



Fortnightly Agri Update

3 December 2014

All bulled up

The ascent of beef prices over the course of this year – especially in contrast with the plunge in dairy prices – has caught the attention of many of our contacts recently. Some of them (more so from offshore) have raised the question at what point might we see a switch in land use away from dairying and towards beef. Others (more so locally) have challenged our forecast that beef prices are set to fall over coming months.

We can't really give a firm answer on the first question; ultimately it will come down to judgements about the long-run returns from each activity, and we suspect that the arithmetic still stacks up in favour of dairying. A second year of below-average milk prices could change some people's thinking, but that's not our forecast at the moment.

On the second question, we'll start by pointing out that our forecast that beef prices will fall from current levels by no means implies outright weakness. In fact, our forecast has prices settling a good 20% above where they were at the start of this year. Beef prices have been on a steady upward trend for many years and we have no reason at this point to argue that the trend has broken. However, the steepness of the run-up in prices this year has all the hallmarks of a temporary supply squeeze, rather than a fundamental shift in demand.

First we need to set out a few facts to establish how this supply shortfall came about. The US is the dominant market for New Zealand beef, taking in almost half of our chilled beef exports. That differs from many of our top export products, where China has been or is rapidly becoming the biggest buyer. (China has become a significant buyer of our beef in the last couple of years, but it remains a distant second in terms of market share.)

Secondly, the global market for beef is fragmented. For instance, even before Russia imposed a temporary ban on food imports from many Western countries, US beef was already more or less shut out of the Russian market (ostensibly on concerns about disease). Consequently, there is no 'world' price for beef as such, and regional prices depend heavily on regional supply conditions.

In the case of the US, supply has been increasingly tight in recent years, as successive droughts have led to a steady reduction in herd sizes. That came to a head over the US summer this year, with inventories very low as demand hit its peak (reportedly, some cuts of meat couldn't be found at any price). Bull beef prices rose by 45% between June and September as US buyers scrambled to restock.

Since then, the situation has started to alleviate: demand is past its peak, and seasonal supply from Australia and to some extent New Zealand has helped to fill the gap. US bull beef prices have eased by 11% from their peak, and we suspect they will have further to go before the market finds a new equilibrium. But as mentioned

earlier, that new equilibrium is likely to involve a higher level of prices than before.

The local scepticism about our forecast for a drop in beef prices probably reflects the fact that local beef prices tend to lag behind the US. The prices paid by New Zealand meat processors didn't really start their run-up until September, just as US prices were coming off their peak. They were still heading higher up until mid-November, but in the last two weeks they have started to edge lower. A look at the recent trend in US prices gives us a fair idea of how far local prices have to go.

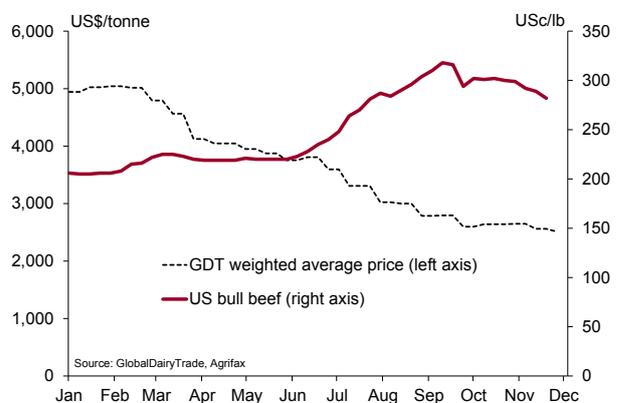
GlobalDairyTrade Auction Results, 3 December

	Change since last auction	Price USD/Tonne
Anhydrous Milk Fat (AMF)	9.0%	\$3,817
Butter Milk Power (BMP)	8.8%	\$2,560
Butter	7.3%	\$2,849
Skim Milk Powder (SMP)	5.7%	\$2,423
Whole Milk Powder (WMP)	-7.1%	\$2,229
Cheddar	5.2%	\$3,017
GDT Price Index	-1.1%	

Payment Forecast Table

	2013/14		2014/15		2015/16
	Fonterra	Fonterra	Westpac	Westpac	
Milk Price	\$8.40	\$5.30	\$4.80	\$6.20	

Diverging fortunes: dairy vs beef



Michael Gordon
Senior Economist

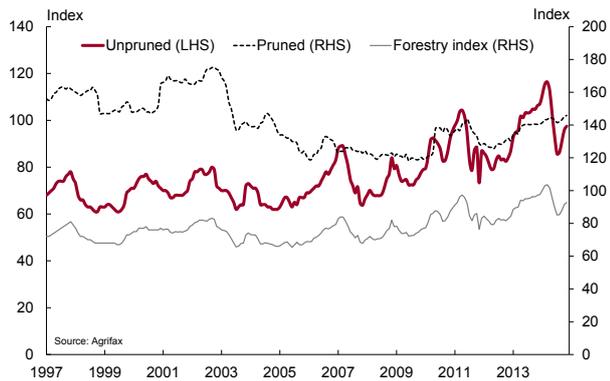
Beyond the farm gate



Forestry

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

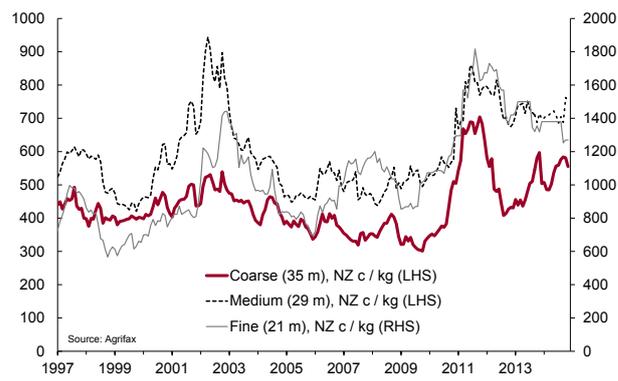
World prices for logs have stabilised in the last few months, and with a weaker New Zealand dollar in that time, local currency prices have rebounded by 8.9% according to the Agrifax forestry price index. We suspect that prices have improved as harvesting has pulled back to match demand – in contrast to dairy, where global milk production has continued to rise this year. There are very tentative signs that steps by Chinese policymakers to revitalise their housing market are having some effect.



Wool

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

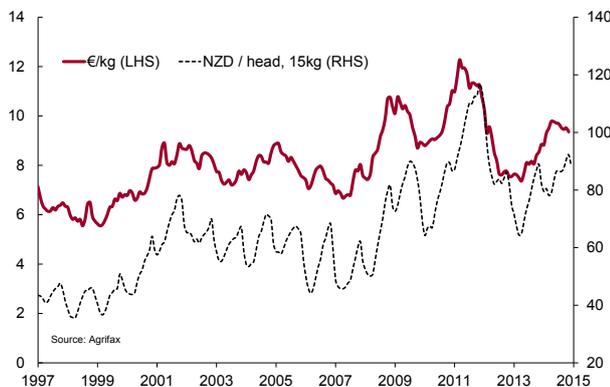
Wool prices have been mixed, with medium wool prices remaining at high levels but coarse wool prices losing altitude in recent weeks. Supplies remain tight locally and internationally, with New Zealand supplies at auction running behind last year's levels.



Lamb

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

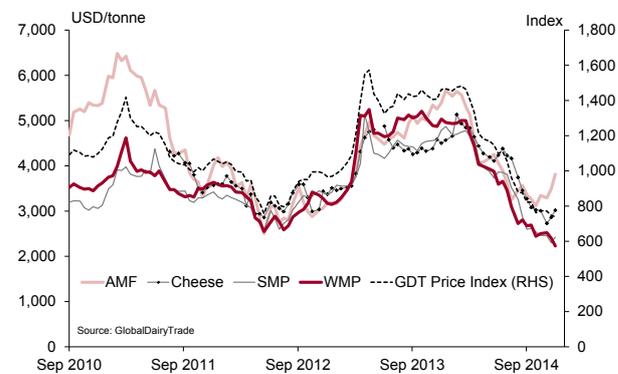
Global lamb production is adequate to meet demand at the moment. UK slaughter numbers and weights have improved on last year, and Australian lamb production is also running substantially above year-ago levels, although this may detract from supplies later in the season. Slower growth in China, and weaker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



Dairy

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

World prices slipped another 1.1% in last night's GlobalDairyTrade auction. While whole milk powder prices were down heavily (-7.1%), there were sharp price increases for every other product on offer. That mix is more consistent with the 'Chinese overstocking' story rather than weak demand per se, which supports our view that the current price weakness will prove to be temporary. Nevertheless, it doesn't bode well for returns for this season. Fonterra's board meets next week to review the milk price forecast for this season; our forecast remains at \$4.80/kg.



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

Westpac economics team contact details

Dominick Stephens, Chief Economist
+64 9 336 5671

Michael Gordon, Senior Economist
+64 9 336 5670

Felix Delbrück, Senior Economist
+64 9 336 5668

Satish Ranchhod, Senior Economist
+64 9 336 5669

Any questions email:
economics@westpac.co.nz

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