



Fortnightly Agri Update

4 December 2013

An incoming tide

International dairy prices remain very high. After trending lower over the previous few GlobalDairyTrade auctions, the headline trade weighted index bounced 3.9% overnight. Prices were higher across almost all products on offer. WMP prices were up 3.4% leaving them just 4% below their peak, with prices on a TWI basis 7% below recent highs. The apparent strength in demand given such high prices and strong production growth in NZ has been impressive. Recent outturns have caused us to nudge up our forecast of 2013/14 milk price to \$8.40 KgMs (previously \$8.30). We anticipate getting an update on Fonterra's own milk price forecast (which currently stands at \$8.30) next week.

But, as the saying goes, what goes up must come down – well eventually at least. Our forecasts for 2013/14 season and beyond rely on dairy prices falling in 2014. Not because we expect demand to evaporate (we anticipate global growth will meander along at about the same pace as this year) but because we expect global supply to increase in response to the exceptionally high prices on offer. In this week's Fortnightly Agri Update we take a look at how supply is shaping up for the world's key dairy exporters.

We've seen a very strong start to the NZ dairy season. Nationwide production was up 7.2% in the 4 months to September. So far, growth has been led by increased production in the South Island. However, over the back end of the season, we would expect to see this switch as the North Island areas hit particularly hard by last summer's drought outperform relative to last year. Even if production drops back to 2012 levels over the second half of the season, we'll be on course for production to be up over 8%.

Australian dairy production contracted by almost 3% in the 2012/13 season. Forecasters had expected a rebound in the order of 1-3% on last year thanks to better growing conditions, lower grain prices and ongoing access to irrigation. But unlike in New Zealand, Australian farmers haven't had a strong start to the season and such predictions are now looking a bit shaky. Production is down 4% over the 4 months to October.

European dairy production has risen sharply over the last few months although volumes at this time of the year are near seasonal lows. Dairy production in Australia and New Zealand peaks in October, while production in northern hemisphere giants EU and the US peak in around May (though with less seasonal variation in milk flows). In September production was up 4% on the same month last year. With domestic demand likely to stagnate in the EU (we're forecasting a 0.1% fall in GDP growth in the Eurozone next year) and production expected to grow further, the bulk of increased production is likely to find its way onto world markets.

US production has been consistently running ahead of last year's levels in recent months. Milk production in the top 23 States was up 1.2% in October on the same month last year. What's more, the number of dairy cattle is well up on last year. Combined with a lift in milk production per cow, and improved margins thanks to lower feed costs, this should see the lift in milk production extend in 2014.

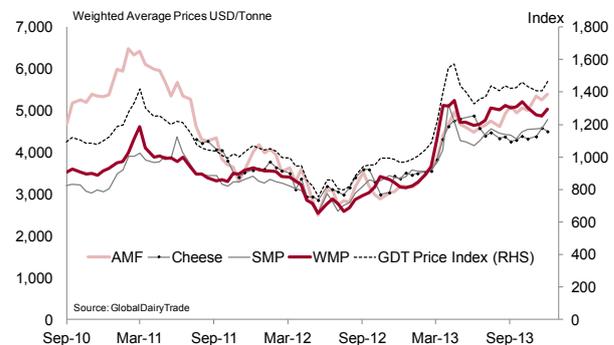
GlobalDairyTrade Auction Results, 4 December 2013

	Change since last auction	Price USD/Tonne
Anhydrous Milk Fat (AMF)	2.7%	\$5,395
Butter Milk Power (BMP)	4.6%	\$4,630
Butter	4.5%	\$3,750
Skim Milk Powder (SMP)	5.6%	\$4,791
Whole Milk Powder (WMP)	3.4%	\$5,035
GDT Price Index	3.9%	

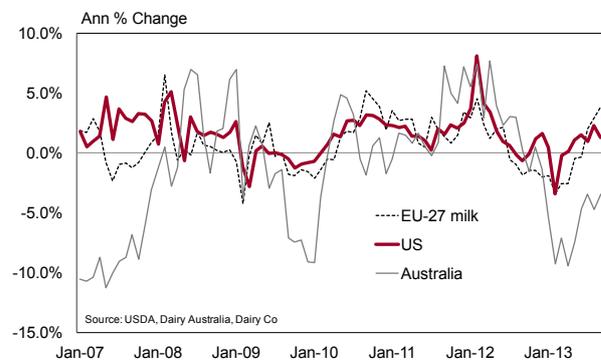
Payout Forecast Table

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

GDT auction prices



Milk production



Anne Boniface
Senior Economist

See overleaf for sector outlooks.

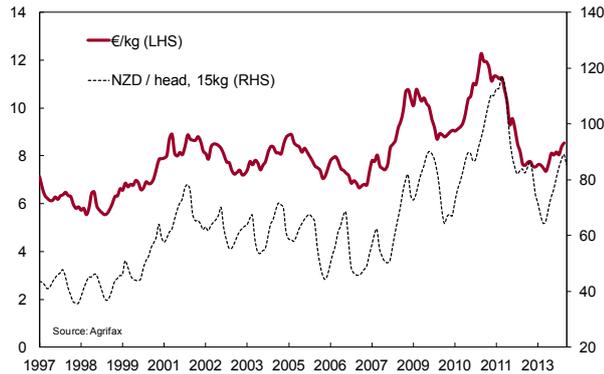
Beyond the farm gate



Lamb

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

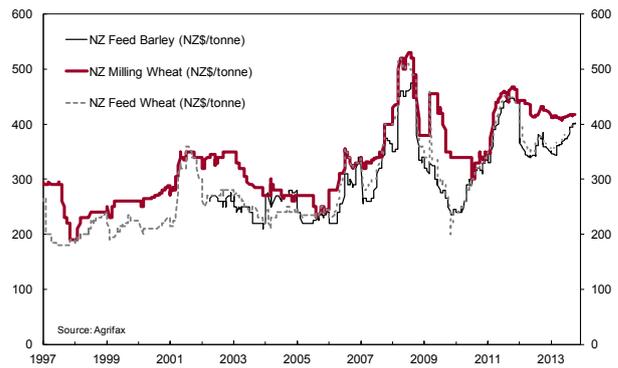
International lamb prices continue to edge higher. With product for Christmas now shipped, we expect relatively tight supply conditions both here and in Australia to continue to underpin prices in the lead up to Easter, the next key source of Northern Hemisphere demand. Improved prices should provide something of a buffer for farmers' incomes against an anticipated drop in production. In their latest outlook, Beef and Lamb NZ expect NZ's 2013-14 export lamb kill to be the lowest in 50 years as the effects of last summer's drought linger.



Grains

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

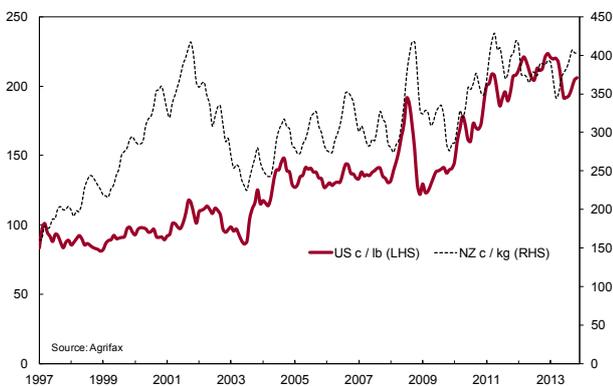
Domestic prices for milling wheat have trended lower. In contrast prices for feedwheat and barley are on the rise in response to demand from dairy farmers wanting to make the most of high milk prices. At the same time domestic supplies remain tight – production growth in Canterbury (a key production 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.



Beef

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

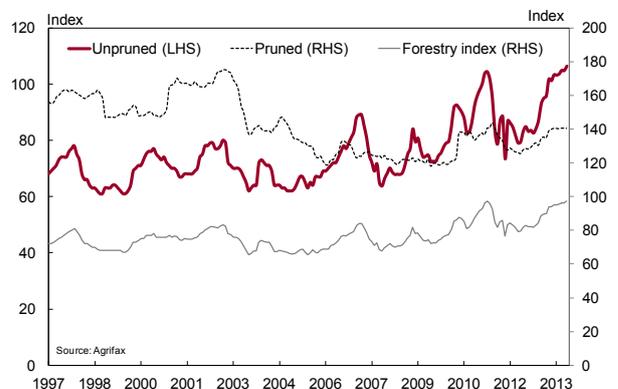
Domestic beef prices remain firm. Tight US beef supplies continue to support prices. US beef production is running well below average levels as producers take the opportunity to rebuild herds after severe culling during recent droughts. This herd rebuilding will take time, and beef prices should continue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



Forestry

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

Forestry prices remained high in November. Unpruned log prices set a new all time high on the Agrifax measure while the aggregate index is within a whisker of new highs. Demand for unpruned NZ logs in China in particular remains strong and there are few signs of it abating in the near term. Domestically, construction activity continues to accelerate as the pace of the Canterbury rebuild picks up. This should provide an additional source of demand. For now we are maintaining our view that prices will moderate from current levels, but are conscious that prices have been coming in above our expectation in recent months.



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

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