

# Escalating crisis hits New Zealand dairy industry

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New Zealand's major dairy exporter, Fonterra, announced this month that the forecast milk price paid to farmers this season will be reduced to \$NZ3.90 (\$US2.60) per kilogram. The latest cut of 25 cents brings the payout to less than half the \$8.40 farmers were earning two years ago. The break-even price is about \$5.40, meaning the vast majority of the country's farmers are losing money.

The continuing slump is causing alarm in wider banking and financial circles. Economist Shamubeel Eaqub told the NZ Shareholders' Association annual conference last September that the impact of the steep dairy payout decline was the worst in real terms since 1912.

Dairy is the country's principal export industry. Fonterra initially announced a brutal cut in its payout last August, down to \$3.85 per kilogram from a forecast \$5.70 just three months earlier. While prices recovered to \$4.60 later in the year, dairy-related income slumped by \$4.9 billion to \$13.2 billion for the 2014–15 season.

The downturn is a sign of ongoing deeply-rooted problems in the wider economy. On March 10, the Reserve Bank announced a surprise cut of 25 basis points to the official cash rate to a record low 2.25 percent. It also lowered the forecast track to the 90-day bank bill rate by half a percentage point over the next two years, indicating another interest rate reduction is still to come. The bank's governor Graeme Wheeler cited low inflation resulting from cheap fuel and other imports, but the dairy crisis was a major factor in the decision.

In January, international credit rating agency Fitch downgraded its outlook for New Zealand's economy, saying it expected slower GDP growth due to falling dairy prices. It reaffirmed the country's AA credit

rating but downgraded the outlook from "positive" to "stable." Fitch gave a "negative" rating to the banking sector due to the "softening" economic environment, predicting that a prolonged period of low dairy prices could lead to farmers not being able to pay off loans.

DairyNZ calculates that the average dairy farmer will be in the red by \$210,000 at the season's end in May. Fonterra expects total production to fall by up to 6 percent this year. Prime Minister John Key told Radio NZ this month that up to 10 percent of the country's 14,000 owner-operators and share-milkers were at risk of "going under" and he expected banks would be "working closely" with farmers to "keep them on their land."

However, on March 17, the Reserve Bank released details of its "stress tests" for the main rural lenders. The dairy industry is carrying almost \$40 billion in debt. If Fonterra's payout remains below \$5 per kilo until the 2018–19 season, land prices are forecast to drop by 40 percent and \$4 billion would have to be written off in loans. By comparison, total bank profits, in today's terms, are \$5 billion a year.

Rabobank, which services 15 percent of the dairy farming market, warned that it would not support all at-risk farmers. General manager Hayley Moynihan told Radio NZ the "severity and prolonged nature" of the downturn meant "not all farmers will survive in terms of their businesses being resilient enough to cope with what will effectively be three years of very low milk prices." Moynihan bluntly declared it was not "in the bank's interest to fund losses where the losses can't be repaid even when markets improve."

The crisis in New Zealand dairy is being fuelled by the collapse in global commodity prices. There is an oversupply of dairy products internationally. In Europe farmers are also struggling due to a Russian ban on

imports in retaliation for EU sanctions. The much-predicted endless demand for NZ milk powder from China's "rising middle class" is beginning to dry up due to that country's economic slowdown.

A recent survey has shown a fifth of New Zealand's small businesses are already being hit by the fall in the dairy price. Accounting software company MYOB, which carried out the survey, said about 100,000 small businesses across the country have been affected by falling revenues. MYOB general manager James Scollay said the downturn was "filtering through to the cities and other industries."

Fonterra has exacerbated the problem by notifying its 4,000 suppliers and contractors that it wants a 10 percent price cut and intends to pay its accounts on a 90-day cycle, instead of each month. Hard-pressed provincial businesses protested that such a procedure was untenable, forcing them to carry the company's debts and effectively act as its "banker." Fonterra confirmed this month the permanent closure of its Kaikoura cheese factory, with the loss of 30 jobs in the small seaside town where it was one of the main employers.

Devon Funds Management chairman Paul Glass cast doubt over the viability of Fonterra, pointing out that it has almost \$7 billion worth of debt but less than \$1 billion in equities. "That is an incredible position to be in. Most banks will only lend you about three to four times your earnings, so Fonterra are very, very heavily indebted," Glass said.

Under these circumstances, Fonterra's farmer-shareholders are expressing growing outrage at the gold-plated financial packages commanded by management. Chief executive Theo Spierings' total earnings last year were \$4.93 million, making him the highest-earning executive in the country. The chairman of the board, John Wilson earns more than \$400,000.

Waikato-based veterinarian and consultant Alison Dewes told Fairfax Media that Fonterra and the government were to blame for encouraging unsustainable intensification in the industry. "It's not surprising farmers have been side-swiped by this crash... growth can't be limitless because at some point we will flood the world with milk. This is exactly [what] has happened and the price has crashed," he said. In 2014, 60 percent of the dairy expansion was based on conversions from other, even less profitable, types of

farming, and just 40 percent on increased productivity.

A DairyNZ and AgFirst report in April is expected to show a looming exodus of farmers from the industry. Greg Yuretich, a Northland dairy farmer for three decades, told Fairfax Media he had experienced the "highs and lows of the industry." The tough times, however, were becoming more frequent and "with this milk price you do ask yourself 'Why am I getting up in the morning?'"

The National government has refused to provide any assistance to farmers. Minister for Primary Industries Nathan Guy this month flatly denied that the dairy industry is in a crisis. Despite farmers enduring "tough" times, Guy declared, "it's my belief we are not at a crisis level. What we are experiencing is a period of volatility."



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