

The grass will be greener

Agricultural production is set to rebound

- After difficult growing conditions in 2007, 2008 is shaping up much better.
- The Southern Oscillation Index suggests that NZ is on the cusp of strong La Niña conditions. La Niña is normally associated with higher agricultural production.
- Agriculture will be a huge contributor to economic growth in the coming year, both from increased production and the flow-on effects of the dairy cash windfall.

This growing season has been a tough one and the Agriculture Minister has advised farmers that they should plan for possible drought this year. We are optimistic that the outlook won't be so grim. In fact, we are hopeful of a fairly strong rebound in agricultural production.

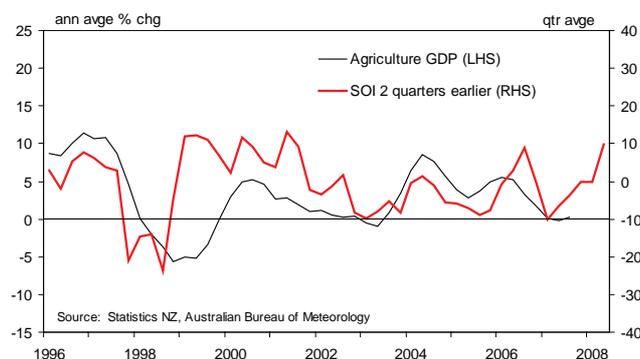
Farming will be a huge contributor to economic growth in the coming year. Most of the economic stimulus will come from the income and multiplier effects of a dairy sector set to enjoy a massive \$4bn plus extra cash in the year to August 2008. Already we are seeing the preliminary impacts of that on demand for agricultural supplies (and their prices!), farm values (up 50% in the year to November 2007), and rural retail spending (up 8% annual versus 3% in the cities). The direct and flow-on effects are, and will be, enormous.

However, agricultural production volumes are also likely to swing from being a non-contributor to GDP growth in the past year (posting just 0.4% year-on-year growth to September 2007), to stimulatory next. This might seem like a pipe-dream when the news has been of: severe soil-moisture deficits (particularly in Hawke's Bay, Marlborough, and parts of Canterbury and Otago); weak grass silage production (down 70% in Canterbury); and lamb numbers down 1.7 million (or 5%, with most of that being in the East Coast of the North Island). The dry conditions and weak production haven't come as a

surprise to us – we had anticipated them.¹ Why the new found optimism? It's all about the weather.

We track the Southern Oscillation Index (SOI) as an indicator of weather patterns (the index measures fluctuations in air pressure between Tahiti and Darwin). The SOI has proved to be a reliable indicator of swings in agricultural production (see Figure 1). Last year NZ was in the grip of El Niño conditions. These are generally characterised as strong westerly winds in summer (bringing rain in the west and drought on the east coast), cold southerlies in winter and south-westerly winds in spring and autumn. NZ agricultural production is hit hard during El Niño conditions – see the 1997/98 period in Figure 1.

Figure 1: Agricultural production affected by weather



La Niña conditions in NZ are typically associated with more north-easterly winds, bringing moisture and rain to the north-east of the North Island. But there is reduced rainfall in the south and south-west of the South Island. La Niña conditions generally see a lift in agricultural production.

The latest monthly read of the SOI for December was 14.4. This brings the 3 month average to 9.9. This is a level on the cusp of being considered strong La Niña

¹ See our Bulletin: 'El Niño conditions in NZ?' 6 September 2006.

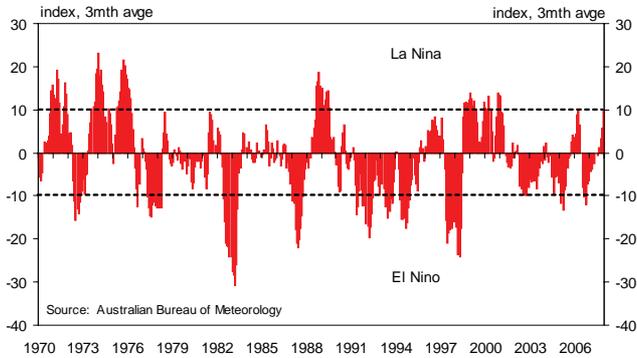
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conditions – indicated by the top dotted line in Figure 2. Moreover, the 30-day average to January 6 stood at a sky-high 20.7.

Figure 2: Southern Oscillation Index



The SOI is a fairly reliable leading indicator of the direction of agriculture GDP growth. It pointed to flat / lower agricultural production in 2007, and is indicating an improvement in 2008. Moreover, New Zealand's NIWA and Australia's Bureau of Meteorology both predict La Niña conditions to persist through to at least autumn 2008. Of course the weather can be fickle, but signs are promising for better growing conditions and production.²

The anticipated increase in agricultural production is one factor behind our expectations of international dairy prices drifting off their peak levels (as more supply comes onto the market) and higher meat prices (as drought related de-stocking turns to re-stocking). The Agriculture sector is set, on average, to have a very good 2008. And that is great news for the NZ economy. After all, NZ is still basically a farm that people like to visit.

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² From the annals of life being unfair, some regions – such as central Otago and South Canterbury – can experience drought in both El Niño and La Niña episodes.