

Welcome

Welcome to the Fortnightly Agri Update, Westpac Economics' new Agri sector publication. Each update will coincide with the fortnightly GlobalDairyTrade auction. As well as reviewing the latest auction results, the update will also include discussion on the latest Agri developments and our latest sectoral outlooks.

Milk Price Forecast Update

We have revised our milk price 2013/14 season forecast up by 30 cents to \$6.50 per kg of milk solids. This isn't as high as Fonterra's opening forecast of \$7.00 per kg. We expect a strong rebound in New Zealand production following this year's drought will put more downward pressure on world prices than Fonterra has currently factored in.

Back in April, we made the call that the spike in world dairy prices would go a long way to alleviating the costs from drought of lost production for the dairy sector as a whole. In our bulletin titled "Drought, Chinese Mums and the price of milk" we outlined how Fonterra has been the preferred supplier in the fast growing Chinese milk powder market. We think as a consequence, the impact of drought on New Zealand production has been the primary factor behind the GlobalDairyTrade price spike.

This story is now largely playing out in line with the dynamics we described. And last week, Fonterra released its opening forecast milk price to \$7 per kg of milk solids for the 2013/14 season, representing a whopping \$1.20 lift on their current season forecast of \$5.80 per kg.

Fonterra's forecast implies that world prices, after coming off their highs, stay at an elevated level for the majority of the season. Fonterra cites weak world production in other producers such as the EU as providing ongoing support for prices.

We agree with Fonterra's view on the outlook for competitors' production levels this season, however we expect supply here to rebound strongly. We have pencilled in a 5% rebound in production volumes at this stage, and there is room for more.

In the same way drought here pushed prices skyward this season, we think increasing local production next season will dampen prices by more than Fonterra is anticipating at this stage. As a result, we expect a milk price of \$6.50 per kg of milk solids for the 2013/14 season, up a more modest 30 cents from our previous forecast of \$6.20 per kg.

As far as the 2012/13 season goes we defer to Fonterra's guidance. That said, we maintain a small premium, with our forecast now at \$5.90 per kg of milk solids compared to Fonterra's forecast of \$5.80 per kg.

Either way, whether Fonterra or our own forecasts prove closer to the money, production volumes and average prices will be higher in 2013/14 than in 2012/13. Overall, it's a shaping up as a bumper season.

GlobalDairyTrade Auction Results

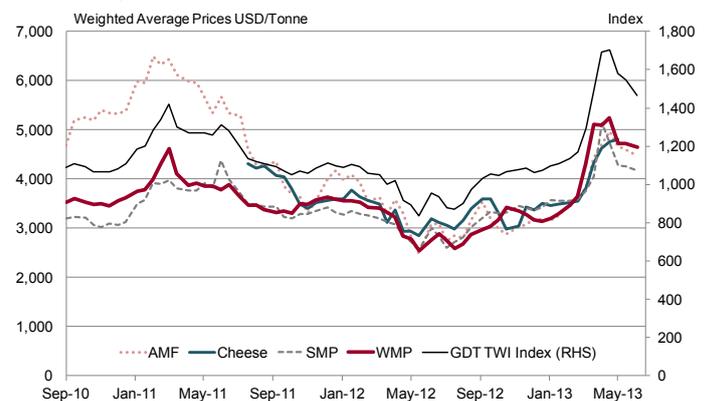
GlobalDairyTrade prices fell overnight by 5.3% on a trade-weighted basis. The fall is in line with our expectations outlined above. In particular, the increasing volumes on offer, most of which now relates to the new season, drove the price fall.

Nathan Penny
Economist

Auction Results

	Change since last auction	Price index USD/Tonne
Anhydrous Milk Fat (AMF)	-4.3%	\$4,478
Butter Milk Power (BMP)	3.3%	\$4,410
Butter	-2.6%	\$3,743
Skim Milk Powder (SMP)	-3.2%	\$4,164
Whole Milk Powder (WMP)	-7.1%	\$4,643
TWI (All Products)	-5.3%	

GDT Dairy Auction Prices



Westpac forecasts of Fonterra milk price

	2012/13		2013/14	
	Fonterra	Westpac	Fonterra	Westpac
Milk Price	\$5.80	\$5.90	\$7.00	\$6.50
plus				
Dividends	\$0.32	N/A	N/A	N/A

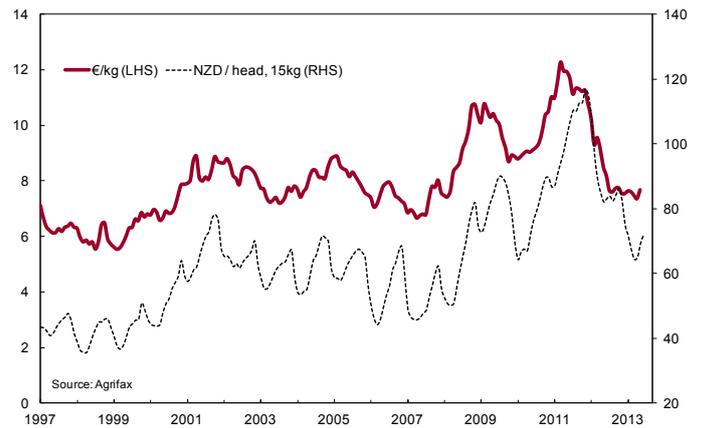
See overleaf for sector outlooks.

Beyond the farm gate

Lamb

	Last 6 months	Next 6 months
Trend	↓	↑

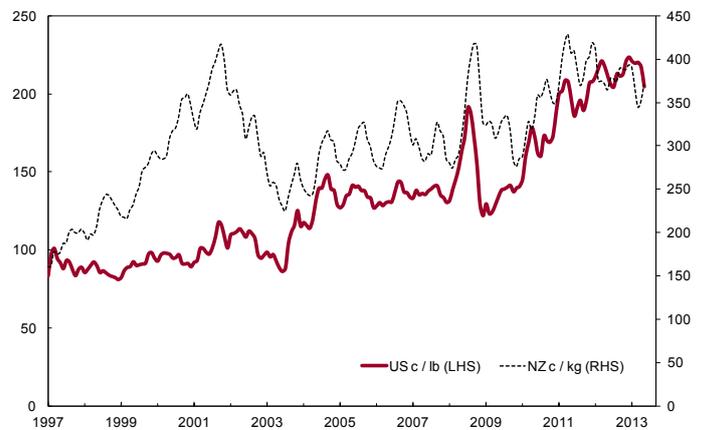
The worst appears over for world lamb prices. After falling in five out of the last six months, world lamb prices posted solid gains of over 4% in May. While European and UK demand remains fickle, it's now apparent to markets that the supply of New Zealand lamb will be severely constrained for the remainder 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. And as a result, the volume of exports into China should continue to grow. We expect these factors to combine and underpin further improvements in world lamb prices over the next six months.



Beef

	Last 6 months	Next 6 months
Trend	↓	↓

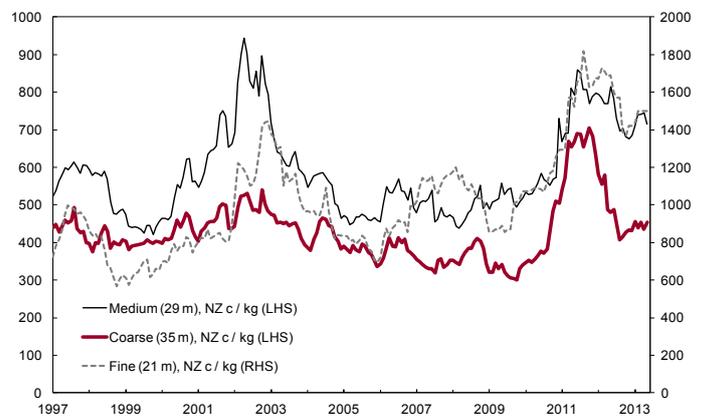
World beef prices have held up well even as the local drought led to the largest slaughter and export of New Zealand beef on record. The US market has to date managed to absorb large quantities of New Zealand beef as US farmers rebuild herds following their own drought. However, the first cracks are appearing. An influx of Australian beef following dry weather there and sluggish US demand have combined to force US prices down by around 6% in May. Moreover, it appears that significant stocks of New Zealand beef have piled up in the US. Overall, we expect these factors to push world beef prices down over the next six months. While we expect prices to fall, they are likely to remain relatively high by historical standards.



Wool

	Last 6 months	Next 6 months
Trend	↑	→

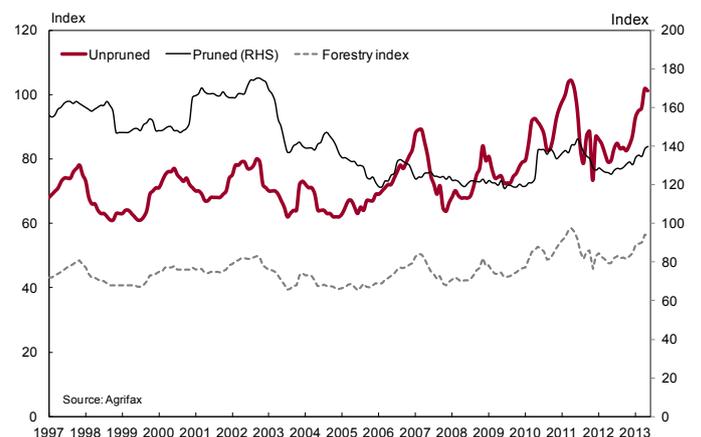
The uptick in wool prices over the last six months appears to be losing steam. Fine wool prices have treaded water while medium was down around 4% in May. Only coarse wool bucked the trend, rising 4%. While Chinese demand by itself appears robust, demand for end products, particularly in Europe, appears to have run out of steam. Unlike food markets, Chinese demand is not quite ready to take up slack. As a result, we expect world wool prices to tread water at their current levels over the next six months.



Forestry

	Last 6 months	Next 6 months
Trend	↑	→

Forestry's stellar run has come to an end. After posting six consecutive rises, the forestry index posted a fall in May. However, this fall has taken little gloss off the sector. Forestry prices remain nearly 20% above the same time a year ago, while the volume of exports is still high. Chinese demand is holding up well at a very high level and will continue to underpin log prices. 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 track sideways. Over the next six months, we expect forestry prices to stay at this elevated level, but for export volumes to still grow.



Westpac Economics Team Contact Details

Dominick Stephens , Chief Economist	Ph: (64-9) 336 5671	dominick_stephens@westpac.co.nz
Michael Gordon , Senior Economist	Ph: (64-9) 336 5670	michael_gordon@westpac.co.nz
Felix Delbrück , Senior Economist	Ph: (64-9) 336 5668	felix_delbruck@westpac.co.nz
Nathan Penny , Economist	Ph: (64-9) 336 5669	nathan_penny@westpac.co.nz

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