Quarterly Update

DairyNZ

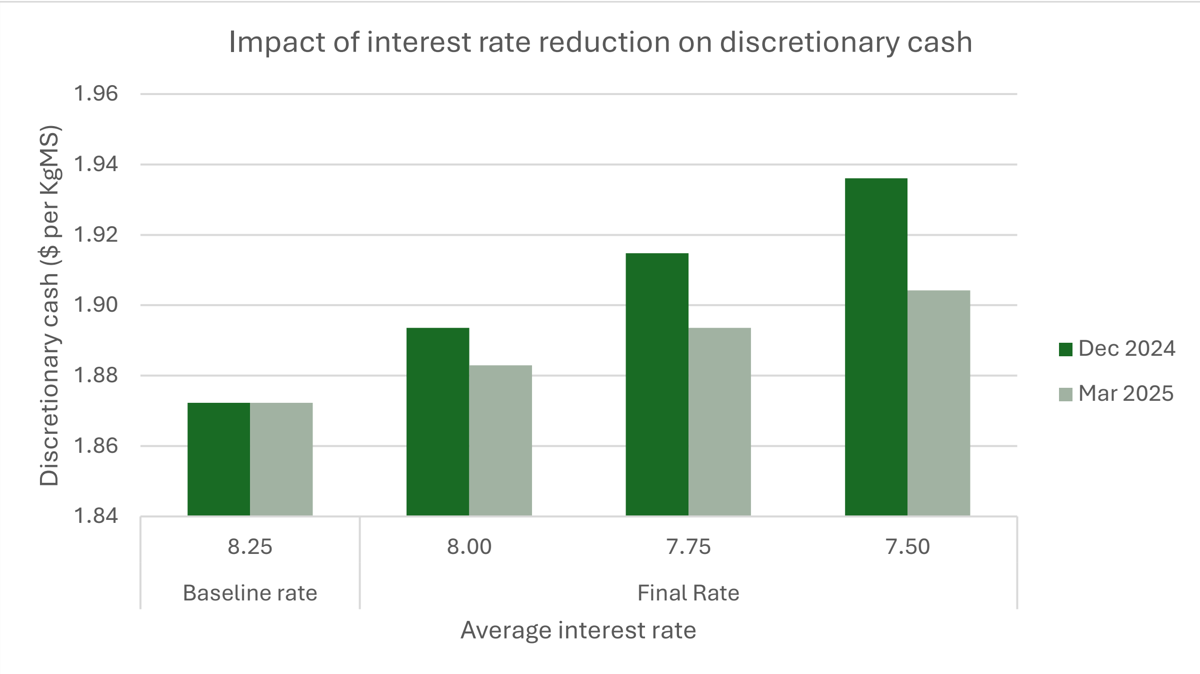
Interest on Interest Rates

16 September 2024

The earlier interest rates come down, the better for farmers - but what might potential further cuts mean for farmers financial position in the remainder of this 2024/25 season?

In our June 2024 update, we predicted a challenging season ahead for New Zealand dairy farmers due to high operating and non-operating expenses, particularly high interest payments amid elevated interest rates. However, recent declines in interest rates, coupled with improved farmgate milk prices, have shifted the outlook, offering a more favorable financial environment. In this article, we examine how the timing of possible further interest rate cuts could further impact the discretionary cash position of New Zealand dairy farmers this season.

Discretionary cash represents the funds available for capital purchases, debt repayments, personal drawings, and extraordinary expenses. It is calculated as the cash operating surplus minus rent, interest, and tax, plus net non-dairy and off-farm income.



The following analysis shows how the timing of interest rate reductions can influence the discretionary cash position of farmers. Earlier rate cuts as expected result in greater cost savings and a stronger cash position compared to reductions made later in the season. For example, If the interest rate drops from 8.25% to 7.50% by December 2024, discretionary cash is expected to rise from $1.87 per KgMS (at the baseline rate in September 2024) to $1.94 per KgMS. In contrast, if the same rate cut were to happen 3 months later in March 2025, discretionary cash would only increase to $1.90 per KgMS for the 2024-25 season. This equates to an improvement in the cash position of the average farmer of $5,675 for the current season, relative to the alternative (3 months later) scenario.

We also consider an optimistic scenario where interest rates are reduced to 7.25% by December 2024. If this were to happen farmers' discretionary cash positions would improve by $15,133 compared to the base scenario with interest rates at 8.25%. However, if a rate reduction at this level were to be delayed until March 2025, the improvement would be smaller, with a difference of only $7,567. This demonstrates that rate cuts later in the season have a limited impact on the current financial year, underscoring the importance of timely adjustments.

The following table highlights the improvements in discretionary cash position for an average owner-operated by interest rate reductions at different times in the season.

Improvement in discretionary cash position per farm by interest rate reductions

	Improvement in discretionary cash		
Timing of reduction	**8.25%**	**7.50%**	**7.25%**
Dec 2024	$ -	$ 11,350	$ 15,133
Mar 2025	$ 5,675	$ 5,675	$ 7,567

In summary, lower interest rates, combined with stronger farmgate milk prices, are likely to provide dairy farmers with greater financial flexibility than initially projected for the 2024-25 season. This improved liquidity can be used to address deferred expenses from the previous season, such as repair and maintenance costs, or to pay down short-term debts, ultimately contributing to a more stable and sustainable financial outlook.

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