

Fortnightly Agri Update

20 November 2013

A watching brief

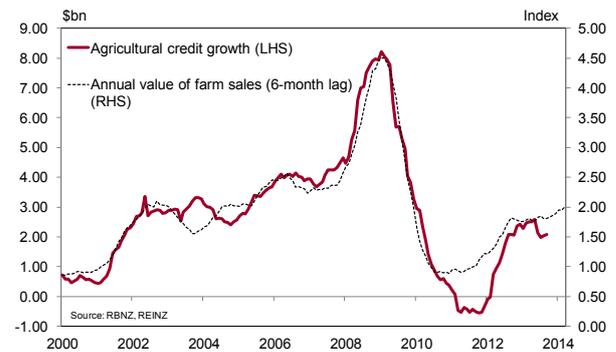
In last week's twice-yearly Financial Stability Report the Reserve Bank once again sent a shot across the bows of the agricultural sector. They warned that the rural sector, and dairy farmers in particular, should be careful to avoid a massive hangover if the current party fuelled by high commodity prices comes to a screaming halt. In this week's Agri Update, we take a look at why the Bank is keeping such a close eye on bank lending to the rural sector and just what has been happening in rural property markets of late.

Given its mandate to ensure a sound and efficient financial system the Reserve Bank has been wary of high debt levels in the agricultural sector for a number of years. Over the last decade, growth in agricultural debt outpaced growth in agricultural incomes, driven by a tidal wave of dairy conversions and strong increases in land prices. The RBNZ's concern is that such high levels of debt create a risk for the wider financial system (not just for the individuals or banks who have taken on the debt). The RBNZ is warning that farmers (and banks) shouldn't count on exceptionally high dairy prices to last forever. And while it might not be the RBNZ's most pressing concern, (the Bank has residential mortgage holders set firmly in its crosshairs) niggling unease about debt in the sector, and the possibility that higher incomes might be capitalised into land values, remain firmly in place.

Activity in the rural property market does look to have firmed lately. True, interpreting rural property market data is fraught with difficulty. Statistics can be thrown around by seasonality and making quality adjustments to farm price data is much more difficult than say for houses – the number of paddocks is not quite comparable with the number of bedrooms! But the REINZ farm price index does attempt to adjust for compositional changes in farm sales. On this measure, farm prices were 7.4% higher in the 3 months to October than a year earlier. Combined with increased turnover (the number of farm sales was over 1600 in the year to October for the first time since April 2009), the value of turnover in rural property markets has been steadily trending higher this year. There have also been reports of heightened interest in conversions to dairying – particularly in Southland.

Despite all this, while the pace of lending to the agriculture sector has certainly picked up over the last couple of years, it's hardly excessive. At a little over 4% on an annual basis, it remains well below the 15% plus growth rates we saw during the mid-2000s. For the time being it looks as if farmers are continuing to take a cautious approach. Anecdotally, many are prioritising debt reduction after the drought and borrowers remain wary of ongoing volatility in commodity prices. That seems sensible given our own forecasts of softer commodity prices and higher interest rates next year. So as long as credit growth remains modest, the RBNZ is likely to be happy keeping a watching brief. But should it ramp up significantly, the Bank may feel compelled to enter the fray.

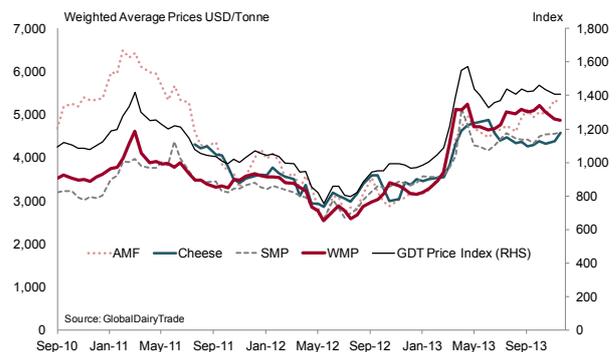
Value of Farm Sales and Credit Growth



GlobalDairyTrade Auction Results, 20 November 2013

	Change since last auction	Price USD/Tonne
Anhydrous Milk Fat (AMF)	-1.6%	\$5,255
Butter Milk Power (BMP)	-0.1%	\$4,753
Butter	1.7%	\$3,583
Skim Milk Powder (SMP)	0.7%	\$4,583
Whole Milk Powder (WMP)	0.0%	\$4,870
GDT Price Index	0.1%	

GDT auction prices



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See overleaf for sector outlooks.

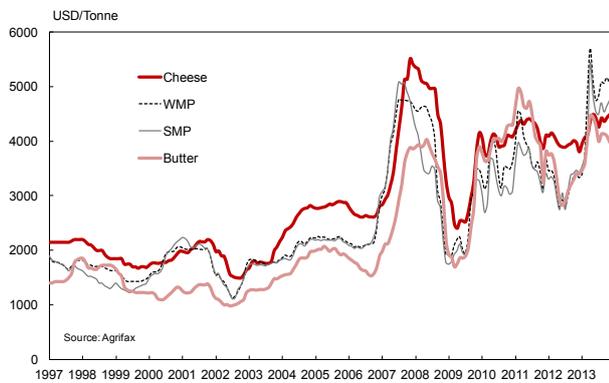
Beyond the farm gate



Dairy

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

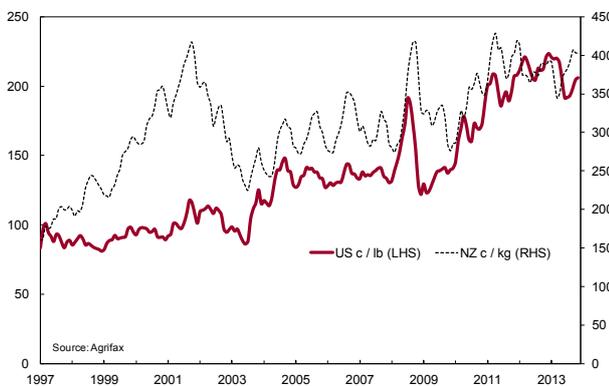
Dairy prices stabilised in last night's GlobalDairyTrade auction (the headline trade weighted index nudged 0.1% higher) following declines in the previous couple of auctions. There were mixed outcomes for individual commodities on offer. WMP prices were flat, while SMP prices continued to trek higher. This was a solid result given the continuation of strong domestic production growth. With over a third of this season's production now in the bag, output continues to run well ahead of last year (in the 4 months to September nationwide production was up an impressive 7.2%). It looks like this season's production may well be up 8.5% up on last year's (we'd previously pencilled in 5% growth). With price action continuing to evolve broadly in line with expectations, we remain comfortable with our \$8.30 forecast for the 2013/14 season. We continue to forecast lower dairy prices in 2014 under the weight of increased global production.



Beef

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

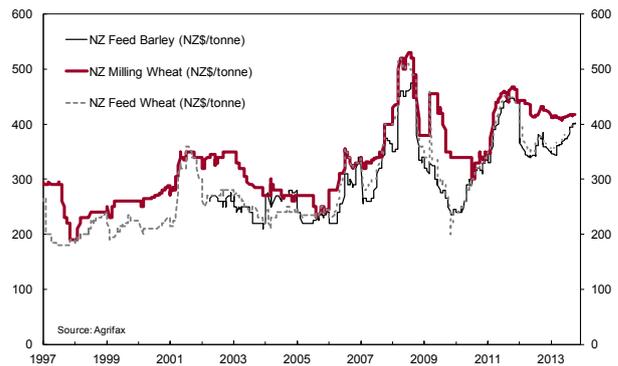
Domestic beef prices remain firm. Tight US beef supplies continue to support prices. US beef production is running well below average levels as producers take the opportunity to rebuild herds after severe culling during recent droughts. This herd rebuilding will take time, and beef prices should continue to be well supported heading into 2014.



Grains

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

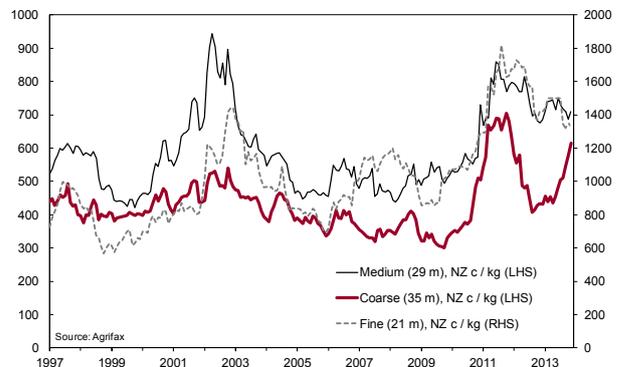
Domestic prices for milling wheat have trended lower. In contrast prices for feedwheat and barley are on the rise in response to demand from dairy farmers wanting to make the most of high milk prices. At the same time domestic supplies remain tight – production growth in Canterbury (a key production region) has been limited as crop farms are converted to dairy or land owners put more effort into lambs. There is also competition from relatively cheap imports. International grains prices remain under pressure thanks to expectations of a record US harvest and solid production prospects in other parts of the world such as South America.



Wool

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

Wool prices remain high with demand for coarse wool particularly strong on the back of tight supplies. Agrifax reports that supply is down 19% on the same point in the 2011/12 season. In contrast consumer demand for fine wool products in key European markets is likely to remain muted as growth prospects in the region show few signs of substantial improvement.



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

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