

Mild relief

Last night's GlobalDairyTrade auction provided a small trace of relief for New Zealand dairy farmers, with world prices rising by 1.4%. That doesn't sound like much on its own terms, and we should bear in mind that it follows a 7.3% fall in prices in the previous auction, which was one of the worst results so far this year. But in light of the growing risks to the global economy, the continued slide in some major commodity prices, and the wild moves in financial markets overnight as the auction was being conducted, even a small rise in prices represents a notable bucking of the trend.

The lift in prices wasn't a universal story. Prices rose by 3.1% for whole milk powder (WMP), New Zealand's major export product, and were up 7.3% for anhydrous milk fat (AMF). In contrast, there was a further 3.6% fall in skim milk powder (SMP) prices, the product more commonly exported by those Western countries that have been the direct targets of Russia's temporary ban on food imports.

Despite the welcome lift in prices at the latest auction, there should be no illusions about where the risks lie around our forecast of a \$4.80/kg milk price from Fonterra this season. WMP prices are currently around \$2,500/tonne; both we and Fonterra have based our milk price forecasts on a return to around \$3,500/tonne by the end of the season, an increase of 40%. That's a big ask in such a short timeframe, made more difficult by the emerging wobbles in the global economy. The risk is that this improvement in prices comes later than we've assumed, which would weigh on the dairy payout for both this season and next season.

Our view remains that dairy prices will benefit from an improvement in Chinese demand early next year, and that eventually lower prices will send a strong signal to producers around the globe to cut back production. One of the reasons we remain upbeat on the outlook for China is a pickup in momentum for the global economy more generally. There's been some media focus on the IMF's recent downgrade to its global growth projections for this year and next year. But much of the downgrade was due to increasing the weights for the emerging market economies, which now make up 57% of the world economy (the previous estimate was around 50%). Since the slowdown in growth this year has largely been an emerging market story, the global average had to be revised down by construction.

In contrast, growth in the developed countries has accelerated this year. And while on some measures China has now overtaken the US as the world's largest economy, the US remains the most significant driver of global economic trends. In fact, our research finds that by far the strongest linkage in terms of global growth runs from the US to China, not the other way around. A stronger US economy over the next year should help to revitalise demand in China as well.

Michael Gordon
Senior Economist

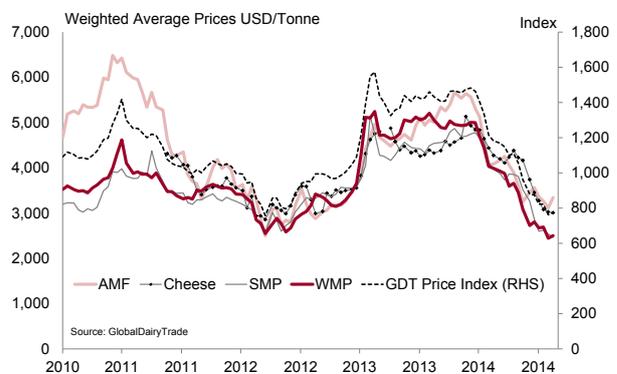
GlobalDairyTrade Auction Results, 16 October

	Change since last auction	Price USD/Tonne
Anhydrous Milk Fat (AMF)	7.4%	\$3,346
Butter Milk Power (BMP)	-3.8%	\$2,685
Butter	3.9%	\$2,614
Skim Milk Powder (SMP)	-3.6%	\$2,462
Whole Milk Powder (WMP)	3.1%	\$2,503
Cheddar	-1.0%	\$3,007
GDT Price Index	1.4%	

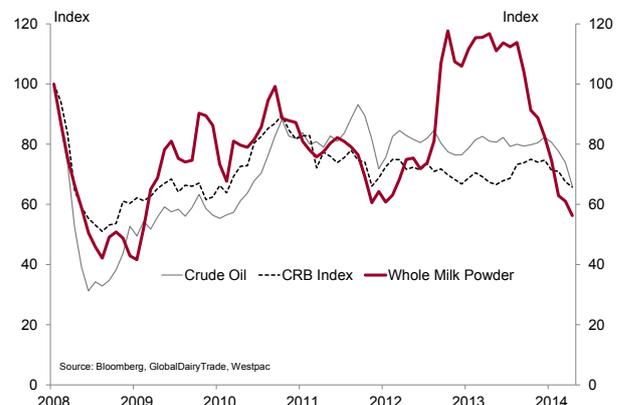
Payout Forecast Table

	2013/14	2014/15		2015/16
	Final	Fonterra	Westpac	Westpac
Milk Price	\$8.40	\$5.30	\$4.80	\$6.60

GDT auction prices



Commodity prices



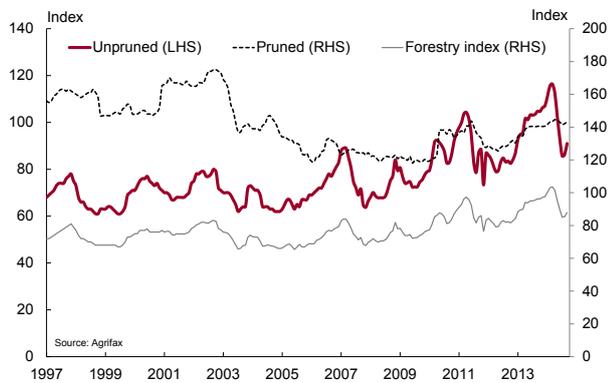
Beyond the farm gate



Forestry

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

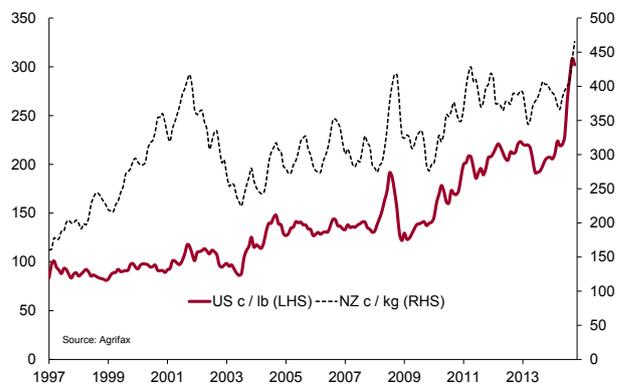
The Agrifax forestry price index has risen 3.3% in the last two months, driven by an improvement in unpruned log prices. Despite this change in direction, we don't think this heralds a return to the high prices achieved last year. It's likely that prices have stabilised precisely because harvesting has pulled back to match demand (in contrast to dairy, where global milk production has continued to rise this year even as demand has slowed). The Chinese housing market is still in a slowdown phase, although policymakers have recently taken steps to revitalise demand by lowering mortgage rates and loosening mortgage restrictions. Solid growth in housing construction in both New Zealand and Australia should continue to support domestic demand for forestry products.



Beef

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

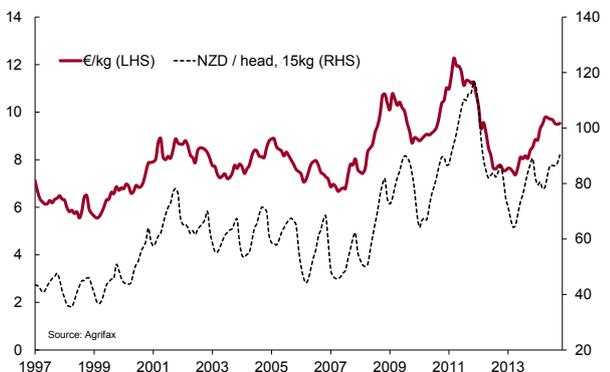
The spike in US beef prices has started to recede in the last few weeks. US supplies became extremely tight over the peak summer demand period, but imports (particularly from Australia) have helped to fill the gap. The US autumn cow slaughter is now getting under way, although record-low cattle inventories at the start of the season (going back to the start of the USDA's survey in 1973) should limit the extent to which prices fall. Locally, favourable prices and climactic conditions helped support the first increase in beef cattle numbers since 2006/07 in Beef and Lamb New Zealand's 2014 stock survey.



Lamb

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

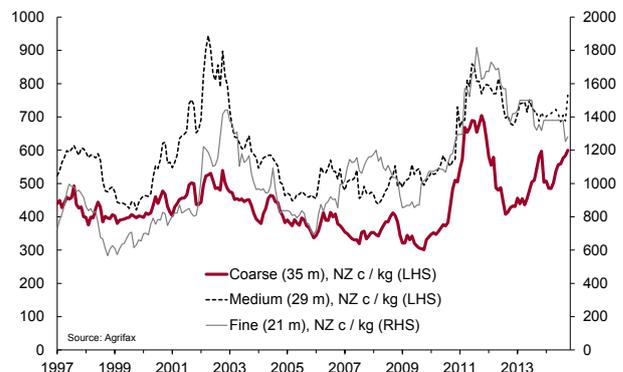
Global lamb production is adequate to meet demand at the moment. UK slaughter numbers and weights have improved on last year, and Australian lamb production is also running substantially above year-ago levels, although this may detract from supplies later in the year. Slower growth in China (and weaker demand for luxury goods) has weighed on pelt prices, taking some of the shine off total lamb returns for farmers.



Wool

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

The ongoing lift in coarse wool prices has been joined by a jump in medium wool prices in recent weeks. Locally and internationally, supplies remain tight with New Zealand supplies at auction running behind last year's levels. In their most recent forecasts, ABARES expects Australian wool production to reach a record low in the 2014/15 season on the back of a significant reduction in the national flock.



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

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