

# WESTPAC ECONOMIC BULLETIN

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**Nathan Penny**, Senior Agri Economist

+64 21 743 579

nathan.penny@westpac.co.nz

**Satish Ranchhod**, Senior Economist

+64 9 336 5668

satish.ranchhod@westpac.co.nz



## Rural cost inflation - light at the end of the tunnel.

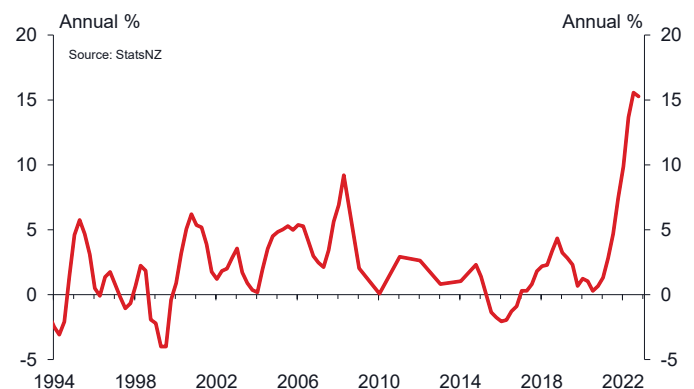
- Annual rural cost inflation stands at a whopping 15.3% in the December 2022 quarter.
- However, we expect that it will cool rapidly from here.
- Notably feed costs, fertiliser and fuel prices are set to drive cost inflation lower.
- Following this extended bout of inflation, farm and orchard cost structures are likely to remain permanently higher.
- That said, we expect farm and orchard margins will widen again as key agricultural commodity prices lift over the remainder of 2023 and into 2024.

### There is light at the end of the cost inflation tunnel...

Rural cost inflation has peaked. Input prices across all farm and orchard types<sup>1</sup> (excluding livestock costs) dipped from an annual pace of 15.6% in the September quarter down to 15.3% in the December quarter.

That's not to say the picture isn't still ugly. At an annual 15.3% rate, rural cost inflation is more than double the rate of a year ago. And the comparison is even starker with the pre-Covid average of around 1.8% annually.

Rural cost inflation has peaked



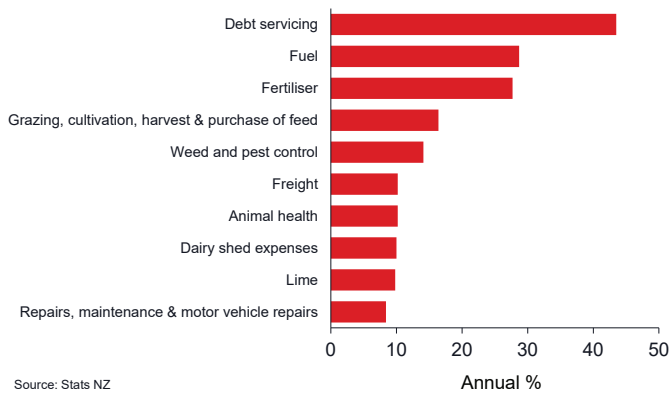
Looking by farm type, dairy farms experienced the biggest spike in input costs, with prices up over 17% over the period.

<sup>1</sup> All farm indexes are a weighted average of the following farm types: sheep, beef, and grain farms; dairy farms; horticulture and fruit-growing farms; poultry, deer, and other livestock farms.

Sheep and beef farmers and cropping farmers experienced the next biggest lift, with prices lifting around 15%, while for horticulture, prices were up closer to 12% for the year.

The chief drivers of rural cost inflation have also changed. Debt servicing costs have risen on average by 45% over the past year. Fuel and fertiliser prices are up 28% and 33%, respectively, over the past year. While those are still large increases, price growth in these areas has slowed sharply from the 40% to 70% increases that we saw in the year to June. Meanwhile, feed cost<sup>2</sup> inflation has remained firm, up 13.4% in annual terms in both the September and December quarters.

Rural cost inflation, selected inputs, December 2022 quarter

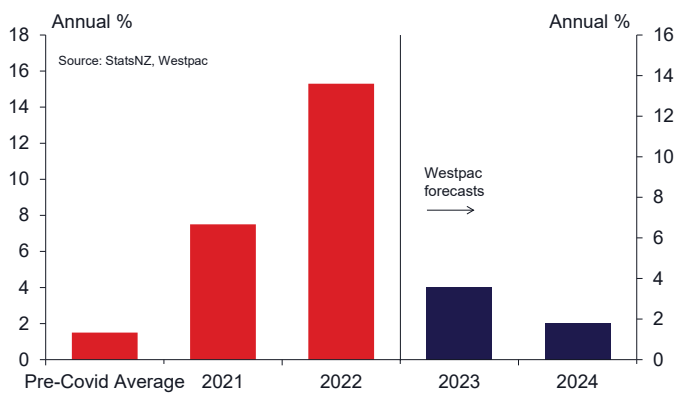


Source: Stats NZ

## ... with cost inflation set to fall relatively rapidly from here.

From here, we expect rural cost inflation to descend relatively rapidly. From the 15.3% reading for December 2022, we estimate that annual rural cost inflation will fall to around 4% by December 2023. We expect a further fall to around 2% by December 2024.

Rural cost inflation forecast (December years)



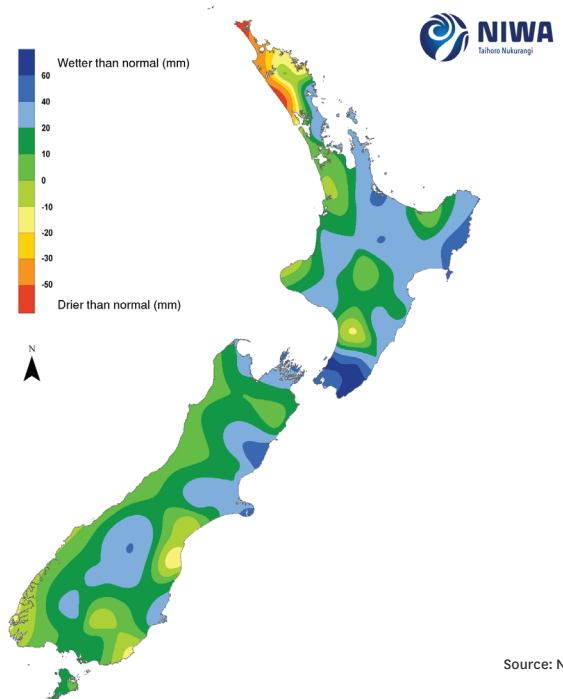
Surprisingly and importantly, we expect feed costs to fall steeply from here. Wet weather, associated with the summer floods and Cyclone Gabrielle, has supercharged pastures over autumn, heading into winter at a time when many farmers often struggle for feed. Instead, farmers now have ample feed for winter, and this is putting downward pressure on feed prices. In addition, falling farmgate prices mean that farm incomes have

<sup>2</sup> Feed costs are technically grazing, cultivation, harvest and purchase of feed.

fallen and with it demand. Note in our last rural cost inflation update (published in August 2022), we had anticipated that feed prices (along with wages) would remain high over 2023 and 2024. With feed costs the largest component of most livestock farm budgets, this is a welcome development on the inflation front.

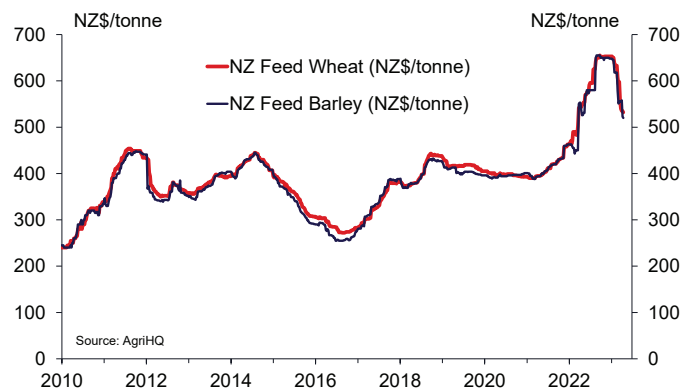
Input	Annual % change Dec 2022	Weighting (%) All farms - all inputs excl. livestock	Direction of change 2023-2024
Feed costs	13.4	18.3	↓
Fertiliser	28.3	10.0	↓
Fuel	33.4	2.7	↓
Interest rates	45.2	16.2	→
Wages	3.3	13.2	↑

Soil moisture anomaly (mm) at 9am on 20/04/2023



Source: Niwa

Arable – feed grain prices are falling rapidly from their peak



Source: AgriHQ

Ongoing declines in fuel and fertiliser inflation will provide additional downward impetus. Fuel (petrol) prices have fallen

by around 20% since the middle of 2022. Local fertiliser prices have headed in the same direction, and with world urea prices, for example, down by around 66% since April 2022, further local price declines are likely.

## Wages are still likely to prove sticky though...

However, we expect wage inflation will buck the overall trend lower. Most current wage measures are at or near record highs. Moreover, with the labour market still very tight - the unemployment rate is at 3.4%, just 0.2% shy of the record low - workers still have negotiating power. In addition, workers are seeking compensation for high inflation. Ongoing increases to the minimum wage are also adding to the pressures.

Wages staying high over 2023, if not 2024



## ... and prices and cost structures have moved permanently higher.

While cost inflation is cooling, we don't think that costs will fall back to previous levels. In other words, farm and orchard cost structures are likely to remain permanently higher.

Dairy farm costs are case in point. Between 2017/18 and 2020/21, DairyNZ estimated that average farm working expenses were in the low to mid \$4.00/kg range. Now for 2022/23, DairyNZ estimates that average farm working expenses have jumped to the low to mid \$6.00/kg range.

That said, we expect that generally farmer and grower margins will widen once again. Indeed, at the same time cost inflation is falling, we expect commodity prices to rise over the remainder of 2023 and into 2024. Farmgate meat prices, for example, have already started to rise. In addition, horticulture prices are likely to lift on last season, helped higher by small kiwifruit and apple crops. Similarly, we expect that dairy farmers will benefit from a jump to a \$10.00/kg milk price next season.

# Contact the Westpac economics team

**Kelly Eckhold, Chief Economist**

+64 21 786 758

**Michael Gordon, Senior Economist**

+64 9 336 5670

**Satish Ranchhod, Senior Economist**

+64 9 336 5668

**Nathan Penny, Senior Agri Economist**

+64 9 348 9114

**Paul Clark, Industry Economist**

+64 9 336 5656

**Any questions email:**

[economics@westpac.co.nz](mailto:economics@westpac.co.nz)

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