

**NZ dollar weaker, but for how long?**

In recent years, a falling NZ dollar has usually been associated with heightened fears about the global economy, leading investors to rush back to the perceived safety of the US dollar; as a result, a lower NZ dollar has tended to go hand in hand with lower commodity prices (which are also priced in US dollars).

But this time, it's been a good news story - the US Federal Reserve has signalled that it believes the US recovery is strong enough to start easing back on quantitative easing, or "money printing". Financial markets have moved to price in the prospect of US monetary policy settings switching from very loose to merely loose over the next year, boosting the US dollar.

The currencies that have fallen the most against the US dollar are, notably, the ones that gained the most in the first place during the height of quantitative easing. Investors were attracted by the relatively high interest rates in New Zealand (and even more so in Australia) compared to the US, Europe and Japan where central bank interest rates have been zero or close to it.

The perception now is that it's time to bring those trades to a close; as a result the NZ dollar has fallen about 6% from its peak on a TWI basis, falling against every currency except the Australian dollar.

For this combination of high commodity prices and a lower NZD to last, the US economy needs to kick on further from here. On that matter our view is that while the US economy is improving it will deliver less growth than both the Federal Reserve and markets anticipate at this stage.

Nevertheless, now that the Fed has opened the door to a reversal in US monetary policy, the issue is not going to go away. So while we expect the NZ dollar to claw back some of its recent losses, it's unlikely to return all the way to the levels that we previously forecast.

We expect the NZD to climb back to 83 cents against the USD by year-end, from 78 cents currently, but then edging down again to average 81c over 2014 (previously 83c).

**GlobalDairyTrade Auction Results**

World dairy prices posted a small rise in Tuesday night's GlobalDairyTrade consolidating the 1.1% rise in the previous auction.

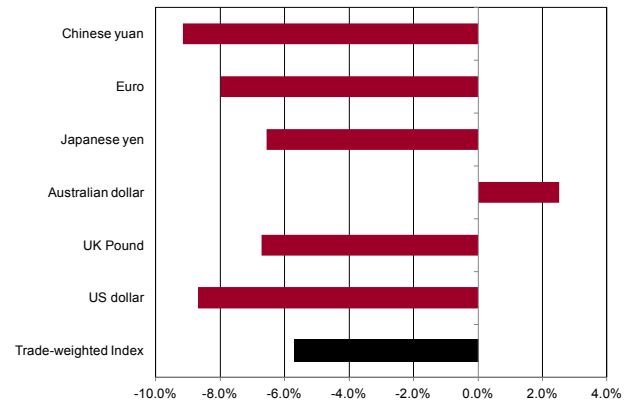
On a trade-weighted basis, dairy prices rose 0.7%. Prices rose in five out of seven of the main products, although the benchmark WMP series was effectively flat (up 0.1%). Prices are now 13% below the record level reached in April. Overall, prices 69% are higher than the same time last year.

Over 2013, as New Zealand production recovers from drought we expect world dairy prices to descend further from their April record peak, but to remain at elevated levels by historical standards. Overall world dairy supply remains relatively tight. Coupled with strong Asian demand, particularly from China, these factors should see dairy prices higher on average over 2013 compared to 2012.

World prices aside, the downward revision to our USD exchange rate forecasts (discussed above) implies upside risk to our milk price forecast of \$6.50 per kg of milk solids. Our forecast is under review as we digest the exchange rate movements, their implications for world dairy prices, and wider dairy market trends.

**Nathan Penny**  
Economist

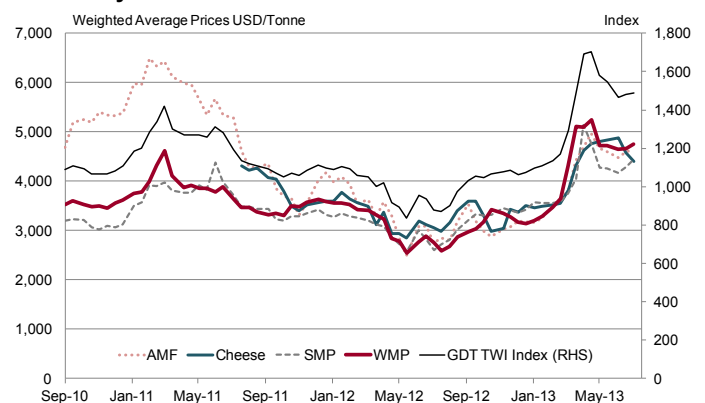
**NZ dollar movements against major currencies from 1 May to 2 July**



**Auction Results**

	Change since last auction	Price USD/Tonne
<b>Anhydrous Milk Fat (AMF)</b>	1.2%	\$4,645
<b>Butter Milk Power (BMP)</b>	6.0%	\$4,610
<b>Butter</b>	-5.7%	\$3,707
<b>Skim Milk Powder (SMP)</b>	3.1%	\$4,441
<b>Whole Milk Powder (WMP)</b>	0.1%	\$4,757
<b>TWI (All Products)</b>	0.7%	

**GDT Dairy Auction Prices**



**Westpac forecasts of Fonterra milk price**

	2012/13	2013/14	2014/15
<b>Milk Price</b>	\$5.90	\$6.50	\$6.20
<b>plus</b>			
<b>Dividends</b>	\$0.32	N/A	N/A

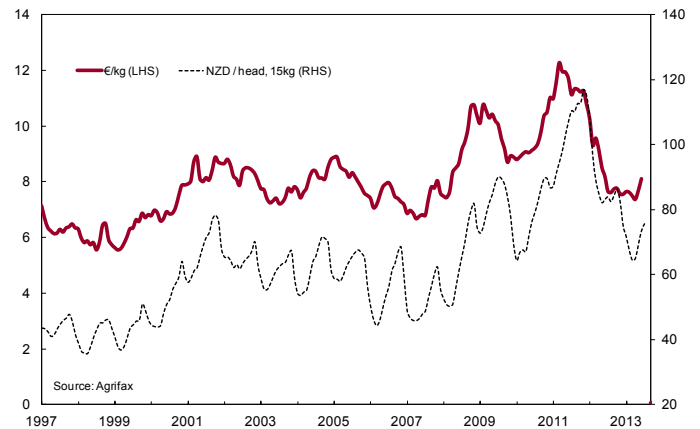
See overleaf for sector outlooks.

# Beyond the farm gate

## Lamb

	Last 6 months	Next 6 months
Trend	↑	↑

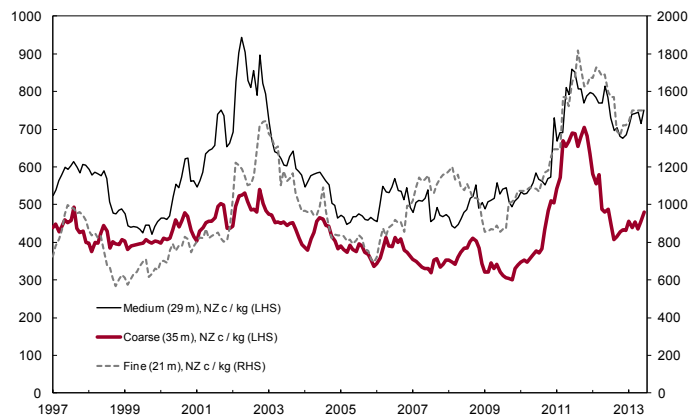
World lamb prices built on May's rise, kicking on a further 5% in June. While European and UK demand remains soft, it's now apparent to markets that the supply of New Zealand lamb will be severely constrained for the remainder of the year. A similar dynamic is playing out across the Tasman, with lamb export volumes expected to be down around 8% in the coming season. At the same time, Chinese demand remains robust. We expect these factors to combine and underpin further improvements in world lamb prices over the next six months.



## Wool

	Last 6 months	Next 6 months
Trend	↑	→

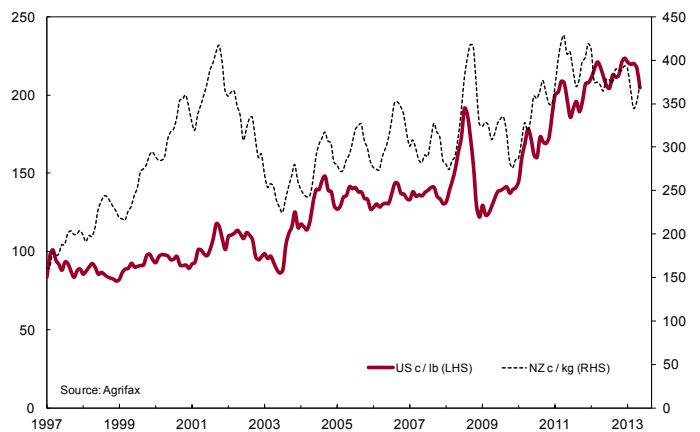
Wool prices have consolidated their 2013 gains, trading largely sideways over the last few months. In June, fine wool prices trod water while medium prices bounced back 5% from their 4% fall in May. Coarse wool is showing the most promise, perhaps off an improving housing market in the US, rising 6% in June to be up 11% in 2013. As the US housing market recovers further, the rise in coarse wool prices may continue. The outlook for fine and medium wool prices is more modest. Scope for further growth in demand for end products, particularly in Europe, appears limited. As a result, we expect world wool prices to generally tread water at their current levels over the next six months.



## Beef

	Last 6 months	Next 6 months
Trend	↓	↓

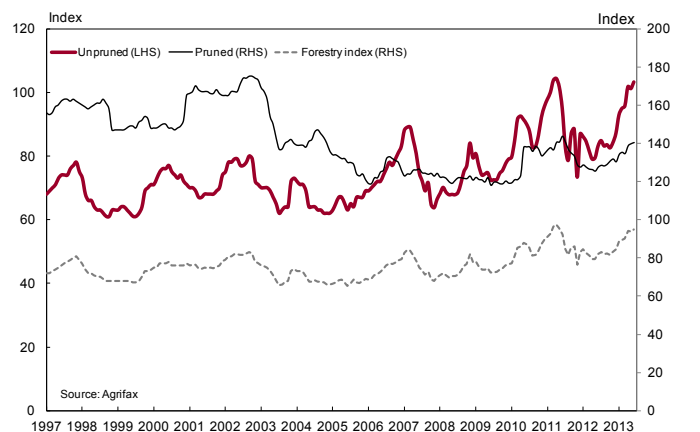
World beef prices are under pressure. Fortuitously however, lower world prices have coincided with a strengthening US dollar, thus pushing up prices in NZD terms. Until very recently, world prices had held up well, even as the local drought led to the largest slaughter and export of New Zealand beef on record. More recently though, an influx of Australian beef following dry weather there has combined with sluggish US demand to force US prices down by 6% in each of May and June. Overall, we expect these factors to push world beef prices down further over the next six months. However, world prices are likely to remain high by historical standards.



## Forestry

	Last 6 months	Next 6 months
Trend	↑	↓

The forestry price index more than reversed its May decline, rising over 1% in June. Unpruned log prices are the third highest on record, while pruned prices are well above their ten-year average. This is all the more impressive given that export volumes in the first five months of 2013 were 20% higher compared to the same period a year ago. At this stage, Chinese demand is holding up well at a very high level. Other markets are mixed. The Korean market is sluggish while the Indian market has posted solid gains. At the same time Russian log exports are weak, while North American exports are tracking sideways. Over the next six months, we expect forestry prices to come off the boil, but to remain comfortably above their ten-year averages.



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

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