



Fortnightly Agri Update

16 April 2014

A fine vintage

Around the country those in the wine industry are starting to feel a bit more optimistic than they have in recent years. Part of the improvement has been thanks to favourable conditions for this year's harvest. In Marlborough many growers have reportedly managed to get a decent chunk of the harvest in before recent rain, while in the Hawke's Bay growers have largely completed a successful harvest in favourable weather conditions. And there are high hopes that 2014 will prove to be a high quality vintage thanks to favourable growing conditions through summer and into early autumn.

But a more buoyant mood in the sector is not all just down to the weather. Conditions in New Zealand's key wine export markets are also gradually improving. Australia is New Zealand's top destination for wine exports (by value) followed by United States, United Kingdom, and Canada. The US and the UK in particular were hit hard by the global financial crisis, with the labour market conditions deteriorating rapidly and consumers responding with a sharp fall in spending. However, conditions have improved over the last few years. And while the repair job on the US and UK economies is by no means complete, unemployment rates have been falling and this should translate to stronger income growth and support further gradual improvement in spending.

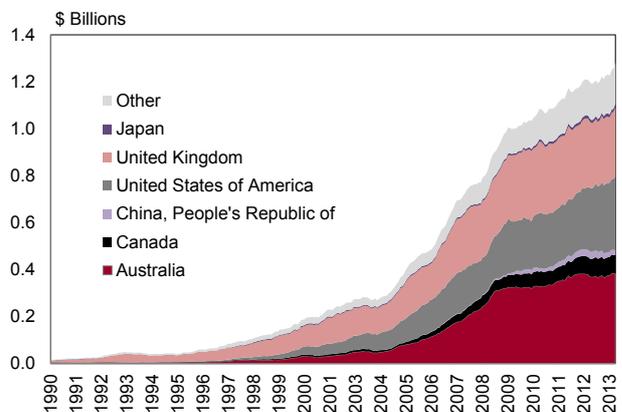
However, like other New Zealand exporters, major potential growth opportunities for those in the wine sector probably lie outside traditional markets. For example, New Zealand's wine exports to China have also grown very strongly over the last few years, albeit off a very low base. Internationally, China has become an increasingly important market for red wine in particular in recent years. And while it is still early days, we've seen with other food products what income growth, changing tastes and preferences, and westernisation of diets can do. Chinese consumers can quickly become an important source of international demand.

A stronger backdrop for demand has probably buoyed confidence, and been one factor helping improve profitability in the sector. The 2013 annual financial benchmarking survey (conducted by Deloitte and New Zealand Winegrowers) showed improved profitability amongst wineries of most sizes (with the exception of the \$1.5m-\$5m category). That said there remained significant differences in profitability of smaller and larger wineries, with smaller wineries finding it more difficult to generate a decent return (with the 0-\$1.5m category still reporting losses in the 2013 survey).

Of course while conditions for wine growers are improving, challenges remain. Like other non-commodity exporters those in the wine industry are facing stiff headwinds from the high New Zealand dollar. We think this could remain the case for some time yet. Our own forecasts have the NZD easing a little from

today's levels but remaining above the 83c against the USD (on average) this year and next. Interest rates are also forecast to rise substantially over the next few years. And New Zealand exporters will always face stiff competition in international markets. In particular competition from Chilean producers has been notable. Yet despite such challenges, it appears as if after a number of difficult years, the sector has grounds for its cautiously optimistic outlook.

NZ Wine Exports



GlobalDairyTrade Auction Results, 16 April

	Change since last auction	Price USD/Tonne
Anhydrous Milk Fat (AMF)	0.6%	\$4,086
Butter Milk Power (BMP)	-8.6%	\$4,075
Butter	-4.9%	\$3,832
Skim Milk Powder (SMP)	-4.4%	\$3,969
Whole Milk Powder (WMP)	-1.6%	\$3,990
Cheddar	-3.3%	\$4,273
GDT Price Index	-2.6%	

Payout Forecast Table

	2013/14		2014/15
	Fonterra	Westpac	Westpac
Milk Price	\$8.65	\$8.65	\$7.10

Anne Boniface
Senior Economist

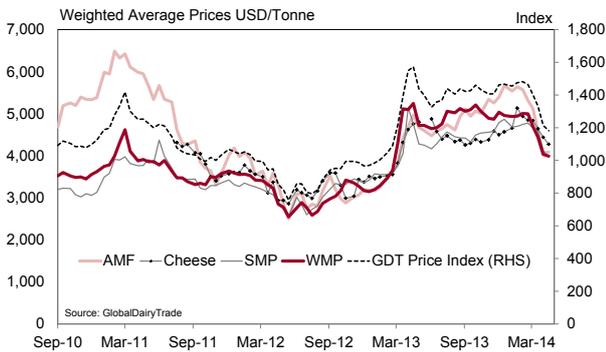
Beyond the farm gate



Dairy

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

Dairy prices eased a little further in last night's GlobalDairyTrade auction, but registered a much smaller fall than in recent events. The trade weighted index was down 2.6%, with this measure now down 20% below its early February levels. Within this, there was a 4.9% fall in butter prices, a 4.4% fall in SMP prices and a more modest 1.6% fall in WMP prices. These developments are consistent with our view that increased supply (in New Zealand) and some seasonality around Chinese demand for dairy products have been key reasons for softer dairy prices. Indeed we could see prices soften a little further over the next few months, but we expect a bit of a rebound later in 2014. We see WMP prices averaging around \$US4000/tonne over the 2014/15 season.

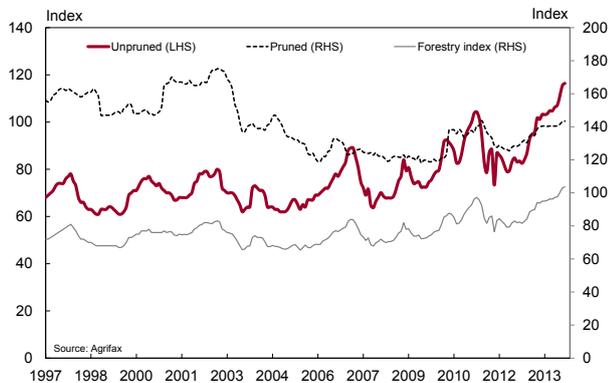


Forestry

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

Log prices remained at record highs in March, thanks in large part to strong demand from China. There are however now reports of growing Chinese inventories. While this is yet to be reflected in prices, there is the potential for higher inventories to weigh on prices over the next few months.

A pickup in building activity is also supporting domestic demand for timber. Excluding the volatile apartment category, residential building consent issuance rose to its highest level in 6 years in February, and continues to be driven by a pickup Auckland and Canterbury. We expect building activity to strengthen further from here.

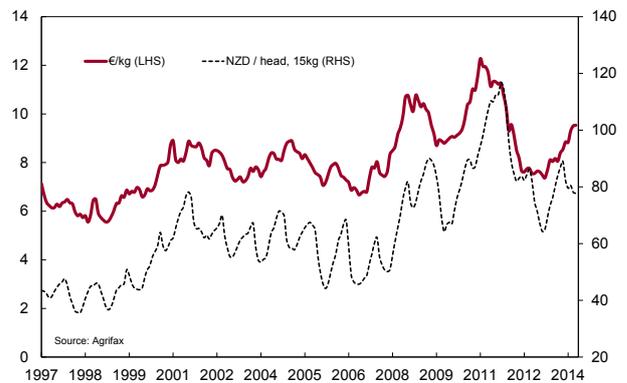


Lamb

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

International lamb prices have continued to move higher over the last couple of months. We think that with supplies still relatively tight in both Australia and New Zealand, and demand conditions improving in some key traditional markets such as the UK, prices could still increase further over the coming months. Demand from less traditional, but increasingly important markets such as China also appears solid.

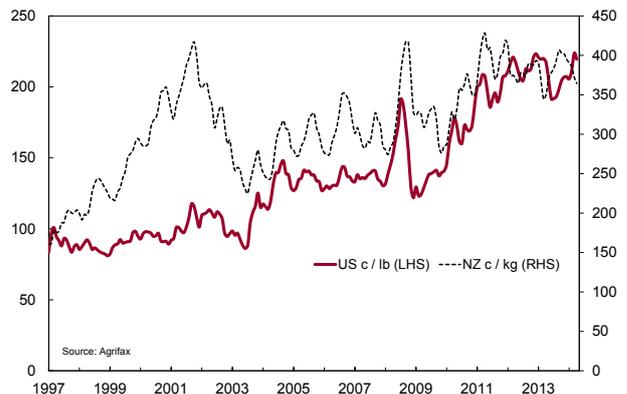
Internationally, NZ and Australia two dominant global exporters of lamb, however New Zealand has distinct trade advantages when it comes to exporting to China and the EU. New Zealand's Free Trade Agreement with China means New Zealand lamb exporters face much lower tariffs than their Australian counterparts, while New Zealand's tariff-free quota for exports to the EU is much larger than Australia's.



Beef

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

International beef prices have eased a touch, but remain at a high level. Global supplies remain tight (especially in the US), and this should continue to support international prices for some time yet. Australia (an important international beef exporter) has recently signed free trade agreements with South Korea and most recently Japan, both important destinations for Australian (and New Zealand) beef exports. While New Zealand is in the process of negotiating an agreement with Korea (and of course is involved in TPP negotiations) Australia's successful negotiations will undoubtedly help give Australian producers a leg up in these markets. For New Zealand perhaps the only silver lining would be potential opportunities in other regions if an increasing proportion of Australian product is destined for Korea and Japan.



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

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