



Fortnightly Agri Update

18 December 2013

2013: Yin and yang

Climbing temperatures, the smell of pine needles and busy beaches are all signs that we're nearing the end of 2013. And what a year it has been for those in the agriculture sector. For many 2013 has been marked by both the best of times and the worst of times.

Early in the year, paddocks around the country began to turn an ominous shade of brown as the rain stopped falling. What eventuated was the worst drought in decades which affected large swathes of the country. Dairy production fell sharply and lack of feed saw stock culled early.

But eventually the rains came and spring growing conditions were favourable in many regions. The second half of 2013 has been marked by an impressive turnaround in agricultural production – in particular in the dairy sector. Dairy production is up 6.3% for the season to October and we think could well finish the season up over 8%. Other sectors, however, will take longer to recover from the drought. Beef and lamb's latest update estimates this season will see the second smallest lamb crop in almost 60 years. 25.53 million lambs were tailed this spring, 4.7% lower than last season. This will flow through to lower export volumes. The impact of the drought on breeding stock is even more severe. Beef and Lamb NZ expects mutton slaughter to fall 20% on the drought driven high of last season. Good pasture condition should support improved slaughter weights in the near term, but we don't expect to see a more substantial improvement in the sector until next year.

One of the biggest surprises of 2013 has been the strength in farm gate prices. A year ago we were expecting export commodity prices to improve, as the effects of a drought in the US lingered and global growth picked up. However prices have risen much more than we were anticipating a year ago. In aggregate, prices for New Zealand's key commodity exports are up 20% since the start of the year in both NZD and world price terms (that's about twice the 10% lift in world prices we had been expecting). Dairy has been the standout performer, but log prices are also near all time highs and there have been sizable improvements in wool and meat prices.

The NZ dollar has also been stronger than expected over 2013 – in part because of strength in export commodity prices. In addition, despite growing speculation that the US Federal Reserve will soon gradually start to reduce the level of stimulus it is providing to the US economy (by "tapering" its asset purchases) this is yet to happen. In contrast, with the New Zealand economy clearly gathering momentum, the Reserve Bank of New Zealand is getting close to pulling the trigger on interest rate hikes.

Looking ahead to 2014 we expect the New Zealand dollar to remain elevated. Although commodity prices are expected to soften under the weight of increasing global supply, fundamentals of the NZ economy are much stronger than those in the US and we expect New Zealand interest rates to rise. Our forecasts have the NZD/USD rising to 85c in the March quarter and averaging above the 80c throughout 2014.

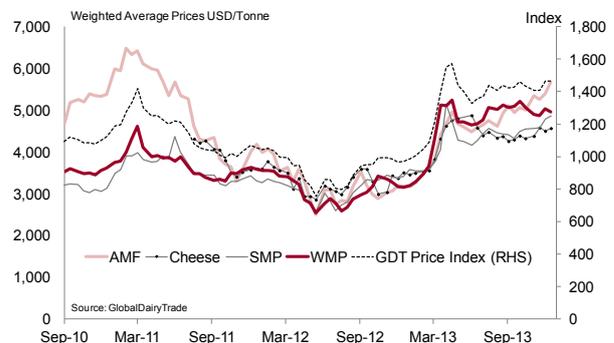
GlobalDairyTrade Auction Results, 18 December 2013

	Change since last auction	Price USD/Tonne
Anhydrous Milk Fat (AMF)	4.4%	\$5,668
Butter Milk Power (BMP)	2.2%	\$5,070
Butter	7.9%	\$4,051
Skim Milk Powder (SMP)	1.7%	\$4,868
Whole Milk Powder (WMP)	-1.5%	\$4,958
GDT Price Index	0.2%	

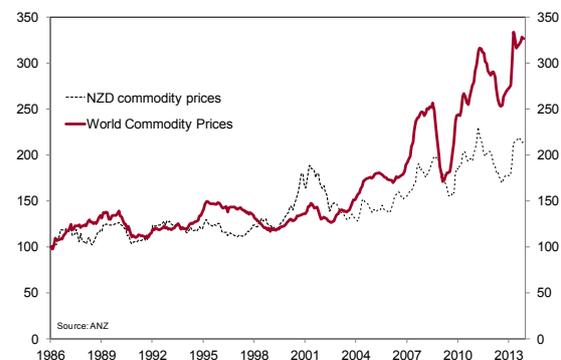
Payout Forecast Table

	2013/14		2014/15
	Fonterra	Westpac	Westpac
Milk Price	\$8.30	\$8.40	\$6.70

GDT auction prices



NZ commodity prices



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See overleaf for sector outlooks.

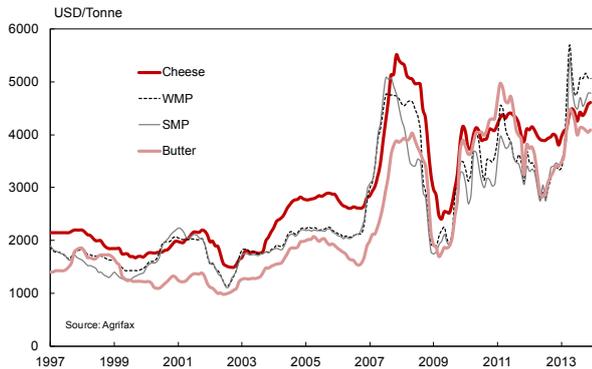
Beyond the farm gate



Dairy

Current price level compared to 10 year average		Next 6 months
Trend	Average	↘

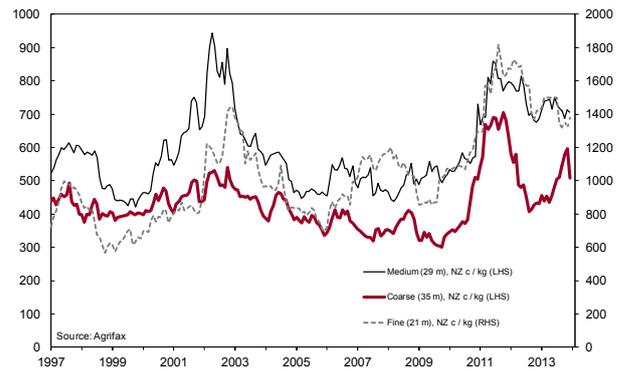
The final GlobalDairyTrade auction of 2013 saw dairy prices remain well supported at very high levels. The headline index edged 0.2% higher, with mixed outturns across the commodities on offer. WMP prices dipped 1.5% while prices for all other products on offer rose. Last week Fonterra reiterated its milk payout forecast of \$8.30 (against growing expectations of an upward revision) but it slashed its dividend payment forecast to 10c a share (previously 32c). Fonterra noted that while the current level of prices for powdered products would support a \$9 milk price, current processing capacity limits their ability to achieve this. While global milk supply is growing, for now, the strength of demand is keeping prices high.



Wool

Current price level compared to 10 year average		Next 6 months
Trend	Above Average	→

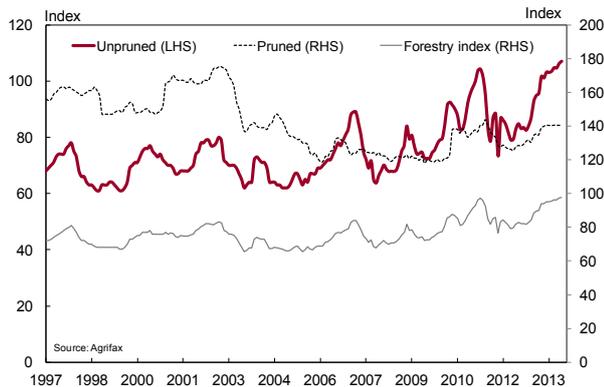
Strong wool prices have moved sharply lower over the past month from relatively high levels. Over the last year, coarse wool prices had risen strongly on the back of tight supplies. However, sentiment appears to have changed in the last month. Agrifax reports that the strength in prices has reduced buying interest at auctions. There have been less dramatic changes in medium and fine wool prices which hadn't experienced the same uplift. With European growth prospects still poor, consumer demand for high end wool products is likely to remain under pressure.



Forestry

Current price level compared to 10 year average		Next 6 months
Trend	High	↘

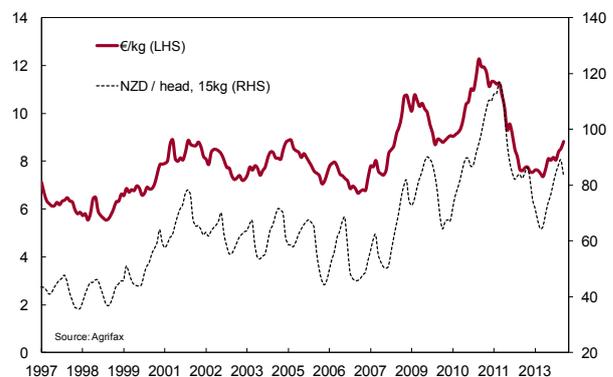
Unpruned log prices edged higher in December – once again setting a new high on the Agrifax measure we follow. This has also pushed the aggregate index to a new record high. Chinese demand continues to drive the market for logs. With seasonal factors set to limit export volumes to China over the next few months, prices are likely to remain well supported in the short term. However, over a longer horizon we remain sceptical that prices can be sustained at such high levels.



Lamb

Current price level compared to 10 year average		Next 6 months
Trend	Average	↑

International lamb prices continue to edge higher. With product for Christmas now shipped, we expect relatively tight supply conditions both here and in Australia to continue to underpin prices in the lead up to the next key source of Northern Hemisphere demand – Easter. Improved prices should provide something of a buffer for farmers' incomes against an anticipated drop in production. In its latest outlook, Beef and Lamb NZ expects NZ's 2013-14 lamb crop to be down 4.7% on last season, which flows through to an expected 6.8% fall in lamb export slaughter numbers on their estimates.



Happy holidays!

This is the last Fortnightly Agri Update for 2013. We will resume on 22 January 2014.

NB: Trend arrows indicate direction of change in world prices.

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