

THE GLOBAL ECONOMIC CRISIS

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The effects of the global economic crisis are likely to be felt by New Zealand's agriculture and forestry sectors for years, rather than months. However, due to the robustness of our banking institutions and the type of goods we export, New Zealand appears to be in a better position than many of our trading partners. In particular, the medium-term outlook for the food-based agriculture sectors remains solid. These sectors will play a key part in what is likely to be an export-led economic recovery.

»» CREDIT CRISIS

The rapid escalation of the sub-prime lending crisis in the US led to a significant reappraisal of risk and risk appetites throughout the world's financial markets in September 2008. Wholesale funding in capital markets all but evaporated and a "credit crunch" ensued. World output and trade started to fall dramatically as it became evident the world was in the grip of a global economic crisis. Because it started as a credit crisis, the scale and breadth of this recession is likely to be worse than other recessions, and recovery slower.

»» TRADING PARTNER PROSPECTS

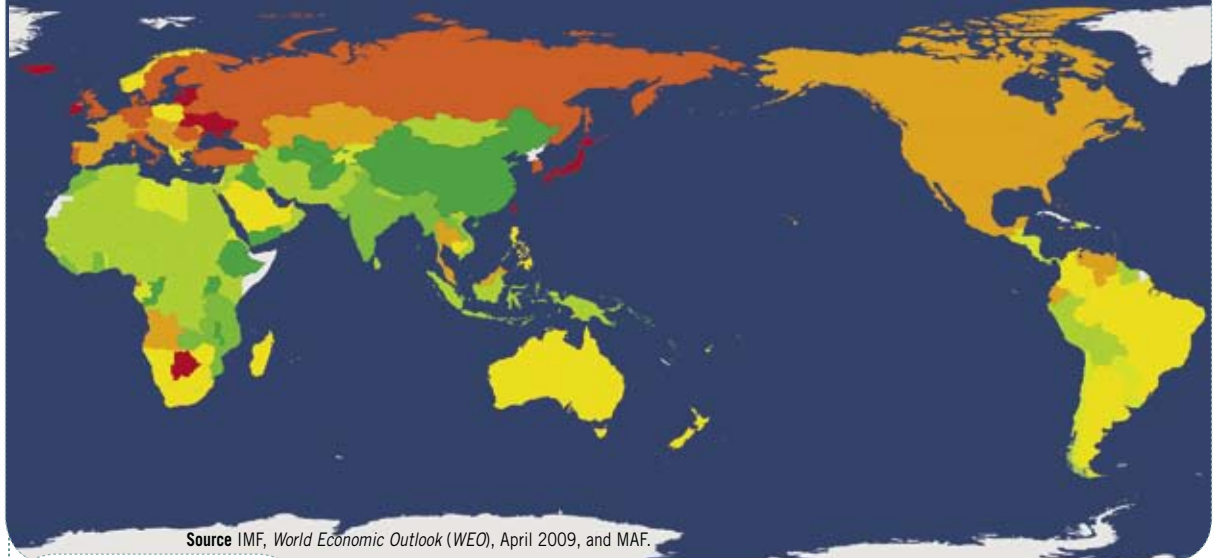
New Zealand agriculture and forestry depends heavily on exports to generate the bulk of its returns. With a small domestic market, exports allow our sectors to achieve economies of scale and scope. However, a reliance on exports exposes New Zealand agriculture and forestry to the fluctuations in the economic performance and consumption levels of our major trading partners.

The economic crisis has led to a substantial drop in world trade – a greater drop than could usually be explained by the relationships between growth and trade. This appears to be due to credit constraints and the lack of certainty and trust pervading the financial markets. For instance, some firms have been unable to access the required trade credit or working capital, and this has halted or delayed a significant amount of global trade. A contraction in consumer spending is also a likely factor, due to a lack of consumer confidence and the tightening up of available credit.

In spite of aggressive worldwide monetary and fiscal stimulus packages, the 2009 outlook for the economies of many of our trading partners

remains bleak. The International Monetary Fund (IMF) forecasts that real GDP in the US economy, the engine of global consumption, will contract by 2.8 percent in the 2009 calendar year. As Figure 3.1 shows, many of our other trading partners do not fare much better. Although global growth is forecast to return to positive in 2010, it will be a number of years before real per capita income in the developed world returns to the peaks of 2008.

FIGURE 3.1: GDP 2009 GROWTH FORECASTS FOR NEW ZEALAND'S MAJOR TRADING PARTNERS



KEY: GROSS DOMESTIC PRODUCT,
CONSTANT PRICES – ANNUAL PERCENT
CHANGE 2008–2009 EST.

- less than –6
- between –6 and –4
- between –4 and –2
- between –2 and 0
- between 0 and 2
- between 2 and 4
- between 4 and 6
- more than 6
- No data

Annual percentages of constant price GDP are year-on-year changes; the base year is country-specific.

»» IMPACTS ON DEMAND

A global economic downturn directly affects New Zealand's exports because lower aggregate demand usually leads to lower commodity prices. Global supply does adjust to changes in demand, but these supply changes can take time to occur. As a result, changes in global growth often produce large short-term fluctuations in commodity prices.

However, there is some cause for optimism in terms of our food-based agricultural exports. Aggregate demand for food tends to be less sensitive to changes in income relative to other consumer goods. While consumer preferences may change, world trade in food-based commodities has been less affected than most other traded goods. On the other hand, forestry and wool exports are primarily used in consumer-durable goods and as inputs for the housing sector, and the aggregate demand outlook for these industries is generally not as strong.

Despite recent exchange rate volatility, our export sectors are benefiting from a lower New Zealand dollar relative to the currencies of many of our trading partners. However, a lower dollar also leads to higher input prices, such as fertiliser and fuel. It is currently assumed that the dollar will remain lower than the long-term average during the next two years.

This type of aggregate behaviour has two key implications for New Zealand: on average, the global economic crisis will affect our food-based agricultural exports less than other sectors, and these food-based exports will probably contribute to New Zealand's economic recovery.

SECTORS WILL FARE DIFFERENTLY

Changes in aggregate behaviour are informative, but often mask more subtle changes in demand and consumer preferences. Changes in demand that are crisis induced vary across product types, companies and whole sectors. For instance, some fast-food businesses have been experiencing high sales volumes as diners downgrade to cheaper options. Conversely, some high-end supermarkets may increase their sales of certain premium meat cuts as wealthier consumers choose to dine at home rather than in restaurants.

Economic growth and consumption spending is not expected to be affected in many developing countries as much as in countries where the standard of living is higher. However, dairy products or fruit, such as kiwifruit or apples, may still be considered luxury items and a discretionary spend that it is prudent to curb.

For forestry exporters, demand has slumped among a good number of our traditional markets. But some opportunities still exist, such as in the log market to China.

These subtleties of demand and consumer preferences are important for our sectors to understand, perhaps now more than ever.

»» TIGHTER LENDING

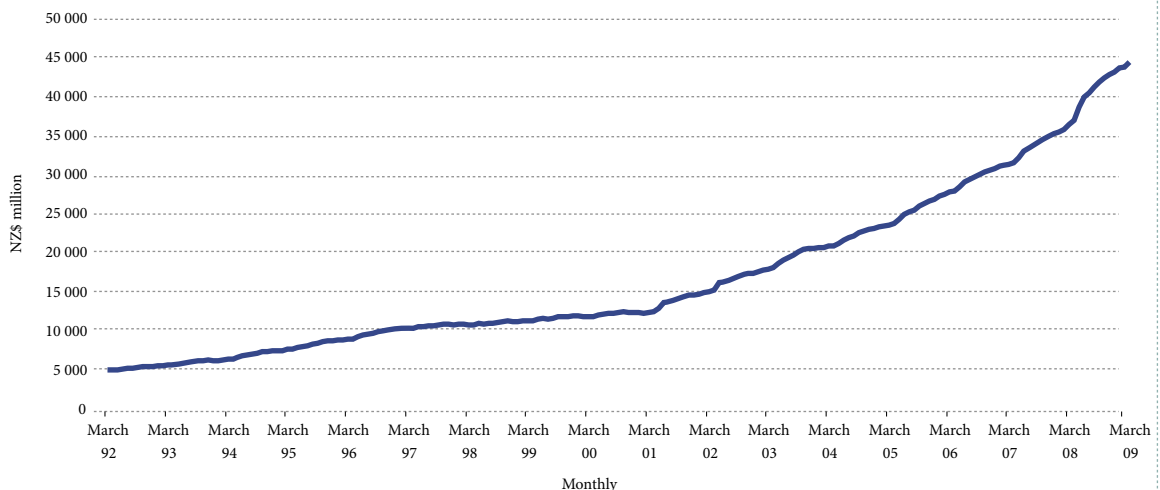
In addition to the restraints on the financing of global trade, tighter credit conditions are directly affecting New Zealand firms. This is because we are highly dependent on offshore borrowings to fund much of our consumption and investment, which means paying a higher price for credit that's also less available.

Financial institutions are lending more conservatively, and are tending to concentrate on continuing to service existing established clients rather than taking on new customers. There is also a significant risk that global credit markets could deteriorate further, which would lead to even tighter credit conditions. This has implications for both on-farm and off-farm agribusinesses.

While there are now signs that lending to the agricultural sector may be slowing, over the past eight years there has been substantial growth in total on-farm agricultural credit (see Figure 3.2). Rising farm-land prices have been a factor in the growth in credit. Traditionally, many farming businesses relied on capital gains as their main source of profitability. But as the rural real estate market slows, and it enters a prolonged period of below-average land-price growth, the future focus is likely to be on cash returns. In light of this, many farmers are putting tighter controls on input costs and cash management, as they seek to become less leveraged and strengthen their balance sheet.

At the exporter level, some firms may require higher levels of working capital in the likelihood that international payments are less prompt. In response to this, and also to mitigate some of the downside risks of a further constrained banking sector, some firms are seeking funding directly from the market, via debt or equity raisings.

FIGURE 3.2: TOTAL ON-FARM AGRICULTURAL SECTOR CREDIT



Source Reserve Bank of New Zealand.

“Many countries are becoming more inward focused and relying less on imports.”

»» UNIQUE ADVANTAGES

Notwithstanding short to medium-term risks, such as a further downturn in the global economy or a higher-than-assumed exchange rate, New Zealand also has some distinct positives that will help our economic recovery. These include a relatively “vanilla” banking sector that is not directly exposed to the worst aspects of the international credit crisis. Our public and regulatory institutions are regarded internationally as highly transparent. High nominal interest rates at the outset of the crisis also allowed significant monetary easing to take place.

New Zealand’s floating exchange rate has been beneficial for exporters as the New Zealand dollar depreciates against our trading partners’ currencies. Often a source of consternation, the floating exchange rate has proved an important shock absorber in the face of economic uncertainty.

»» OUTLOOK REMAINS POSITIVE

Although the above factors are encouraging and place us in a better position than many other countries, the global economic crisis has compounded many challenges already faced by New Zealand’s agricultural and forestry sectors in the short-term. As demand drops, competition in offshore markets is increasing. Consumers are becoming more discerning and demanding greater value from their spending. Many countries are becoming more inward focused and relying less on imports.

Nevertheless, the medium-term outlook for many of our sectors remains positive, as opportunities present in high-end wealthy markets and rapidly developing countries. But to take advantage of these opportunities, investment is required in areas such as innovation, improved product offerings and market development. While acknowledging the need for businesses to focus on input costs and cash management, some sectors need to invest higher returns back into their businesses so as to have a sustainable business model over the longer-term.

»» OPPORTUNITY KNOCKS

The New Zealand dollar is assumed to remain low over the next two years, buffering returns to the primary sectors through the worst of the downturn. However, we cannot simply rely on a low dollar in order to enjoy a high material standard of living. Over time, a better-performing New Zealand economy will result in a structurally higher dollar. This global economic crisis gives the primary sectors an opportunity to both reassess and reduce their cost structures, but also to invest in and plan for a high-productivity, high-income future.