas party. The goods do not enter NZ.

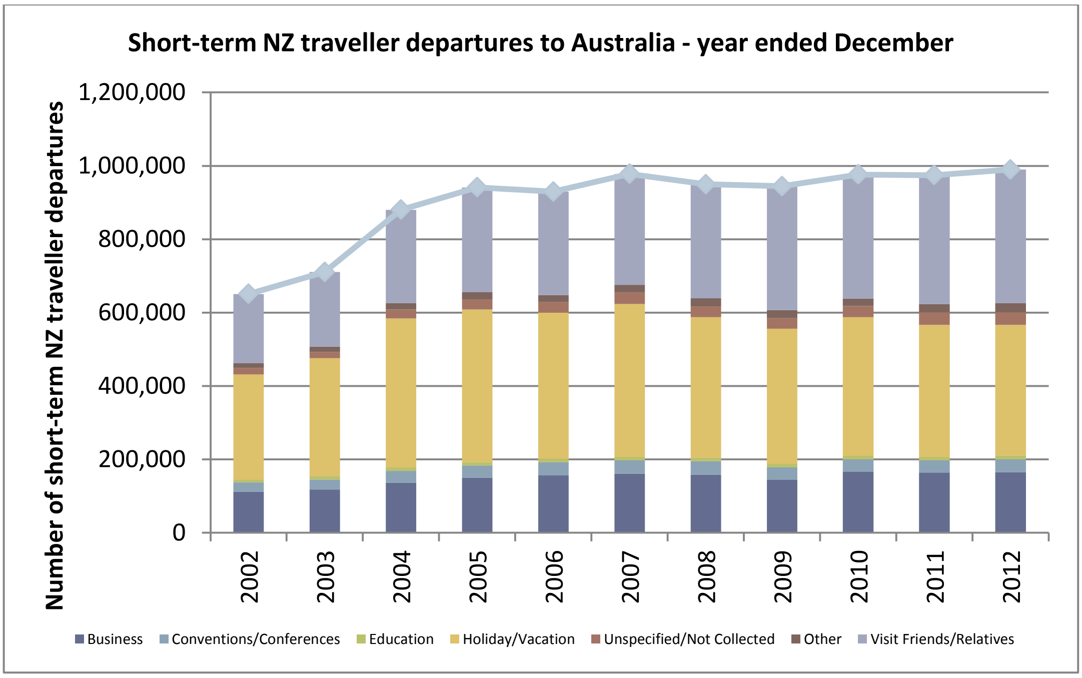
IMPORTS OF SERVICES

For a full breakdown of services imported from Australia for the year ended June 2012, please refer to the Appendix.

Imports of services from Australia totalled $4.9 billion for the year ended December 2012, pushing Australia ahead of China to be our largest import market (in terms of goods and services trade). During this year, imports of services from Australia declined by 4.3% compared to the previous year. Imports of services from Australia comprise around a third of our total services imports.

The types of services we import from Australia are broadly similar to what we export. For the year ended June 2012, imports of commercial services comprise 42% of total services imports from Australia. We imported $2.1 billion worth of commercial services from Australia. These were mainly, management fees between related parties, computer services, royalties and engineering and technical services.

Imports of travel services comprised 35% of total services imports from Australia, with the bulk being tourism related. For the year ended June 2012, NZ imported $1.7 billion worth of tourism from Australia – an annual increase of $24 million. Akin to our exports to Australia, the main reasons NZers travel across the Tasman is to visit friends and relatives or for a holiday. In 2012, nearly 1 million NZ travellers visited Australia (see graph below).

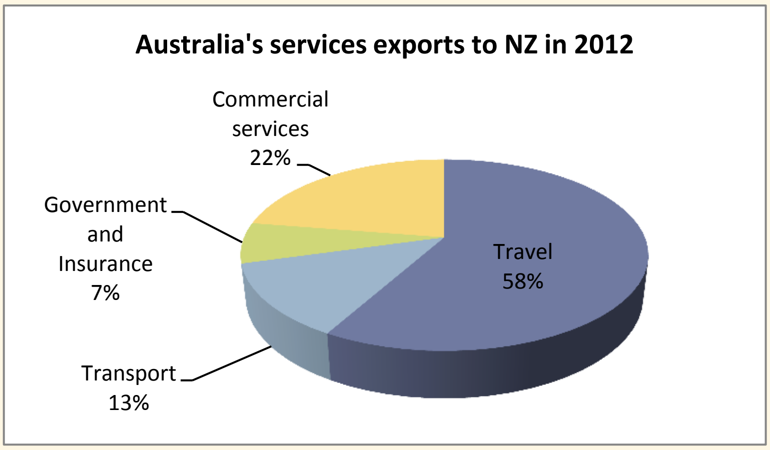


Box 6 Spotlight on Australian Services Trade

Australia provides a range of services, such as telecommunications, travel, banking and insurance. Like NZ, the services sector comprises a significant part of the Australian economy (around 70% of GDP cf. two-thirds of GDP in NZ). It is reported that the services sector in Australia employs four out of five Australians.

Over the past 10 years, Australia's exports of services have grown at an annual average rate of 3.6%. Australia's main services exports category is education-related travel services, followed by recreational travel services.

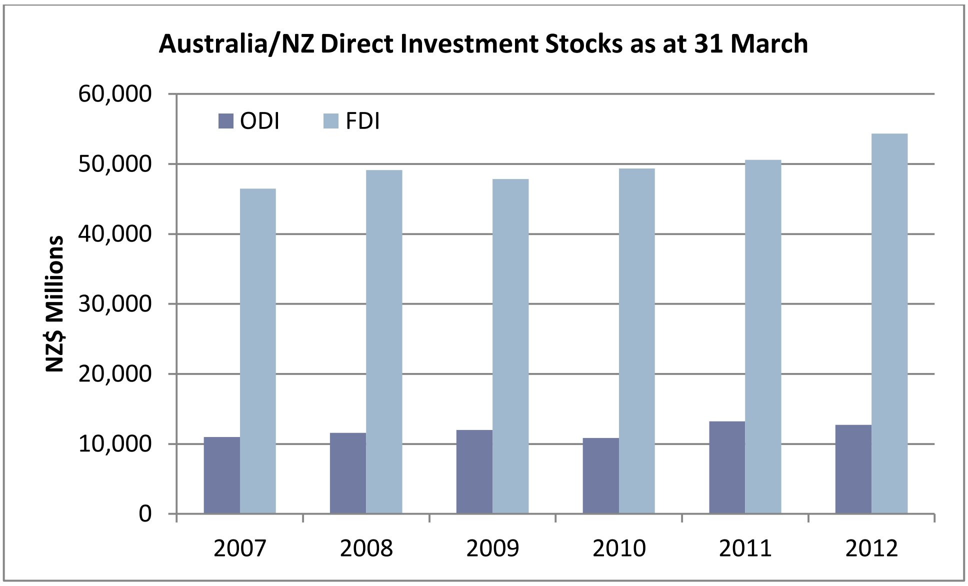
The following chart details Australia's exports of services to NZ in 2012:



Source: ABS, Note: No updated travel services split available for NZ. Assume that the bulk of 'travel' is tourism as NZ students do not need a visa to study in Australia.

PART III – INVESTMENT

A high level of integration between NZ and Australia has supported trans-Tasman investment for many years, with Australia remaining our number one investment partner. The amount of direct investment from Australia in 2012 was $54 billion – 56% of total direct investment in NZ. NZ directed $13 billion (or 53%) of total ODI to Australia over the same period (see chart below).



In general, there are few (or no) formal barriers to flows of investment (as well as with trade and people) between Australia and NZ. Our markets are similar, as are our laws and standards. There is also relatively low risk in both economies.

FDI

Australia is very important to NZ as both a trading partner and as a source of investment. Since the 1980s, Australian investment has supported the "emergence of NZ's wine industry, bringing with it know-how, technology and international market access".[17] Moreover, the Australia and NZ banking systems are closely linked, helping make Australia a likely source of capital for NZ companies. The private equity and venture capital sectors have also been active investors in NZ in the past. Most Australian investment in NZ has been (and is) in the non-tradable sector, such as in finance and retailing.

NZ'S FOOTPRINT IN AUSTRALIA

–TARGETING THIRD MARKETS VIA AUSTRALIA

Australia's relatively robust economy and large population (five times the size of NZ's) offers NZ businesses growth opportunities that are not present in our domestic market. And for many NZ firms, Australia is generally not a difficult market to enter (albeit, it can be quite difficult to fully exploit). NZ direct investment in Australia has remained static since 2003 – ranging from $9-$12 billion.

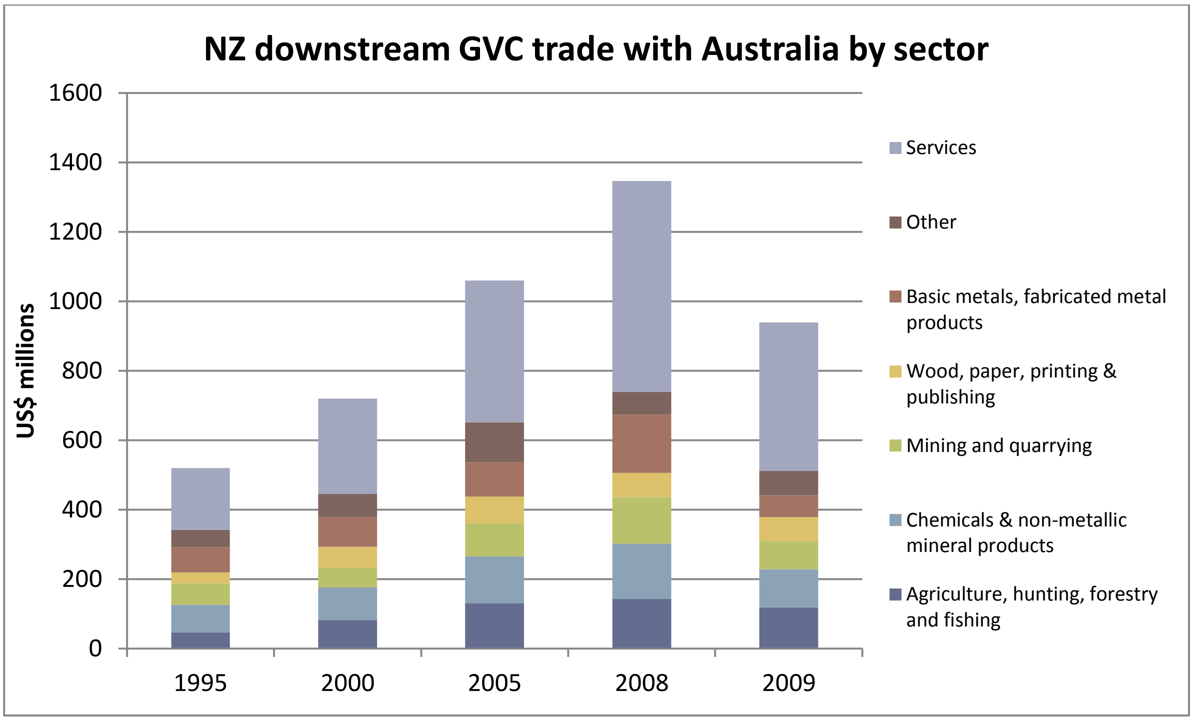
[17] Source: Hon Bill English, Speech to the NZ Contemporary China Research Centre, 12 August 2012.

NZ companies tend to use Australia as a means of internationalising – as a stepping stone to accessing the high growth economies of Asia. This is because Australia offers NZ firms a platform to achieve the experience, profitability and scale required to tackle larger markets. Australia's proximity also means that NZ firms have easy access and is therefore, one of the first international markets NZ businesses tend to target.

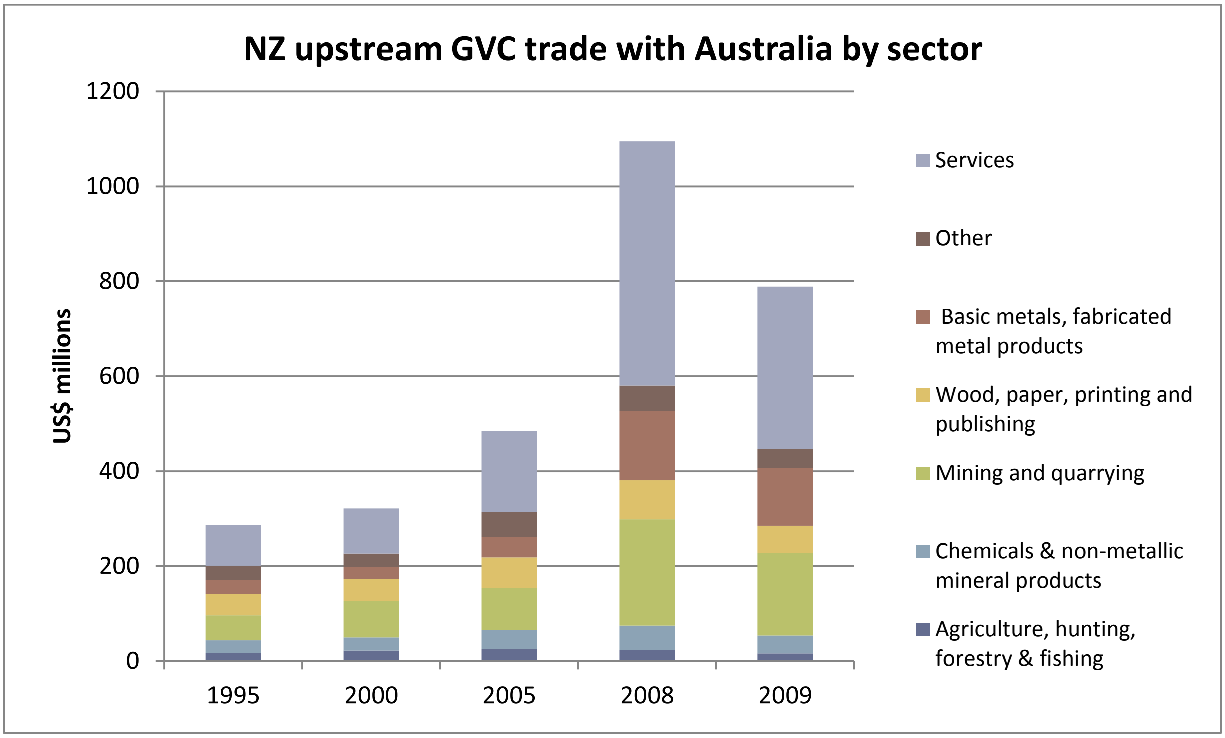
PART IV – TRADE IN VALUE-ADDED

Traditional measures of trade measure the gross value of import and exports. Trade in value-added (TiVA) data – a joint initiative by the OECD and WTO – estimates trade flows in value-added terms in order to take into account the increasing international fragmentation of production through GVCs, i.e. where the value is added to a final product or service.

Trade along GVCs occurs as firms increasingly locate different activities for producing a final good or service, such as research and design, manufacturing, and marketing, in different countries. NZ and Australia are part of this phenomenon. About 12% of New Zealand exports to Australia by value are used as inputs into Australia exports (NZ downstream GVC participation). The following chart shows the originating sector of NZ goods and services used in Australian exports. Around 54% of the value of intermediary exports to Australia from NZ is goods, whilst the remaining 46% are services. Intermediary goods sent from NZ to Australia for use in the production of their exports originate mainly from our agriculture sector (13% of total NZ value-add). Our main services inputs that feed into Australian exports are transport, storage, postal and telecommunication services; and business services – which contribute between 20-30% of total NZ value-add into Australian exports, when combined.



Similarly, about 20% of NZ imports from Australia by value are used in NZ exports (NZ upstream GVC trade). The following chart displays the originating sector of Australian value-added of goods and services used in NZ exports. Goods account for 57% of the value of imported intermediates from Australia used in NZ exports – originating predominantly from the Australia's mining sector (around 22% of Australian value-add). The main service import from Australia used as an input into our exports is transport, storage, postal and telecommunication services.



For a more detailed breakdown of NZ's downstream and upstream GVC trade with Australia by sector, please refer to the appendix.

APPENDIX

DETAILS OF PROCESSED FOODS TRADE CODES

List of detailed HS codes included in the processed foods category:

170410	190420	200570	210112
170490	190490	200580	210120
180310	190510	200590	210210
180500	190520	200600	210220
180610	190530	200710	210230
180620	190540	200791	210310
180690	190590	200799	210320
180631	200110	200811	210330
180632	200190	200819	210390
190120	200290	200820	210410
190110	200310	200830	210420
190190	200320	200840	210500
190211	200410	200850	210610
190219	200490	200860	201690
190220	200520	200870	230110
190230	200540	200880	230120
190240	200551	200892	230910
190300	200559	200899	230990
190410	200560	210111	

Source: “Driving growth in the Processed Foods sector”, Coriolis.

NZ/AUSTRALIA BILATERAL TRADE BALANCE

	NZ Exports to Australia (fob)	NZ Imports from Australia (cif)	Total Trade (exports plus imports)	Trade Balance (exports minus imports)
	NZ$ millions			
1983	1,078	1,543	2,621	-465
1984	1,554	2,212	3,766	-659
1985	1,890	2,078	3,968	-187
1986	1,779	1,893	3,672	-114
1987	1,907	2,450	4,356	-543
1988	2,347	2,419	4,766	-72
1989	2,804	3,045	5,849	-241
1990	3,020	3,229	6,249	-208
1991	3,132	3,208	6,340	-76
1992	3,609	3,622	7,231	-13
1993	3,896	3,795	7,691	101
1994	4,389	4,295	8,684	94
1995	4,269	4,584	8,853	-315
1996	4,262	5,188	9,451	-926
1997	4,380	5,516	9,896	-1,135
1998	4,720	5,129	9,849	-409
1999	5,133	6,536	11,669	-1,403
2000	5,960	6,804	12,764	-843
2001	6,181	6,939	13,120	-758
2002	6,221	7,347	13,568	-1,125
2003	6,119	7,175	13,293	-1,056
2004	6,400	7,812	14,212	-1,412
2005	6,589	7,682	14,271	-1,093
2006	7,076	8,285	15,361	-1,209
2007	8,023	8,622	16,644	-599
2008	9,995	8,738	18,733	1,257
2009	9,132	7,397	16,529	1,735
2010	10,025	7,697	17,722	2,328
2011	10,848	7,369	18,217	3,479
2012	9,908	7,184	17,093	2,724

Source: Statistics NZ, year ended December.

BREAKDOWN OF EXPORTS OF SERVICES TO AUSTRALIA

Data presented below is for June years and is sourced from Statistics NZ.

	2006	2007	2008	2009	2010	2011	2012	2012 share of total services exports to Australia
	NZ$ millions							
Tourism related travel	1,705	1,742	2,004	1,875	2,032	1,837	1,862	42%
Education related travel	239	221	255	278	341	332	353	8%
Other commercial services	768	793	933	C	1,020	1,271	1,333	30%
Government, insurance	17	19	21	C	30	28	29	1%
Transport	488	595	582	591	573	583	898	20%
Total sum of exports	**3,217**	**3,370**	**3,795**	**3,789**	**3,996**	**4,051**	**4,475**	**100%**

Note: C denotes values that are suppressed for confidentiality reasons.

BREAKDOWN OF IMPORTS OF SERVICES FROM AUSTRALIA

Data presented below is for June years and is sourced from Statistics NZ.

	2006	2007	2008	2009	2010	2011	2012	2012 share of total services imports from Australia
	NZ$ millions							
Tourism related travel	1,643	1,591	1,618	1,580	1,586	1,670	1,694	34%
Education related travel	31	36	34	44	52	53	54	1%
Other commercial services	1,311	1,341	1,631	C	1,816	2,166	2,123	42%
Government, insurance	150	101	82	C	94	130	215	4%
Transport	785	1,053	1,012	883	667	937	928	19%
Total sum of imports	**3,920**	**4,122**	**4,377**	**4,474**	**4,215**	**4,956**	**5,014**	**100%**

Note: C denotes values that are suppressed for confidentiality reasons.

TRADE IN VALUE-ADDED: NZ'S DOWNSTREAM GVC TRADE WITH AUSTRALIA BY SECTOR

	1995	2000	2005	2008	2009
	US$ millions				
Total	**519.8**	**719.7**	**1060.1**	**1346.4**	**938.7**
Goods	**341.8**	**444.7**	**651.1**	**738.5**	**511.4**
Agriculture, hunting, forestry and fishing	46.7	81.9	131.0	142.7	118.9
Chemicals & non-metallic mineral products	79.5	93.9	134.6	159.0	109.8
Mining and quarrying	61.8	57.3	94.2	134.5	81.0
Wood, paper, printing & publishing	30.7	59.8	77.8	69.3	69.2
Basic metals, fabricated metal products	72.9	85.5	98.4	167.9	62.6
Food products, beverages and tobacco	20.7	22.5	28.8	23.9	34.1
Textiles, textile products, leather, footwear	8.4	9.7	19.2	15.2	13.6
Machinery and equipment, nec	3.5	4.8	4.5	9.9	7.6
Transport equipment	9.0	14.1	16.9	7.9	7.2
Electrical and optical equipment	6.7	13.2	43.7	5.3	5.9
Manufacturing nec; recycling	1.7	2.1	2.0	3.0	1.5
Services	**178.1**	**275.0**	**408.9**	**607.9**	**427.3**
Transport, storage, post & telecoms	47.6	86.5	132.6	170.5	135.1
Business services	58.1	90.0	127.8	198.6	133.8
Wholesale, retail trade; Hotels, restaurants	32.0	41.6	65.3	99.6	68.6
Financial intermediation	16.3	24.7	39.6	73.8	48.2
Electricity, gas and water supply	11.9	14.9	18.8	27.4	15.2
Other services	7.0	11.3	17.6	20.8	14.4
Construction	5.1	6.0	7.1	17.3	11.9

TRADE IN VALUE-ADDED: NZ'S UPSTREAM GVC TRADE WITH AUSTRALIA BY SECTOR

	1995	2000	2005	2008	2009
	US$ millions				
Total	**286.4**	**321.9**	**484.8**	**1095.0**	**788.8**
Goods	**200.8**	**226.4**	**314.4**	**580.5**	**447.0**
Mining and quarrying	52.6	76.0	88.9	223.4	173.8
Basic metals, fabricated metal products	29.3	25.7	43.3	146.4	121.0
Wood, paper, printing and publishing	45.0	46.6	64.3	82.8	57.3
Chemicals & non-metallic mineral products	27.2	27.6	40.5	52.3	37.9
Agriculture, hunting, forestry & fishing	16.8	22.3	24.8	22.7	16.3
Electrical & optical equipment	5.0	2.9	11.7	15.1	13.8
Textiles, textile products, leather, footwear	12.4	13.2	21.4	13.4	9.6
Machinery & equipment, nec	3.6	3.3	4.0	9.6	7.5
Transport equipment	2.7	2.2	4.1	5.3	3.7
Food products, beverages & tobacco	4.2	5.2	9.2	5.4	3.6
36T37: Manufacturing nec; recycling	2.1	1.4	2.2	4.0	2.4
Services	**85.6**	**95.5**	**170.5**	**514.5**	**341.8**
Transport, storage, post & telecoms	20.4	20.2	39.8	172.6	102.2
Business services	21.8	26.3	46.7	110.6	79.2
Wholesale, retail trade; Hotels, restaurants	19.0	18.8	34.0	121.3	72.7
Financial intermediation	8.1	9.3	17.3	39.6	29.5
Electricity, gas & water supply	9.2	9.4	12.2	27.5	23.5
Construction	3.2	5.5	7.6	21.9	19.0
Other services	3.9	6.0	12.8	21.0	15.7