Sporadic

11 June 2015

Fieldays 2015

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This week I am doing my usual three day stint in the BNZ tent at National Farm Fieldays in Mystery Creek, Hamilton. That is not by itself worth writing a Sporadic about given my aim to only write something here which I think differs from all the other stuff out there. The feedback so far in that regard has been good. Thanks for that.

But what is it that I have learnt from Fieldays which merits mention here? Just a few things.

Firstly, while I have received many questions regarding where I think the NZD will go, not a single person has ventured the opinion to me that it is too high. Even dairy farmers and people in the dairy support sector, while acknowledging that the NZD/USD rate has fallen and believing like myself that it will fall further, don't whinge. They just reckon the fall won't be enough to save the payout this season and they are tightening their belts – or stopping spending completely according to one of my conversants.

Second, while debt in the dairy sector has been the focus of some discussions, the farmers which I have been speaking with have tended to view the expected failure of some late-cycle buying highly-indebted operators as a natural capitalistic process – and as noted above they hope to buy their land cheap. In other words, while the Reserve Bank has rightly expressed concern about a possible fall in dairy land prices and the impact on some indebted operators, plenty of folk are ready and waiting for the land auctions. To quote the RBNZ's recent Financial Stability report….

"**Dairy incomes have declined significantly in the current season. Milk prices remain well below their peak in early 2014, and continued weakness in prices could markedly increase financial stress in the dairy sector. This vulnerability is exacerbated by high levels of dairy debt, concentrated among a small number of more vulnerable borrowers, and the potential for farm land prices to fall significantly…….there is a significant risk that milk prices remain low for an extended period**."

Third, as I have discovered in Auckland, when it comes to those selling property, they have little problem with foreign buyers coming in and delivering them extra largess. In fact in Auckland people who have a house which failed to sell have a growing tendency to call their agent and complain about the lack of Asian buyers at their auction.

Fourth, farmers, being regionally based, have at the margin backed up the view that people are increasingly buying residential property outside of Auckland. It has happened in past cycles so this is nothing new.

Fifth, and this is something which I picked up more last week when in Hastings for the Horticultural Fieldays. Dairying may be in for two weak seasons in a row, and sheepmeat prices are off their highs, but pip fruit is into it's third good year, wine its second, and Kiwifruit is making a very good comeback. Throw in a booming tourism sector which enjoyed a 21% rise in international receipts in the year to March and one sees that although the dairy crunch will affect the economy, the export sector is not munted. The exchange rate is not looking set for a major decline.

What is it that I am saying to the farmers? Apart from an expectation that the NZD will oscillate lower but not plunge, and that the interest rates outlook is benign but to watch rising fixed rates as US monetary policy gets tightened later this year, I also talk about dairying. I have not been giving a payout forecast. (Tried that, bombed out spectacularly some years back. Mucho trouble!)

Instead I have been pointing out the complete impossibility of attaching credence to anyone's forecast of what the payout will be because there are some huge factors in play about which we know next to nothing.

Specifically, consider this list.

1. Caps on European Union dairy production disappeared on April 1. No-one seems to have the foggiest idea how much European dairy production will rise. All we know is that the Irish have a goal of doubling their production by 2020 and are well on the way to doing so.
2. No-one knows to what extent the world's biggest dairy producer by far, the United States, will boost output because feed costs have fallen because biofuel producer demand has fallen because biofuel prices have fallen because oil prices have fallen because the oil industry's economics have been changed forever by cheapening shale oil extraction.
3. China is our biggest buyer. Growth forecasts for the Chinese economy keep getting cut and the Beijing authorities keep loosening fiscal, monetary and housing policies trying to restimulate things. So far without much success and hence still downward growth revisions. No-one knows when these downward revisions will end therefore one cannot yet say that dairy demand, to the extent it is related to economic growth in a country filled with lactose-intolerant people, will revive.
4. Based on commentary from those trying to explain why prices keep fall at the Global Dairy Trade auctions, no-one seems to know the true level of milk powder inventories in China. That is a big problem given the huge effect on prices which stock level changes can have.
5. There is an ongoing depressing impact on prices of the Russian ban on imports of Western dairy products. No-one knows when the ban will end and to what extent it will continue to exert downward pressure this season. Given the returning Cold War this ban could stay for many years.
6. With oil prices not only down but expected to stay low, no-one can be sure to what extent dairy demand from oil exporting countries will decline.
7. The Australian Bureau of Meteorology considers it highly likely that a potential strong El Nino weather pattern will strike this year. If it does food prices risk rising a lot, but production will be slashed in largely eastern parts of New Zealand. Maybe, maybe not.

And it pays to remember that Fonterra's initial forecasts of $7 for each of the past two seasons ended up at $8.40 and $4.40. What then is the lesson here? Predictability of the dairy payout is out the window. Dairy farmers, bankers, and the growing number of businesses in the dairy support sector need to explicitly factor this income volatility into the level of debt they consider safe, the types of input supply contracts they sign themselves up to, and the prices they pay for land and animals. It also pays to remember that in the world of financial markets, if a thing has high volatility attached to its potential income stream, the up-front price goes down. One wonders if farm buyers have truly factored this altered income dynamic into their bidding prices for land?

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9. A Shift in the Wind – NZ Growth To Slow. http://tonyalexander.co.nz/wp-content/uploads/2015/06/Sporadic-9-June-3-2015.pdf
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Sporadic is written by Tony Alexander, Chief Economist at the Bank of New Zealand. The views expressed are my own and do not purport to represent the views of the BNZ. It is a supplement to the monthly NZ Observer. Please sign up at www.tonyalexander.co.nz
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