NZ Insight: What does the Russia-Ukraine situation mean for New Zealand's agriculture sector?

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How will the NZ agriculture sector be impacted by the Russian invasion of Ukraine?

Key points

- Russia and Ukraine are minor trading partners for New Zealand.
- However, our commodity food exports are likely to experience upward price pressure as global supply tightens.
- However, the invasion of Ukraine is also pushing up fuel and fertiliser input costs.
- More broadly, it's adding to global inflation and means the RBNZ has yet more work to do.

Economic consequences

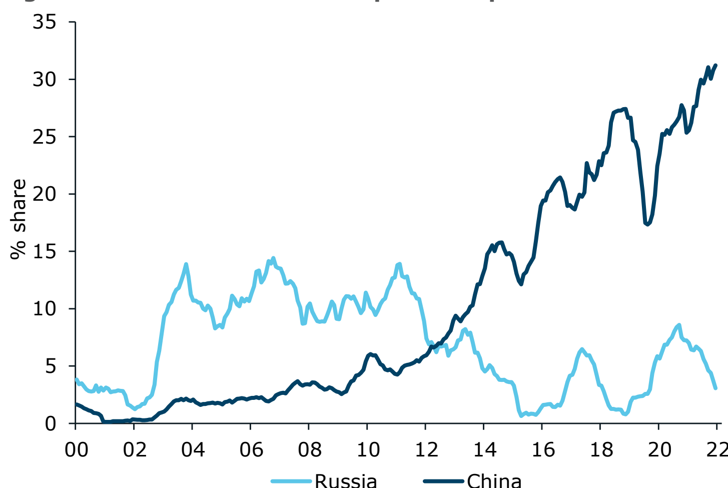
The recent invasion of Ukraine by Russian forces is having an horrific impact on those caught up in the conflict. The economic impact of the conflict will be most acutely felt in neighbouring European regions that have a strong trading relationship with Russian and/or Ukraine.

The New Zealand link

The impact on New Zealand and its agriculture sector will mainly be indirect, as the trading relationship between New Zealand and Russia has diminished over the past twenty years.

Russia now accounts for just 0.4% of New Zealand's good exports. That puts Russia down at number 27 in terms of their importance as a trade partner. (New Zealand's trading relationship with Ukraine is even smaller.)

Figure 1. Share of NZ butter exports to specific markets



Source: StatsNZ

Dairy products – particularly butter and anhydrous milkfat – account for much of the goods we do send to Russia. New Zealand has supplied butter to Russia for decades. Indeed, it was once our largest market for dairy fats, but rising demand from other markets (particularly China), and the fact that doing business in Russia has become increasingly complicated, has reduced the size of the trading relationship (figure 1).

New Zealand also exports some apples, wine and kiwifruit to Russia, but these volumes are not particularly significant.

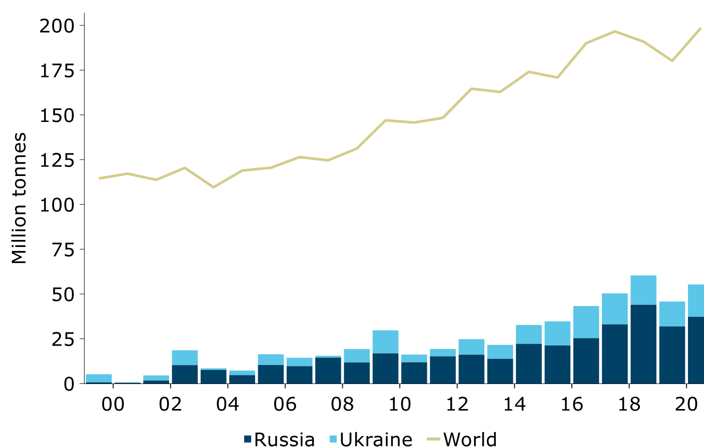
Bread-basket supply concerns

But that's not to say the war won't impact New Zealand's export prices.

Ukraine and Russia are both large producers and exporters of corn and wheat, with the Ukraine often referred to as the "Breadbasket of Europe". If the situation is not resolved before the next harvest, then supply shortages could occur, with implications for both food and animal feed markets.

Nearly 30% of the world's wheat exports are supplied by Russia or Ukraine. The portion of corn supplied from these regions is a little lower, just under 20%, but that is still a significant amount. The Ukraine is also the largest supplier of corn to China.

Figure 2. Global wheat export supply by country



Source: FAO, Macrobond, ANZ Research

Crops are due to be harvested late in the Northern Hemisphere summer, about July. That is still some time away, but financial markets are already pricing in the risk of these grains being in short supply.

Sanctions imposed to date do not include food products, and basic foods are typically excluded from sanctions, so wheat could potentially still be supplied from Ukraine and Russia to other parts of the world. However, this may be logistically challenging in terms of actually moving the product. Further, it may be very difficult to process payments.

There are some fears that a global grain shortage or excessively higher grain prices may reduce food security and trigger unrest as civilians go hungry.

Following the invasion of Ukraine, wheat prices breached USD10/bushel – a level not seen since 2008. Corn prices are 16% higher than mid-February – and 52% higher than a year ago.

The increased cost of feeding grain to livestock will restrict the global supply of beef, pork and milk, and push the prices of these goods higher in order to cover the increased costs of production.

New Zealand dairy and beef farmers are not directly impacted by higher grain prices due to our cattle being primarily pasture-fed. However, they will benefit from higher global food prices. That's a pretty good position to be in.

Unfortunately, there's a hit on the import side too.

An energy powerhouse

Russia supplies about 40% of Europe's gas. Russia is also the world's third largest producer of oil, and supplied 11% of the oil traded globally in 2020 – of which half was purchased by European countries. Ukraine is also a big energy exporter. Any reduction in oil and gas supply as a consequence of the conflict and sanctions will increase prices as has already become evident.

The restricted supply of energy from Russia is rapidly pushing up the price of goods such as fuel and fertiliser. Energy prices were already high before Russia invaded Ukraine, but the current situation has further exacerbated things.

New Zealand imports only small quantities of oil and fertiliser directly from Russia. Russia supplied about 4% of the oil we imported last year and 1.5% of our fertiliser. Therefore, the direct impact on supply of these goods is minimal.

However, recent restrictions imposed on trade with Russia by a large swathe of counties will result in generalised supply shortages of these products, and therefore push up prices. And restrictions on fertiliser exports from Russia could be imposed by Russia itself in retaliation to sanctions. Russia supplies about 60% of the world's ammonium nitrate and has previously imposed export bans. New Zealand doesn't use much ammonium nitrate so the direct impact on NZ would be relatively limited, but it would indirectly push fertiliser prices higher more broadly.

Oil prices have responded quickly, breaching USD120 per barrel and trending higher still. Although oil and gas were largely carved out of sanctions, a general unwillingness of global firms to trade with Russia and the flow-on impacts of the financial sanctions has meant an effective restriction on Russian supply in any case.

Figure 3. Crude oil price (WTI)

Source: CME Group, ICE, Bloomberg, Macrobond, ANZ Research

Global freight disruptions

Another hit to New Zealand agriculture could come via freight. The sanctions on Russia are already disrupting global freight channels, which weren't in great shape to start with. Several of the major carriers have said they will not be servicing Russian ports. The logistics of moving product in and out of Ukraine are also incredibly challenging at present and could remain this way for some time due to damage to port infrastructure. While these aren't key channels for New Zealand exports, anything that adds more pressure onto an already fragile and struggling global freight network is unlikely to be helpful.

Impact on the NZD

The NZD usually rides one of three horses: commodity prices, global risk appetite, or interest rate differentials.

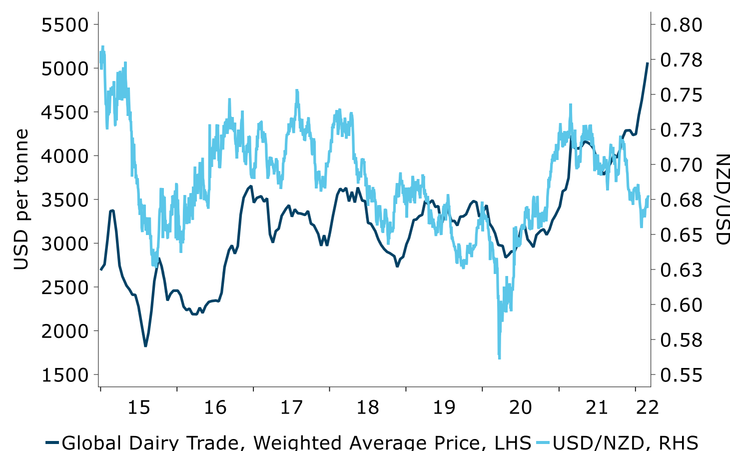
At the moment, global risk appetite is dominating. During periods of uncertainty investors tend to flock to safe-havens like gold and the US dollar. This tends to inflate the value of the USD and therefore decrease the value of the NZD – which tends to be labelled as a proxy for 'global growth risk' via the commodity channel. So all other things being equal you would expect the conflict to weigh on the NZD.

But it is quite a complicated situation. That logic depends on commodity prices falling when investors are worried about global growth. But investors are worried about global growth partly because supply-side shocks are driving commodity prices higher. With its natural hedge via food exports, New Zealand is in a better boat than many, and it's not obvious our currency should be punished more than others. We can't rule out that the NZD might jump with little warning onto the commodity (dairy) price horse, because as figure 4 below shows, a divergence like we're seeing at the moment is both unusual and not typically sustained.

Additionally, the RBNZ is generally ahead of most other central banks in its monetary policy tightening cycle so that puts upward pressure on the NZD.

For now, though, the NZD being weaker than otherwise is good news in terms of export returns, but bad news in terms of higher import costs, including fuel and fertiliser. And it's inflationary, which all else equal means interest rates will have to do more of the anti-inflation work.

Figure 4. NZD/USD vs GlobalDairyTrade average price



Source: Global Dairy Trade, RBNZ, Macrobond

All up, the NZD is receiving mixed messages and it is difficult to know exactly how it will react in the coming months. But for the record, our forecast is for the NZD to trend up from US0.68c currently to US0.72c by the end of the year.

Bringing it home

The Ukraine situation is a human tragedy that has the potential to get considerably worse yet. It's an immensely complex and uncertain situation in terms of geopolitical and economic ramifications.

Putting the narrow lens of the New Zealand agriculture sector's fortunes over the situation, it's a matter of counting our blessings. While higher energy and fertiliser prices will drive input costs up further, and global supply chains both in and out could become yet more tangled, as a nation we do have a natural hedge, insofar as we are a large net food producer.

However, while higher import and export prices might offset each other from a national net income point of view, it's a very inflationary mix, particularly when you take into account all the indirect impacts of higher energy prices on goods production. And the risk aversion that's putting downward pressure on the NZD just adds to imported inflation. All else equal, that means more work for the RBNZ to do to rein in roaring inflation – and the job was looking pretty daunting already.

All up, it means more pressure on everyone from lower-income households who face still-higher petrol and food prices, to those who have to service debt. And while New Zealand's commodity exports will benefit from higher prices, the conflict will spell tougher times for New Zealand's other exporters, if global growth takes a hit.

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