

# Fortnightly Agri Update

5 March 2014

## Cherry on top

The current dairy season is shaping up as a record breaker on a couple of fronts. Firstly, there's the payout. With last week's upgrade by Fonterra, the forecast milk price payout for the 2013/14 season is now \$8.65. That's a whopping 48% above last season's level of \$5.84. This is easily a record in current dollar terms (with the 2011 farmgate milk price a distant second at \$7.60). New Zealand's other dairy companies are also capitalising on high international dairy prices. Westland has also been revising up its payout forecast. It's most recent forecast in December was \$7.90-8.30 (including retentions) and Synlait expects to pay its farmers \$8.30-\$8.40 KgMs.

Last season, Fonterra collected 1,463 million Kg of milk solids. Consequently, the jump in milk price means an extra \$4.1 billion in revenue for Fonterra farmers (assuming no growth in production).

But it doesn't end there. The real cherry on the top this season is the bounce in production. Here too, the 2013/14 season looks set to go down in the record books. At times in the past, high dairy prices have been driven by tight supplies locally. But that's certainly not the case this season. Dairy NZ reports that nationwide milk flows are running 6% ahead of last year (for the season to the end of February). And we think production could finish the season close up 10% to set a new high.

However, conditions have become much more challenging in some parts of the country as pastures have dried out. Waikato, parts of Northland, Wairarapa, Wanganui-Rangitikei and Marlborough are amongst the worst affected regions. In the Waikato milk production is up just 4% for the season to date according to Dairy NZ figures. That's well below the Bay of Plenty which is 9% ahead. Improved cash flow will help farmers in these parts of the country mitigate the impact of the dry conditions (e.g. by purchasing supplementary feed) to eke out as much milk as possible in the remaining few months of the current season.

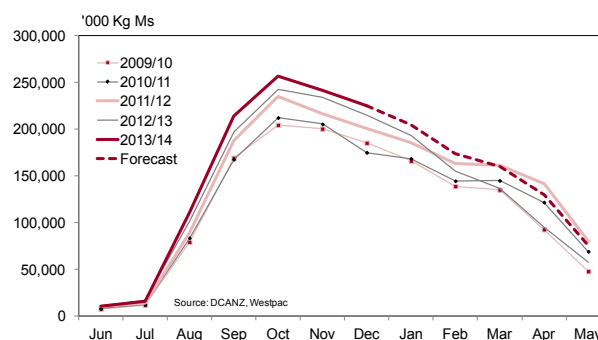
Overall high prices plus a bounce in production means \$5.4bn extra revenue for Fonterra farmers (and close to a \$6bn boost if incomes for non-Fonterra farmers are taken into account). That's equivalent to around 2.4% of GDP. So where will all this extra revenue end up? We think it will be a combination of saving/paying down debt, investment and spending on farm, with at least a portion flowing through to spending on consumer goods.

But while 2013/14 season will go down in the record books, we don't think such a sweet spot can persist indefinitely. We expect to see international dairy prices soften this year under the weight of increasing global supply. Indeed, we saw the biggest fall since mid-2013 in last night's GlobalDairyTrade auction. Prices fell 4% on a trade weighted basis, with lower prices for a range of products on offer including WMP (down 5.7%), SMP (down 3.9%) and AMF (down 3.5%).

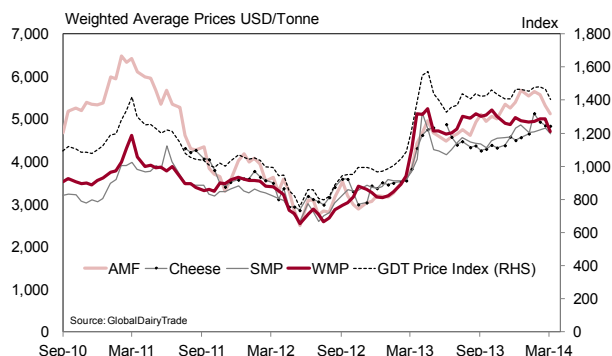
We are cautious about reading too much into a single GDT auction outcome (as these can be volatile from fortnight to fortnight). Indeed, the increased volume of WMP and SMP on offer in last night's auction may have been one factor weighing on prices.

However, we will be watching closely to see if last night's move signals the start of a move lower in prices.

## NZ Milk Production



## GDT auction prices



## GlobalDairyTrade Auction Results, 5 March

	Change since last auction	Price USD/Tonne
Anhydrous Milk Fat (AMF)	-3.5%	\$5,126
Butter Milk Power (BMP)	3.9%	\$4,746
Butter	3.9%	\$4,746
Skim Milk Powder (SMP)	-3.9%	\$4,658
Whole Milk Powder (WMP)	-5.7%	\$4,703
Cheddar	0.70%	\$4,837
GDT Price Index	-4.0%	

## Payout Forecast Table

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

Anne Boniface, Senior Economist.

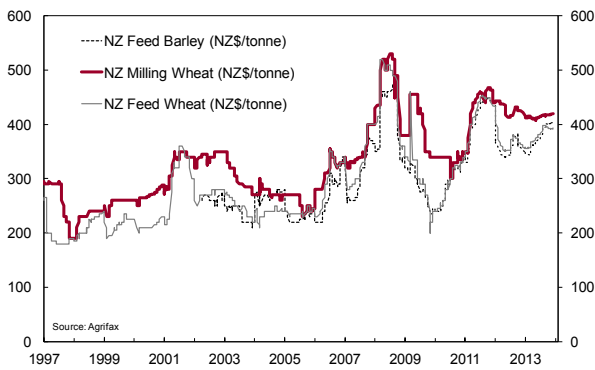


## Grains

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

International grain prices have been among those commodities affected by tensions between Russia and Ukraine. Ukraine is expected to be the third-biggest corn exporter and the sixth biggest wheat shipper this season, and prices surged on fears that this supply would be disrupted by Russian troops moving into the Crimea region. Closer to home, ABARE's latest estimates are for Australian wheat production for the 2014/15 season to be 24.8m tonnes, down from 27m tonnes last season which should help support prices there.

NZ Feed grain prices rose over the course of 2013 and have broadly consolidated at these levels at the start of this year. Looking ahead, local prices may be supported by tight supplies, with the ongoing conversion of arable land into dairying (particularly in Canterbury) coinciding with high demand for feed grain in the region. Agrifax reports strong demand for maize grain in the North Island as dry conditions for dairy farmers and the high payout on offer underpin demand for supplementary feed.

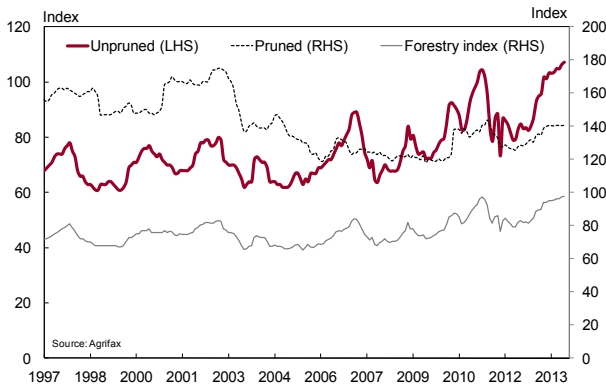


## Forestry

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

Log prices continued to trek higher in February as demand from China remained strong and inventories at ports there remained tight. NZ is now the biggest softwood exporter to China, and limited supply from alternative sources is supporting demand for NZ product.

In January, the Ministry of Primary Industries upgraded their forecasts of forestry exports. Export revenues from the industry are now expected to be around 20% higher in both 2013/14 and 2014/15 than they thought 6 months ago. NZ log producers are responding to very high prices on offer by increasing their harvest rates.

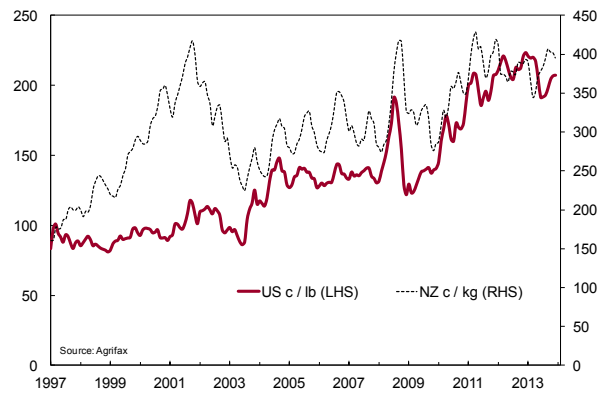


## Beef

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

US domestic beef supplies remain very tight, with cattle numbers starting 2014 1% lower than levels a year ago, which is flowing through to reduced slaughter numbers. This was the 16th year of decline in beef cow inventories since 1996, which will continue to weigh on US beef production over the next couple of years as producers gradually rebuild herds.

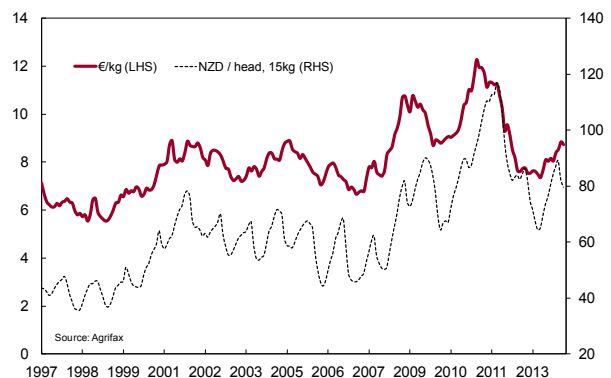
In contrast to tight US supplies, Australian beef exports were very strong in January, as drought conditions persist across much of Queensland. Australian producers are also optimistic about increased trade with South Korea on the back of an FTA due to be signed shortly by the two countries. While this is not great news for New Zealand producers, it could potentially provide opportunities in other regions if an increased proportion of Australian beef exports are diverted to Korea.



## Lamb

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

International lamb prices have continued to edge higher in recent months. Domestically tight supplies, a remnant of last summer's drought and good pasture conditions encouraging farmers to add more weight to stock, should underpin prices during the seasonal decline over the next few months. While the Eurozone remains unambiguously weak, the UK economy has shown some positive signs in recent months, which may support consumer demand for lamb. Tight supplies in NZ and Australia should also help underpin prices. Locally many farmers are looking to take advantage of good pasture growth to improve finishing weights.



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

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