

## Fortnightly Agri Update

3 September 2014

## Diverging fortunes

Falling dairy prices have been hogging the headlines in recent months. And fair enough too, with prices down 45% since February and dairy NZ's biggest export product. But it has not been such tough times for all commodity exporters. Peering beyond the dairy sector reveals much brighter prospects for other producers.

Dairy prices continued to slide in last night's auction. We had been cautiously optimistic that there were signs of stabilisation in dairy prices a fortnight ago. However, this has proven premature. In last night's event the headline trade weighted index fell another 6%. This included a more than 4% fall in Whole Milk Powder (WMP) prices (more than reversing the 3.4% increase we saw a fortnight ago), and another hefty, 9.5%, fall in Skim Milk Powder (SMP) prices.

SMP prices have fallen particularly sharply over the last month or so. Prices are down 20% from early August, while WMP prices are just 1% lower. Strong growth in milk supply from Northern hemisphere producers (US milk production is up almost 4% on a year ago in July, while European production in the 6 months to June is up 5.1% on the same period last year) and the impact of Russia's yearlong ban on food imports from a number of western countries are likely to be two factors weighing on prices. Russia is an important importer of butter, SMP and cheese from the European Union and this important customer closing its doors to exports from Europe will increase global supplies of these products. (Although the European Commission has responded by introducing aid to cover the cost of storing some surplus goods, giving producers the option of selling product at a later date.)

So once again, the risks to our payout forecast for the current season (which currently sits at \$5.80) are clearly skewed to the downside. For its part, Fonterra has been reluctant to downgrade its own payout forecast. Last week it opted to retain the \$6 KgMs forecast it made in late July. In doing so, it acknowledged that it continues to expect commodity prices to improve in late 2014/early 2015, but there "remains further downside risks" and continued to encourage farmers to exercise caution with their budgeting. Westland (a smaller NZ dairy company) went further, announcing it expects to pay its farmers \$5.40-\$5.80 KgMs (before retentions). Fonterra will have another opportunity to update the market on its view at the end of this month, when it announces its financial results and the final payout for the 2013/14 season. Given recent price action, a downgrade to Fonterra's forecast would come as no surprise.

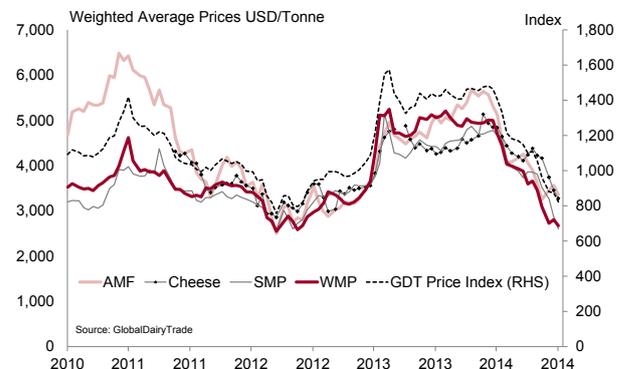
## Global Dairy Trade Auction Results, 3 September

	Change since last auction	Price USD/Tonne
Anhydrous Milk Fat (AMF)	-5.8%	\$3,360
Butter Milk Power (BMP)	-12.9%	\$3,174
Butter	-5.6%	\$2,753
Skim Milk Powder (SMP)	-9.5%	\$2,600
Whole Milk Powder (WMP)	-4.3%	\$2,673
Cheddar	-4.9%	\$3,275
GDT Price Index	-6.0%	

## Payout Forecast Table

	2013/14		2014/15		2015/16
	Fonterra	Westpac	Fonterra	Westpac	Westpac
Milk Price	\$8.40	\$8.40	\$6.00	\$5.80	\$6.60

## GDT auction prices



But while dairy prices remain in the doldrums, not all commodity producers are finding themselves in the same boat. Lamb prices are holding up well, horticulture prices for many growers are favourable, and seafood prices are up 7% on a year ago. But the real star performer has been beef. Back in January we warned that beef prices would be one to watch this year, and that has certainly proven to be the case.

Tight supplies continue to be the key factor driving prices higher. In the United States (New Zealand's key export market) cattle inventories as at the 1st of July were at their lowest level since this particular survey began in 1973.



And despite improving pasture conditions, favourable feed costs and high prices on offer, US producers have been slow to increase breeding cow inventories. While we still expect US producers to eventually respond to the incentives on offer, this process will take time. The US Department of Agriculture points out that if heifer retention doesn't occur until next summer, it won't be until 2017 that calves will be marketed as fed cattle (adding to beef supplies) and a significant expansion in breeding cattle will take even longer.

In the meantime, the US is importing more beef from Australia, NZ and Canada. Supply out of Australia has been particularly strong on the back of increased slaughter. Poor pasture conditions have seen cattle and calf slaughter jump to its highest level since 1978-79 and this in turn has boosted beef and veal production. ABARES estimates that beef and veal production is up 10% in 2013/14. But such trends can't last indefinitely, and 2014/15 slaughter numbers are expected to decline by 6%. In contrast, Beef and Lamb NZ estimates that NZ beef cattle numbers increased in 2013-14 for the first time since 2006-07. And with high prices on offer and conditions for calving generally favourable we could see a modest increase in beef exports in the coming year.

Of course supply conditions are only half the story. For international prices to remain at such favourable levels, demand also needs to remain robust. In the US, prices for traditional beef substitutes such as pork are also rising (pork producers have been hit by a virus which has killed large numbers of piglets) and general consumer sentiment has continued to improve thanks to a recovering labour market. Demand from less traditional, but increasingly important, markets such as China also appears to be holding up as domestic supplies struggle to keep pace with growing demand.

**Anne Boniface**  
Senior Economist

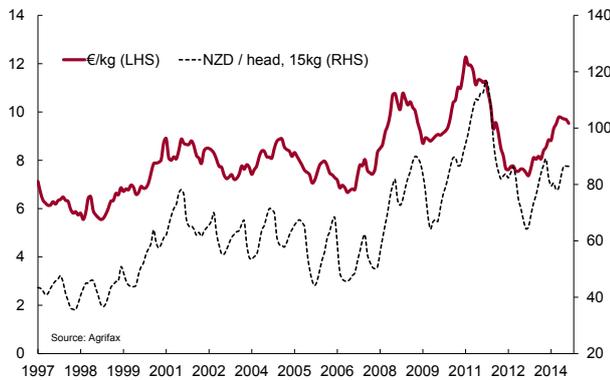


## Lamb

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.

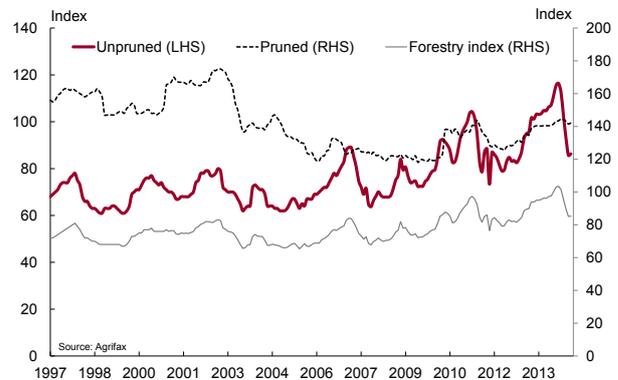
Improved lamb prices this year are likely to continue to encourage ongoing productivity gains in the sector. Demand for NZ exports in traditional markets such as the UK appears to have remained relatively buoyant, despite a strong lift in domestic slaughter there. Coupled with solid demand from emerging markets, this has supported prices. With Australian production expected to moderate next season, the outlook for prices going forward remains favourable.



## Forestry

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

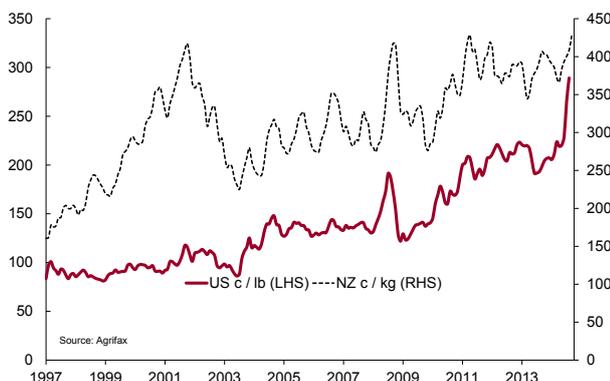
Like dairy prices, log prices have been a bellwether of Chinese demand. Unpruned log prices fell 26% on the Agrifax measure between March and July. However, prices stabilised in August, edging almost 1% higher. This is consistent with anecdotal reports that the large inventories that built up in the first half of the year are now starting to stabilise. While a sustained recovery in prices will likely require an improvement in the Chinese housing market (which is yet to occur), we could well see prices hold near current levels in the next few months.



## Beef

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

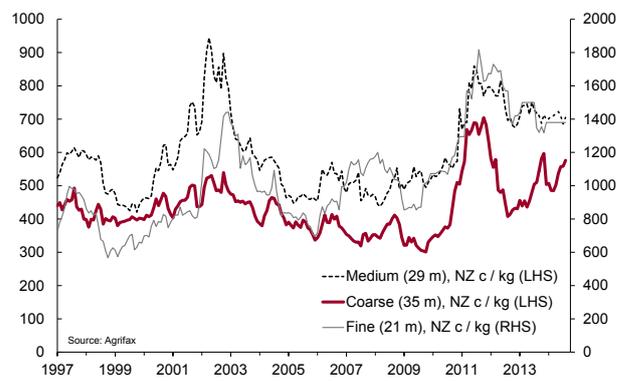
Beef prices have remained elevated as tight US supplies continue to dominate markets. USDA data shows that on July 1st this year, cattle inventories were at their lowest level since this particular survey began in 1973. While numbers are expected to grind higher on the back of record prices, improved 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 climatic 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.



## Wool

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

Coarse wool prices have improved a little over the last month. Locally, supplies are reported to be tight. The improvement in coarse wool prices has seen the premium between fine and coarse wool prices decline, but it is not yet back to the late 2013 lows. The theme of tight supply also continues globally. 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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