

# Fortnightly Agri Update

21 May 2014

## A sensible head on their shoulders

Last week the Reserve Bank published its biannual *Financial Stability Report (FSR)*. This is a chance for the Reserve Bank to comment on the health of New Zealand's financial system and discuss any sources of vulnerability. As always a wide range of topics were covered. Debt levels in the farm and particularly dairy sector, was once again covered in some detail.

The dairy sector is an area the Reserve Bank watches particularly closely for a number of reasons. Firstly, it carries the bulk of agricultural debt – around 65% of all agricultural debt is in the dairy sector. And secondly, dairy debt is relatively concentrated. The RBNZ reports that 50% of all dairy debt is held by around 10% of farmers. Consequently, dairy debt has the potential to create risks for the financial system (and farmers) if dairy prices were to fall sharply, or if there was an extreme weather event which disrupted production.

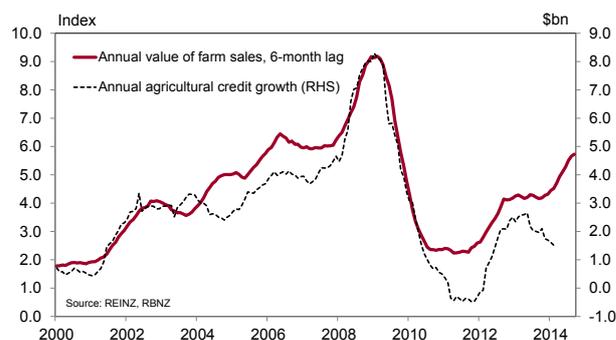
Fortunately neither of these events have hit the current dairy season where both prices and production are expected to set new records. Combined with interest rates which have risen but remain at relatively low levels, this season has been an excellent one for many dairy farmers.

However, we don't think such outstanding conditions can persist indefinitely. Weather is always something of an unknown (there are already fears of a possible El Nino event next season) and commodity prices are notoriously volatile. Dairy prices have fallen around 23% since early February and we expect the 2014/15 payout will be significantly lower than the current season (our forecast is for a \$7.10 milk price). What's more, interest rates are rising. And with 70% of dairy debt on floating mortgage rates (according to Reserve Bank data) one of the most significant costs for many dairy farmers are rising.

But it's not just the Reserve Bank who is wary of the risks on the horizon. For the most part, farmers too appear to be treading carefully and taking a relatively cautious approach to the current income boost. Farm turnover has picked up noticeably, climbing 27% in the year to April 2014, and there has been upward pressure on prices. There has also been a pickup in investment on farm. Yet despite this, growth in farm debt has slowed. Instead of capitalising higher incomes into higher land prices, many farmers are opting to use the additional cash flow this season to reduce debt.

The Reserve Bank seems reasonably pleased with the apparent attitude of farmers. While the Bank remains concerned about the risks facing farmers, the cautious approach currently being adopted by farmers does help mitigate these somewhat. What's more, if farmers continue to tread carefully, the Reserve Bank may not feel the need to slap restrictions on farm lending as some have speculated it might.

## Value of farm sales and credit growth



## GlobalDairyTrade Auction Results, 21 May

	Change since last auction	Price USD/Tonne
Anhydrous Milk Fat (AMF)	1.9%	\$4,255
Butter Milk Power (BMP)	-1.9%	\$3,950
Butter	-3.8%	\$3,667
Skim Milk Powder (SMP)	-3.5%	\$3,733
Whole Milk Powder (WMP)	-1.1%	\$3,877
Cheddar	-2.1%	\$4,108
GDT Price Index	-1.8%	

## Payout Forecast Table

	2013/14		2014/15
	Fonterra	Westpac	Westpac
Milk Price	\$8.65	\$8.50	\$7.10

**Anne Boniface**  
Senior Economist

# Beyond the farm gate

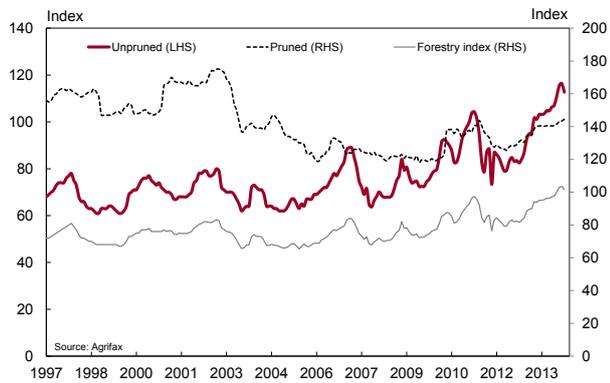


## Forestry

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

Log prices continue to hover near record levels, but expectations of a correction are growing on the back of a build-up in inventories after record Chinese log imports. Those imports have come not just from NZ but also from other places around the world such as Russia.

In New Zealand building consent issuance continues to grow, and this should support demand for construction materials. However housing markets in other parts of the world remain sluggish. In the US home building has struggled to fully recover after being hampered by poor weather at the start of the year. The outlook in Australia is stronger, with March consent issuance pointing to growth slowing but activity remaining at a relatively high level.

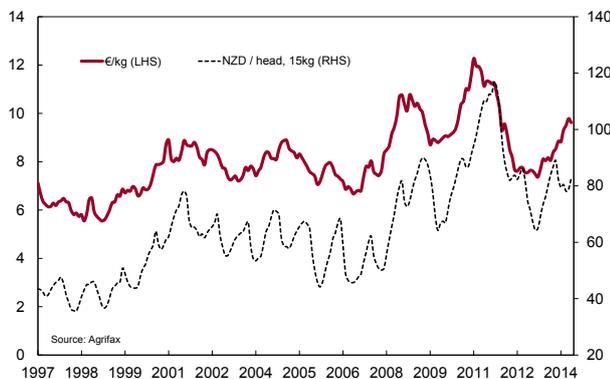


## Lamb

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

International lamb prices have improved noticeably in 2014, supported by tight supplies and improving demand conditions in key traditional markets such as the UK. Demand from less traditional, but increasingly important markets such as China also appears solid and we think prices could improve further over the coming months.

Beef and Lamb recently released its mid-season update. Because of last year's drought, the lamb crop is expected to be down 1.9% this season compared to (although this decline isn't as large as Beef and Lamb initially anticipated). The 5.3% fall in slaughter numbers is partially offset by higher carcass weights.



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

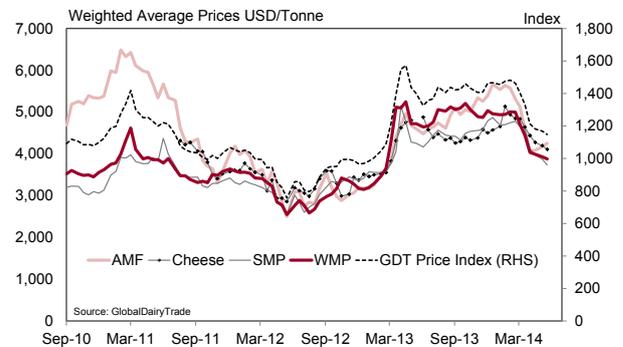
## Dairy

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

Dairy prices fell further in last night's GlobalDairyTrade auction, declining 1.8%. Prices have now fallen 23% since they started declining in early February, and are at the lowest level since February last year.

In recent auctions, skim milk powder prices have come under greater downward pressure than whole milk powder prices. This probably reflects the fact that SMP supply from the US and Europe is growing as milk production lifts to a seasonal peak, whereas WMP production in New Zealand (the dominant global WMP supplier) is winding down as the season draws to a close.

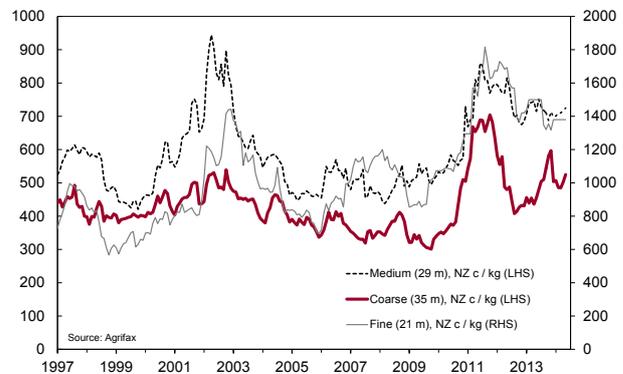
Fonterra is due to announce its opening forecast for the 2014/15 season next week. They may also use the opportunity to update their 2013/14 payout forecast. For our part, we're forecasting a \$7.10 milk price for next season, and think that there could well be a small downgrade to the forecast for the current season (we're picking a \$8.50 milk price).



## Wool

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

Coarse wool prices have stabilised over the last few weeks, after trending lower in the early part of this year. Tight supplies globally, combined with the gradually improving outlook for growth in developed countries such as the EU and US, should see a period of relative stability in prices.



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