



Fortnightly Agri Update

17 September 2014

Dairy downgrade

A fortnight ago we warned readers that our \$5.80 milk price forecast was once again looking too optimistic. This week we've formalised this risk, downgrading our payout forecast for the current season to \$5.30.

There have been a number of developments which have led us to lower our forecast. Firstly, recent GlobalDairyTrade (GDT) auctions have been weaker than expected. While prices stabilised in last night's auction, this follows a 6% fall in the previous auction. What's more, there remains little sign of pent up demand. In the most recent event, Whole Milk Powder (WMP) buyers were willing to pay a similar price for product to be delivered in two through to five months' time. Skim Milk Powder (SMP) buyers were willing to pay slightly less for product with later delivery dates. With volumes sold on the GDT platform now near their seasonal peaks, auction outturns can have a big impact on our payout forecasts.

Russian import bans haven't helped either. With more Northern Hemisphere production likely to be diverted into SMP production (thanks to its superior storage qualities and the support measures available) we think SMP prices could remain under pressure over the next few months, even if WMP prices start to improve.

Developments in China have also added to the sombre tone in commodity markets. The Chinese economy is going through a soft patch and this is darkening the mood of Chinese consumers. The August Westpac MNI China consumer sentiment survey showed consumers remain distinctly unimpressed by the state of the economy, their own job prospects and family finances. We'll get the next monthly read on consumer sentiment next week, but right now it appears that it could be a while longer before more upbeat Chinese consumers are underpinning an improvement in dairy prices.

Importantly, we don't expect this situation to last forever. Chinese policymakers are likely to step in with further support if their growth targets are threatened. There was more evidence of this attitude overnight with reports that the People's Bank of China is providing additional liquidity support to China's 5 largest banks which would help bolster economic growth prospects. Eventually stronger growth and an improving housing market should help improve the mood of consumers. This, combined with the usual seasonal lift in Chinese demand and the rundown of stockpiles built up earlier in the year, should drive an improvement in dairy prices. However, that pickup is now expected to be slightly later than in previous forecasts.

Dairy farmers will be partially insulated from feeling the full force of a sharply lower payout on their cashflows by retrospective payments from the record breaking 2013/14 season. But while one tight year is likely to be manageable for most, the outlook for 2015/16 becomes very important. At this stage, we're still

comfortable with our forecast of a \$6.60 milk price payout in 2015/16. A result that relies on a combination of a recovery in dairy prices from their current levels, and a weaker NZD next year as the pace of the RBNZ hiking slows and major central banks around the world start their own tightening cycles.

Clearly another factor that is important for farm cash flows are Fonterra's advance payment rates. Fonterra left these unchanged when it downgraded its 2014/15 season payout forecast to \$6 back in late July. But with \$6 now looking pretty optimistic on our estimates, Fonterra may opt to tweak these, and potentially its own payout forecast, around the time of its 2014 annual results announcement (scheduled for Wednesday next week).

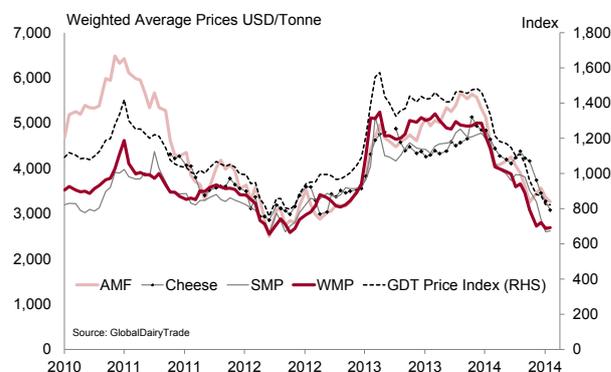
GlobalDairyTrade Auction Results, 17 September

	Change since last auction	Price USD/Tonne
Anhydrous Milk Fat (AMF)	-2.2%	\$3,264
Butter Milk Power (BMP)	-6.9%	\$3,140
Butter	-2.5%	\$3,140
Skim Milk Powder (SMP)	0.9%	\$2,619
Whole Milk Powder (WMP)	0.6%	\$2,692
Cheddar	-6.5%	\$3,077
GDT Price Index	0.0%	

Payout Forecast Table

	2013/14		2014/15		2015/16
	Fonterra	Westpac	Fonterra	Westpac	Westpac
Milk Price	\$8.40	\$8.40	\$6.00	\$5.30	\$6.60

GDT auction prices



Anne Boniface
Senior Economist

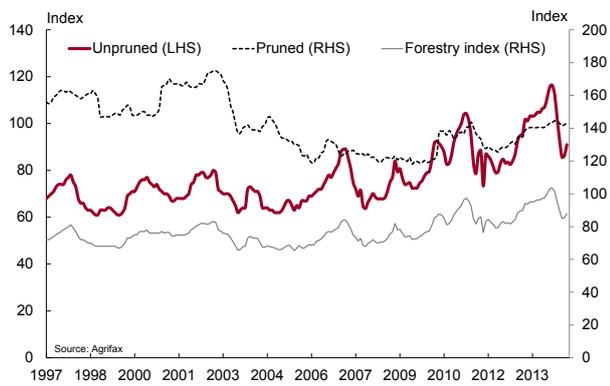
Beyond the farm gate



Forestry

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

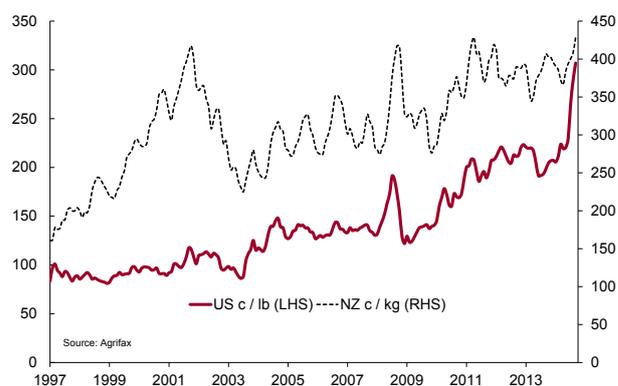
Log prices improved slightly in the Agrifax measure in August (unpruned log prices were up 5% in the month). However reports that Chinese log inventories remain relatively high, and ongoing weakness in the Chinese housing market, are likely to keep a lid on log prices for a while yet. And while the outlook for China is key to the fortunes of the forestry sector, prospects for forestry products in other export markets are a little more upbeat with the US housing market hinting at further signs of improvement. Domestically, demand should continue to be supported by ongoing growth in the construction sector. Latest data showed construction activity increased further in the June quarter, to be up 17% over the last year.



Beef

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

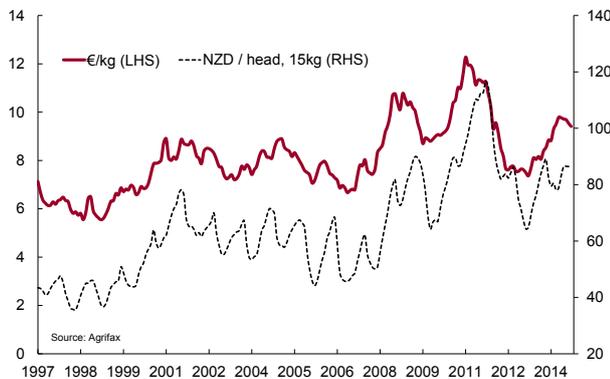
Beef prices have remained elevated in the last few weeks, as tight US supplies continue to dominate markets. USDA data shows that on July 1st this year, cattle inventories were at their lowest level since this particular survey began in 1973. While numbers are expected to grind on the back of record prices, improved pasture conditions and lower fed costs, this will take time. In the meantime, producers in Australia and New Zealand remain well placed to fill the gaps. 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. Beef cattle numbers were up 1.6% in the year, with the bulk of the increase coming from herds in the North Island.



Lamb

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

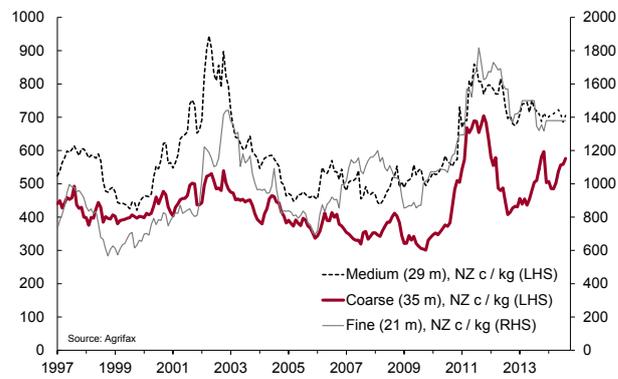
Beef and Lamb New Zealand's 2014 stock survey recorded a 3.2% decline in sheep numbers (to 29.8million) in the year to June 2014. But with ewe condition and feed supplies more favourable at mating this year, the lamb crop is expected to remain fairly flat (up just 0.3%) despite a decline in breeding ewe numbers. Improved lamb prices this year are likely to continue to encourage ongoing productivity gains in the sector. And with volume of product exported from Australia set to slow next season, the outlook for international prices remains relatively favourable.



Wool

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

Local coarse wool prices have improved a touch in the last month, helped by a weaker NZD. Locally and internationally, supplies remain tight with NZ 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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