

GlobalDairyTrade Auction Results

Overall, world dairy prices are back where they started following the Fonterra whey contamination issue. In Tuesday night's GlobalDairyTrade auction prices rose 2.3%, effectively wiping out the 2.4% fall in the previous auction.

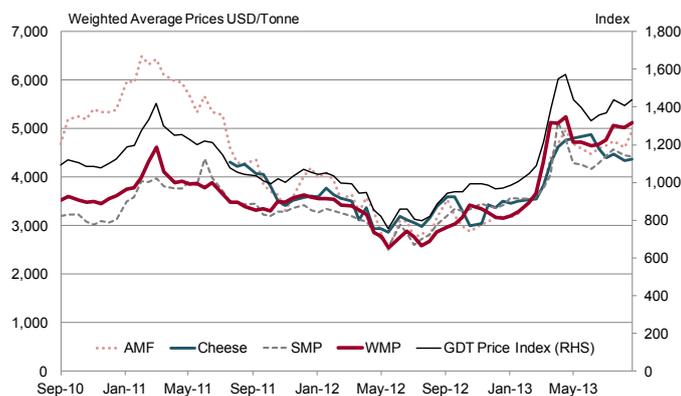
The world continues to pay high prices for NZ dairy products. Prices are the fourth highest on record and are over 62% higher than a year ago.

Importantly, prices for Fonterra's flagship product, WMP, more than reversed their falls from the last auction. Prices rose 2.7% after the 1.6% fall in the previous auction. Also, WMP prices for all contracts are now above \$5,000/MT, indicating that confidence has returned to the market. Prices rose for all contracts with the largest price increase (4.4%) recorded for product for delivery in October.

Fonterra SMP prices did continue to fall relative to its competitors. All of Fonterra's SMP contracts fell relative to the last auction. On the other hand, Dairy America and Amul's prices rose. In the one directly comparable product, Fonterra's premium over Dairy America narrowed further from 14% to 6%.

However, we don't put this all down to the whey contamination issue. Fonterra SMP volumes were up 8% compared to the previous auction; and while we don't have their competitors' volumes, with the northern season winding down, we suspect they may have been lower than at the previous auction. Also, the overall movements in Fonterra and Dairy America butter prices favoured Fonterra.

GDT Dairy Auction Prices



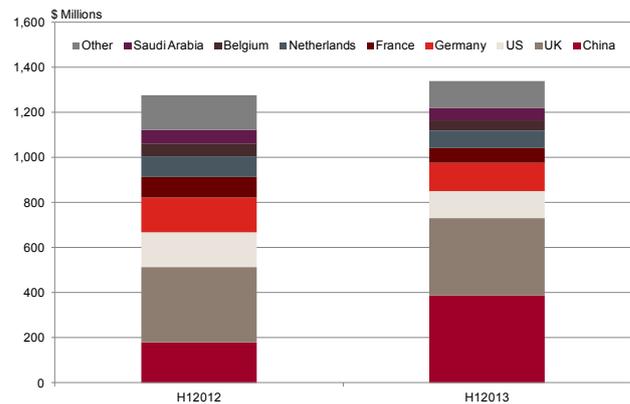
The Chinese lamb market at a glance

The importance of the Chinese market for dairy products is well-known, but the emergence of the Chinese market for the sheep sector is less-publicised. In this *Fortnightly Agri Update*, we take a glance at its importance and growth outlook in terms of export volumes and prices.

By value, China is New Zealand's largest market for lamb. In the June year, New Zealand shipped \$389m or 24% of lamb exports to China. The UK, in second place, accounted for \$335m or 21% of exports.

The emergence of the Chinese market has been particularly sudden. Chinese exports have more than doubled from the June 2012 year. The catalyst for the surge in exports has been this summer's drought and the associated increase in slaughtering. In particular, China has hoovered up the much of the increase in ewe slaughter. In the first half of 2013,

Lamb exports by value

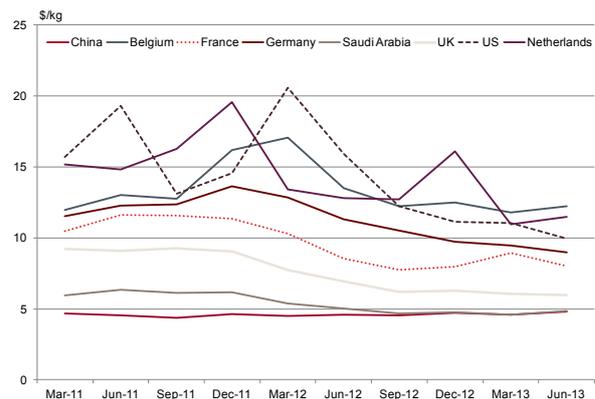


China took 71% of frozen sheepmeat (excl. lamb) exports. This has jumped from 30% in the first half of 2012 and from 13% in 2011.

While the increase in volumes is massive, prices are quietly increasing, in contrast to other markets. In the first half of 2013, frozen lamb prices in the Chinese market increased by 4%. In the other top 7 markets, prices fell by between 10% and 46%. The combined increase in prices and volumes indicates to us that the Chinese market is developing a preference for lamb.

However, prices are still low compared to most of our other main markets. Again in the frozen lamb market, prices attract a premium in all markets compared to China except Saudi Arabia. The premium ranges from a dollar in the UK to up to \$7 in Belgium. Overall, this indicates that traditional markets will retain importance.

Frozen lamb export prices



We expect the importance of the Chinese market to continue to grow. However, its impact on lamb prices will be more subtle. Firstly, the Chinese market will provide a floor to overall prices. In future drought years, slaughtered ewes will attract a higher price than they have historically. More generally, as the Chinese market continues to develop a preference for lamb prices will track gradually higher. In this sense, the Chinese market will be a slow burn for lamb prices compared to the instant heat it provides to dairy prices.

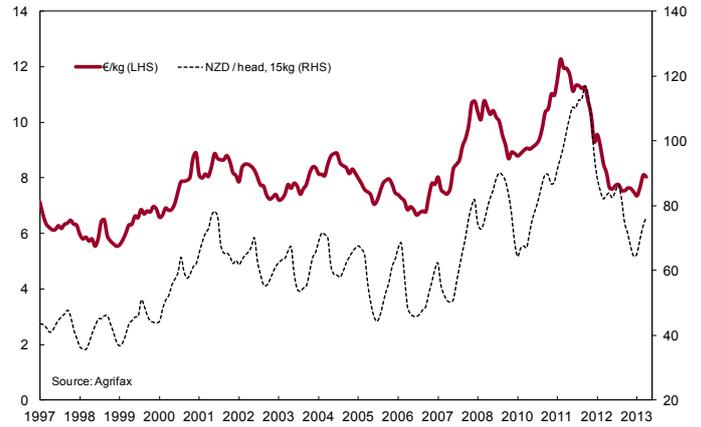
Nathan Penny, Economist

Beyond the farm gate

Lamb

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

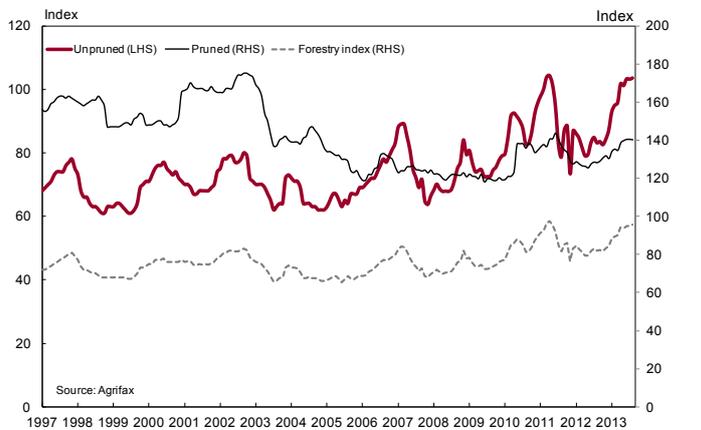
It appears that Chinese demand continues to pick up the slack in world lamb markets. Prices in NZD terms rose 1.5% in July, despite marginally weaker prices in Europe and a higher NZ dollar against the euro and pound. Over the June quarter, the Chinese market accounted for 25% of lamb exports by value – up over one percent from the March quarter. What’s more, we expect constrained export volumes from both New Zealand and Australia in the season ahead to push prices up further.



Forestry

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

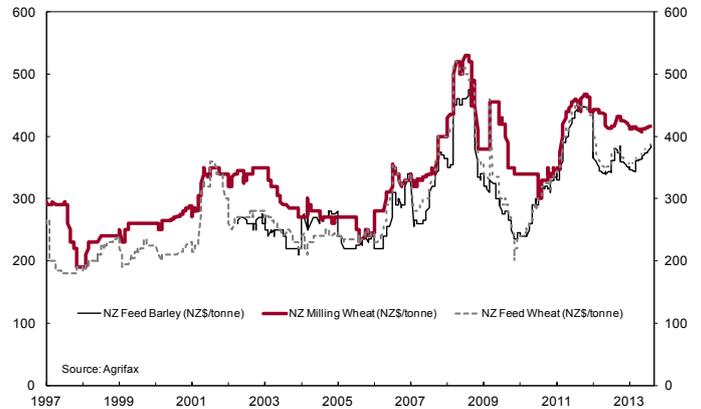
To date the so-called ‘wall of wood’ appears to be finding a Chinese home. The forestry price index rose a touch in August. Unpruned log prices are the third highest on record, while pruned log prices remain well above their ten-year average. This is particularly impressive given that export volumes in the first half of 2013 were 14% higher compared to the same period a year ago. With the Chinese economy entering a soft patch we expect forestry prices to come off the boil, but to remain high by historical standards. Forestry prices will be supported by the recovery in the US housing market.



Grains

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

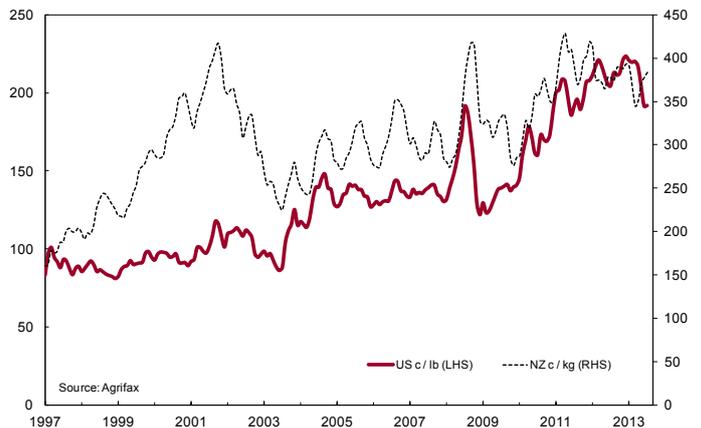
Grains prices, particularly for feed, have steadily moved higher over recent months. Feed barley has led the way, with average prices over the last four weeks nearly 2% higher than the four weeks prior. The impetus has come from the dairy sector as the forecast milk price has moved higher; our latest forecast stands at \$7.40/kg, which would be the third highest on record. As the dust from the whey contamination scare settles further, we expect interest in feed grain to increase and for grain prices to track higher.



Beef

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

World beef prices held up well at a high level in July despite an influx of Australian beef into the key US market. Also, if anything August prices appear headed a touch higher. While Australian exports are at record levels, US beef supply remains under pressure. A top US meat packer (that slaughters around 25% of US cattle) has announced that it will no longer buy cattle fed with Zilmax, a drug that can add 30 pounds to the average steer. Further out, we are sticking with our forecast for world beef prices to fall over the next six months. However, world prices are likely to remain high by historical standards.



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

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