

## Westpac's milk price forecast revised up to \$8.30/kg

	2012/13		2013/14		2014/15
	Fonterra	Westpac	Fonterra	Westpac	Westpac
<b>Milk Price</b>	\$5.80	\$5.90	\$7.80	\$8.30	\$6.70

World milk prices continue to defy gravity. This comes as a genuine surprise and has forced us to upgrade our forecast of the 2013/14 milk price.

So far this season, Fonterra has been paid on average over \$9 per kg for milk. With the largest auctions of the season having past in August a lot of this season's milk price is already in the bank. So our current forecast of \$7.40 per kg is looking decidedly skinny.

We had thought the NZ supply rebound and China slowdown would bring prices down. And despite global supply remaining tight in the US and Europe for example, we expected prices to fall over 2013. However, it is now apparent that another major factor is in play.

The reduction in auction volumes offered by Fonterra has had a major impact. The chart shows that Fonterra expects that the volume of WMP offered in the GDT auctions this season compared to last will fall by 20%.

Fonterra has stated that their motivation for reducing the volume "reflects Fonterra's strategy of moving from being commodities-driven to a more value-added, higher-margin products business". While Fonterra may also be dealing direct with some buyers and thus outside of the GDT auctions, this move represents a major shift in the market.

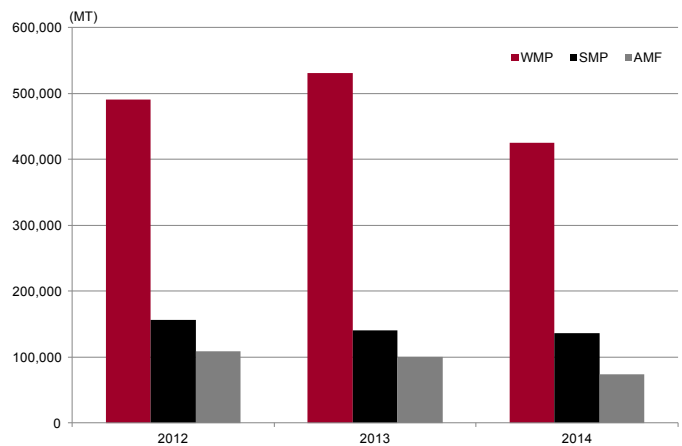
The first round impact of reduced auction volumes has been apparent with buyers supporting prices at what are very high levels. After falling to around \$4,600 per MT in June, weighted average WMP prices have held above \$5,000 per MT over the last four auctions.

The second round impact is what we find really interesting. As Fonterra moves into retail markets such as the market for Chinese infant formula, increasing competition, retail prices should fall. Note that the recent Chinese pricing inquiry has already forced some reduction in retail prices. Lower retail prices will increase the quantity of milk consumers demand. In turn, these higher quantities will put upward pressure on wholesale prices i.e. GDT auction prices. Breaking down retailers' pricing power benefits both consumers and wholesalers.

Of course the other factors remain in play. But we now see world prices holding at very high levels for another couple of months before the rebound in New Zealand milk supply kicks in. Back in July we had anticipated a 20% fall in WMP prices by the end of the year. Now we expect a fall closer to 10%.

With the above in mind, we have revised our forecast of the Fonterra milk price for the 2013/14 season up by 90 cents to \$8.30 per kg of milk solids. We have also revised our forecast for the 2014/15 season up by 20 cents to \$6.70 per kg on the back of a weaker currency forecast.

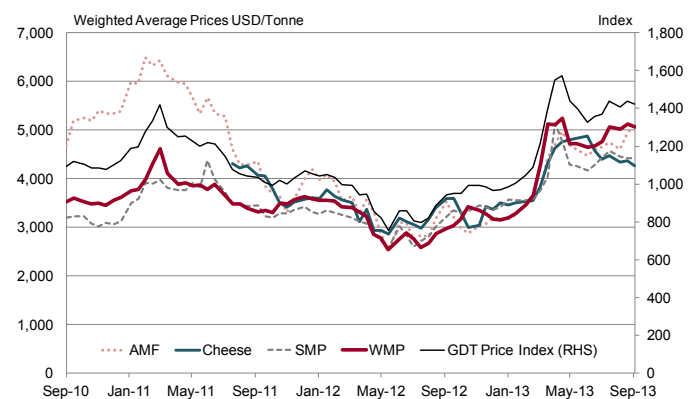
## Fonterra GDT Auction Volumes and Forecasts



## Auction Results

	Change since last auction	Price USD/Tonne
<b>Anhydrous Milk Fat (AMF)</b>	3.1%	\$5,109
<b>Butter Milk Power (BMP)</b>	0.3%	\$4,566
<b>Butter</b>	2.7%	\$3,710
<b>Skim Milk Powder (SMP)</b>	-0.8%	\$4,420
<b>Whole Milk Powder (WMP)</b>	-1.7%	\$5,058
<b>TWI (All Products)</b>	-1.1%	

## GDT Dairy Auction Prices



**Nathan Penny**  
Economist

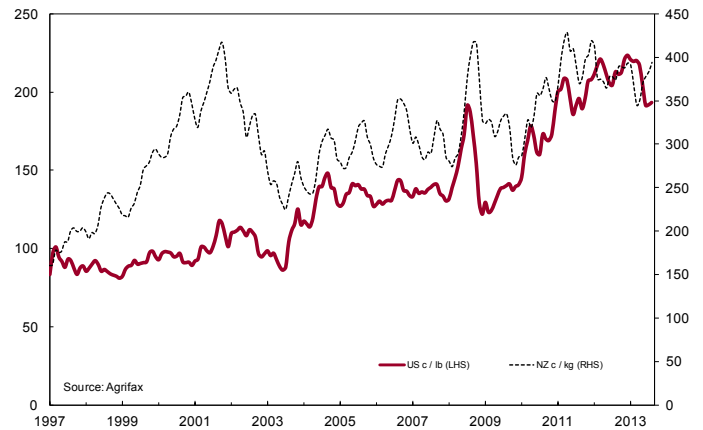
See overleaf for sector outlooks.

# Beyond the farm gate

## Beef

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

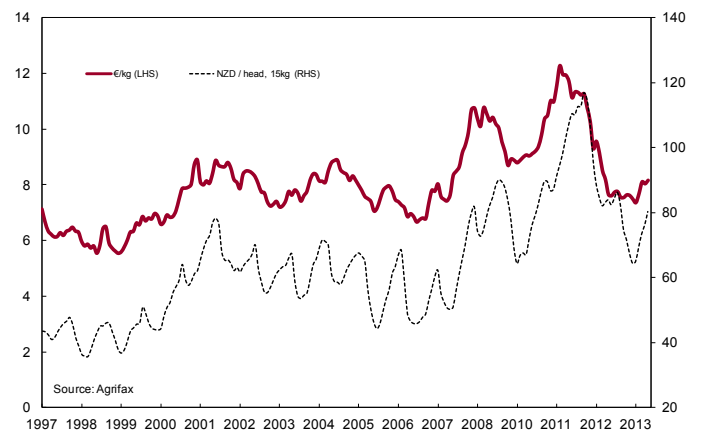
World beef prices continue to defy gravity so much so that we have now changed our outlook for prices over the next six months. World prices rose nearly 1% in August, while a weaker Kiwi dollar contributed to a 4% rise in NZD terms. US slaughtering of processing beef is falling and expected to remain low. This reduced supply is supporting prices for NZ exports. With this in mind we now expect world prices to hold around current levels for the next six months.



## Lamb

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

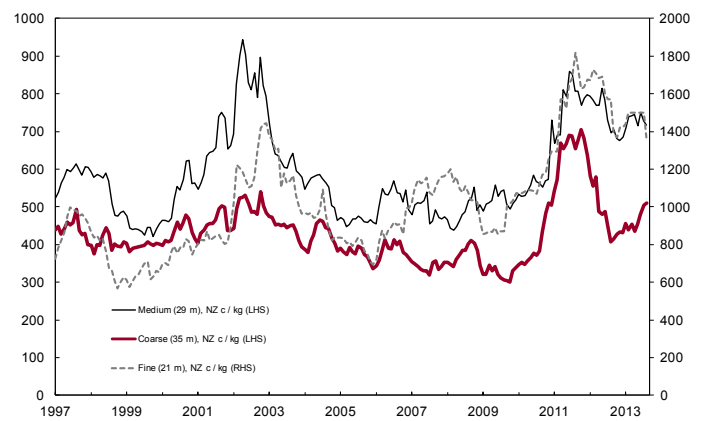
Lamb prices in both world and NZD terms pushed higher in August. A fortnight ago we talked about rising Chinese demand. It may also be that European demand, while still weak, is starting to respond to lower prices. As a result, world prices are now closing in on their historical average for this time of year (after being below average over the past year). What's more, we expect constrained export volumes from both New Zealand and Australia to push prices up further over the next six months.



## Wool

	Current price level compared to 10 year average	Next 6 months
Trend	Above Average	Coarse ↑ Fine/Medium ↓

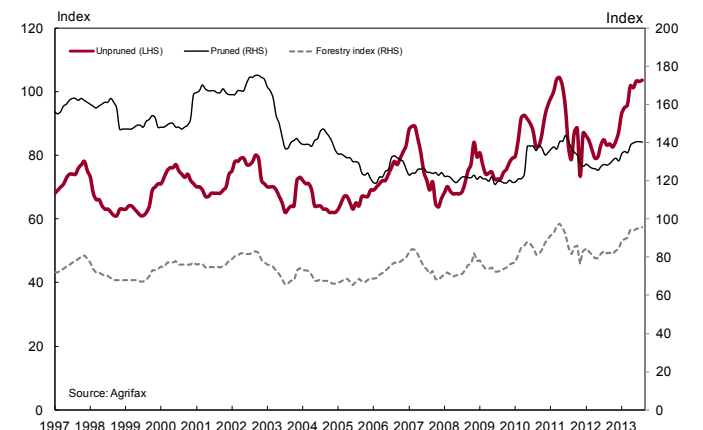
The wool market has split, with coarse wool prices continuing to firm while fine and medium wool prices head in the opposite direction. Coarse wool prices have risen 17% since April. This improvement is in line with the improving housing market in the US. As the US housing market recovers further, the rise in coarse wool prices is expected to continue. On the other hand, the outlook for fine and medium wool prices is subdued. Fine prices fell 10% in August, while medium prices also fell (down 1%). With demand for end products weak, particularly in Europe, we expect prices to fall further over the next 6 months.



## 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 in 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.



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

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