BNZ Weekly Overview

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Mission Statement

To help Kiwi businesspeople and householders make informed financial decisions by discussing the economy and its implications in a language they can understand.

The Reality Facing NZ Agriculture

New Zealand farming has a problem. Just before heading overseas earlier this year the Prime Minister, with no industry consultation, announced a policy of imposing a ban on new offshore exploration for oil and gas. She could then laud the country's green credentials to the world's leaders and media. Shortly after we wrote that the NZ business sector should shiver a little ahead of subsequent trips offshore because signalling virtue and could lead to some new deep and little researched policies.

Just recently the PM increased the refugee quota immediately before heading to the United Nations. No impact for the business sector there so one imagines there was a collective sigh of relief. But what lies ahead?

Well, the most important document to hit the world's presses possibly ever was released this week warning of the potential extinction of 400,000 species, complete eradication of coral reefs, and huge impacts on hundreds of millions of people from global warming showing no signs of slowing down.

It is true that very little NZ does will have much impact and the biggest impacts will come from alterations in economic and social practices in the big economies. But this argument of the magnitude of impact from change has never stopped politicians in New Zealand from taking bold signalling steps – women's voting rights, nuclear free etc.

In this case the need to act to reduce the pace of growth and to then engineer a reversal in annual carbon emissions means everyone must do their part no matter the percentage contribution to global changes.

In the NZ context, given that we already have over 80% use of renewable energy for electricity generation, our big changes need to come in two key areas. One is transport and that is impossible to turn around in a short period of time. The money is not there to construct efficient public transport systems in our cities for one thing. The other is that while people think buying electric cars will help, in truth nothing of the sort happens. As long as electricity generation in NZ remains dependent upon some contribution from non-renewable sources, each electric car placed on the road represents increased demand from those non-renewable but easy to crank up energy sources.

The other area is of course agriculture – a sector which has been protected by previous governments from paying anything approaching the full cost of their environmental impacts – waterways and global climate.

It is certainly true that with half of the NZ contribution to our global warming impact coming from the pastoral farming sector, any radical moves to reduce emissions from animals will collapse it. No government will take such moves. But the writing is on the wall and increasingly the Prime Minister and others will be getting asked by their counterparts and lobbyists offshore, what exactly are the hard decisions being made in New Zealand to contribute toward reducing global warming? Because without strong moves being signalled on reining in agricultural sector emissions the claims by any of us offshore regarding pulling our weight in making a contribution will be meaningless.

The Prime Minister knows this and knows that when it comes to making our contribution we are falling well behind.

What does this mean? At some point the PM will attend an international meeting at which climate change mitigation policies will be discussed. It will be a meeting at which everyone will be expected to bring something to the table. And what attendees will be expecting New Zealand to bring will be a set of policies leading to reductions in emissions from our pastoral farming sector.

The problem however, as farmers have rightly long pointed out, is that the technologies do not yet exist to allow them to continue to be dairy and meat farmers whilst radically reducing animal emissions. But that clock of needed technologies has been ticking for at least 15 years and time is running out. Our camera-seeking PM will not want to attend whatever the eventual international meeting will be without being able to parade something which convinces her counterparts and the cameras that she is doing something beyond mouthing platitudes." We too"? Not if farming remains as it is.

So the writing is on the wall for our pastoral sector in its old form. There will not be immediate radical changes forced on farmers. But they are going to start feeling some pain. One of those pain points will be people thinking about entering the sector soon more forcefully pricing expected penalties and mitigation costs for emissions into the prices they will be prepared to pay for pastoral land.

Already we have seen the example of one farm-focussed fund moving away from intensive dairying (an environmental disaster right up there with Bitcoin mining) and toward other areas like horticulture. As noted here some months back we are seeing falling prices of coastal properties at risk from rising seas in the United States compared with other property prices. We will soon see property prices in NZ cities adjusting to reflect the premiums being demanded by insurers for the specific earthquake and inundation risks which they face.

The markets will adjust pricing to reflect expected future imposts and this will start to affect NZ pastoral land prices.

Of course the preferences and willingness to pay of potential farm buyers will not be the only route through which these price adjustments will occur. Consider the changes which banks have made in their lending practices over the past three decades to reflect societal attitudes towards particular industries like manufacturing of cluster bombs, munitions generally, and coal mining in Australia.

It is perfectly reasonable to expect (and I have zero knowledge of whether this is in fact coming or not) that banks will eventually start to react to the global threat from climate change by changing the terms upon which they will lend to polluting industries. Credit availability one day for buyers and existing owners of high greenhouse gas emitting assets will diminish.

It is impossible to know the timeframes for when these pricing and credit decisions will be made. But it is interesting to note, as we did just above, that in the capital markets investors are already reallocating away from intensive dairying.

Life, economics, everything is all about change. We all change and will have to change and the best we can all hope for is not necessarily that we predict the change, but that when it comes we have the capacity to recognise the need, the willingness to undertake it, and the time to make changes without bankrupting or collapsing ourselves.

Farmers still have time on their hands. But the days of new intensive dairying operations are essentially over. Existing farmers, like those who 100% pooh-poohed the idea at Fieldays of people eating factory-grown meat, may well deny that change is coming. That doesn't matter. What matters in economics is always that which is happening at the margins. And at the margins new investors are already changing their attitudes. And soon they will change the prices they will pay for land.

Farmers would do best to recognise that the mother of all threats after foot and mouth is coming to many (not all) of them and start altering what they do and how they do it before our PM next books a trip offshore to a major gathering of global leaders. She knows that in light of the recent IPCC report and the growing recognition that our two biggest exporters (long distance tourism is the other) are huge contributors to climate change, she cannot show up empty handed.

If I Were A Borrower What Would I Do?

Nothing new except that there is some upward pressure on wholesale interest rates from still very good economic data in NZ (Eftpos spending), rising US interest rates, and growing pressure on the government to loosen fiscal policy. That loosening probably won't come for some time, but it will come. There is currently upward pressure on inflation from rising fuel costs. But the Reserve Bank have already said that they will look through the first round effects of higher fuel prices when gauging underlying inflation. So tighter NZ monetary policy still remains a long way off and the NZ markets are pricing about a 25% chance that the official cash rate will be cut next year.

If I were borrowing currently I would personally show favour toward a three year fixed rate.

The Weekly Overview 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. **This edition has been solely moderated by Tony Alexander.** To receive the Weekly Overview each Thursday night please sign up at www.tonyalexander.co.nz
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