

# TDB Digest, July 2015

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## Dairy matters

The downturn in global dairy prices has been dramatic and most analysts are now projecting a farm-gate milk price for 2015/16 well short of Fonterra's May 2015 forecast of \$5.25 per kg of milk solids. Forecasting commodity prices is inherently difficult, if not impossible. In our latest dairy research paper (<https://www.tdb.co.nz/wp-content/uploads/2022/02/TDB-Advisory-Farm-Gate-Milk-Price-Forecasting-2015.pdf>) we question whether Fonterra should even be publishing its forecasts. The risk is that, because of its status in the New Zealand market, Fonterra's forecast are given a degree of credibility that they may not deserve. The consequence may be that market swings are aggravated rather than dampened. If, for example, Fonterra's supplier-shareholders invest on the basis of over-optimistic forecasts the adjustments they must face and the disruptions to the local economy are likely to be even greater than they would otherwise be.

## Strategic reviews

With the proposed "super-city" for Wellington off the table, the question is where to now for Wellington governance. TDB's analysis (available here <https://www.tdb.co.nz/wp-content/uploads/2016/05/TDB-Advisory-Should-Wellington-Become-a-Super-City-2015.pdf>) suggests the key question is not whether Wellington's councils should be amalgamated but rather what functions of the councils should be amalgamated (and what functions should be kept local). Our research indicates there are economies scale in – and therefore a good economic case for amalgamating - the capital-intensive, network activities of the councils like fresh-water, storm-water and sewerage services and public transport and roading. With the "three waters" already jointly managed (by Wellington Water), the main outstanding candidate for integration is land transport. Indeed, the regional integration of the councils' land transport activities has been publicly supported, in principle, by almost all of the nine councils in the region. Now is the time to get on with it.

## Pricing in the wholesale electricity market

TDB has recently carried out investigations into the New Zealand electricity market's locational pricing system. In principle, having many pricing points (nodes) around the country improves the price signals electricity consumers and suppliers receive about where to locate their operations. On the other hand, the more pricing nodes there are, the greater the cost and complexity for industry participants. Complexity is not a major problem for large incumbents, but it may act as a barrier to entry for smaller participants. With 259 different pricing nodes, New Zealand currently has a relatively high number of nodes by international standards given the size of our electricity market. Our research indicates that, for many parts of the country, the degree of price variation between many nodes has in practice been immaterial, thus suggesting little if any price information may be lost if the number of nodes was reduced. Read the report here: <https://www.tdb.co.nz/wp-content/uploads/2016/05/TDB-Advisory-Nodal-Pricing-Report-2015.pdf>

## Curious correlations

Finally, given the focus in this edition of the TDB Digest, we thought the following graph might be of interest. It's not hard to find curious – and spurious – correlations when it comes to dairy, road transport and locational matters.

