



Fortnightly Agri Update

5 November 2014

Buffet or buffer

Many years ago we looked at the issue of whether a free-floating New Zealand dollar has been a help or a hindrance to commodity producers.¹ We found that the floating exchange rate had substantially reduced the volatility of prices for New Zealand's commodity exports as a whole. However, that won't always hold true for every commodity, nor could we reasonably expect it to – commodity prices can fall out of sync with each other for their own reasons, and these relative price shifts will occur regardless of what happens to the exchange rate.

The latest ANZ commodity price index, released yesterday, shows that our findings still hold today. World prices for New Zealand's main commodity exports fell by 0.8% in October, and are now almost 14% below the record high reached in February this year. Pelt prices fell sharply, lamb and wool prices edged down, and beef prices eased back from the peaks reached during the US summer. Log prices appear to have bottomed out, and dairy products were reported as being steady (surprisingly, given the sharp fall in auction prices in early October).

However, with the New Zealand dollar in decline, commodity prices in local currency terms actually rose for a second straight month, up 2.4%. And looking back a bit further in time reveals the buffering role that the exchange rate has played on both the upside and the downside: the peak in commodity prices earlier this year was less extreme in NZD terms than in world price terms, and the subsequent fall hasn't been quite as large.

The commodity price index also highlights the significance of relative movements in commodity prices. Dairy products are New Zealand's biggest export item by quite some margin, but they're not the only game in town. So while world dairy prices are at their lowest in around two years, meat prices have risen significantly in that time – and a lower New Zealand dollar simply adds fuel to the fire. Put together, the NZD price index has effectively 'troughed' at its average level over the last five years – if the low reached in August does indeed prove to be the trough in this cycle.

Last night's GlobalDairyTrade auction didn't give a sense one way or another as to whether the low has been reached. Prices for whole milk powder, New Zealand's major export product, rose for the second straight auction. However, there was a further drop in prices for skim milk powder and especially for value-added products such as cheese, suggesting that Russia's ban on imports from many Western countries is still weighing heavily on the global market. Our forecast of a \$4.80/kg milk price from Fonterra this season does allow for some softness in world dairy prices over the near term, but a substantial recovery in prices next year remains crucial.

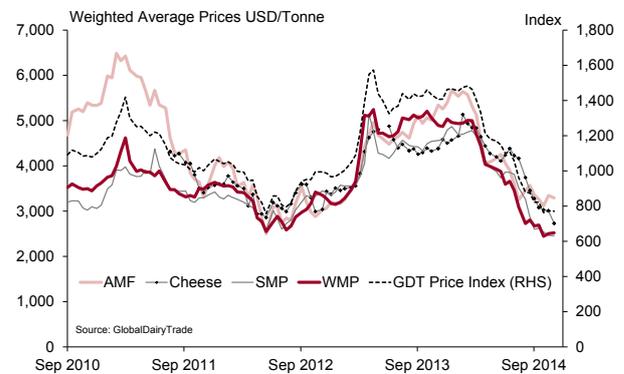
GlobalDairyTrade Auction Results, 5 November

	Change since last auction	Price USD/Tonne
Anhydrous Milk Fat (AMF)	-1.6%	\$3,292
Butter Milk Power (BMP)	-6.9%	\$2,426
Butter	-4.1%	\$2,505
Skim Milk Powder (SMP)	-1.2%	\$2,457
Whole Milk Powder (WMP)	1.6%	\$2,522
Cheddar	-9.2%	\$2,728
GDT Price Index	-0.3%	

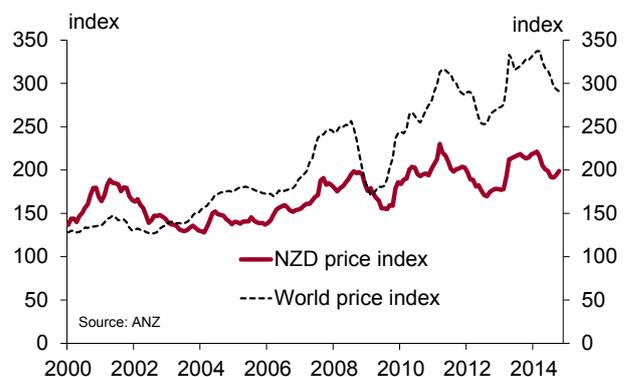
Payout Forecast Table

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

GDT auction prices



ANZ Commodity Price Index



¹ See "Buffet or buffer?", available at www.westpac.co.nz/assets/Business/Economic-Updates/2012/Bulletins-2012/Buffer-or-buffer.pdf

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Senior Economist

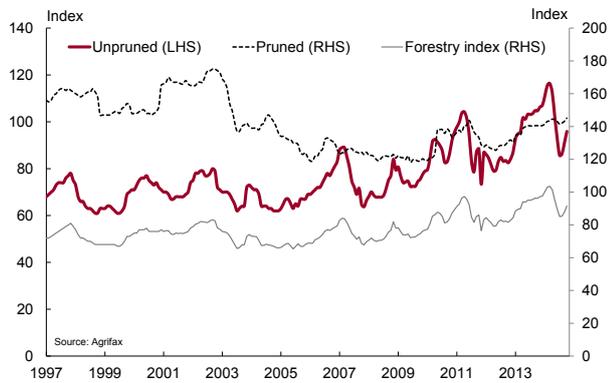
Beyond the farm gate



Forestry

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

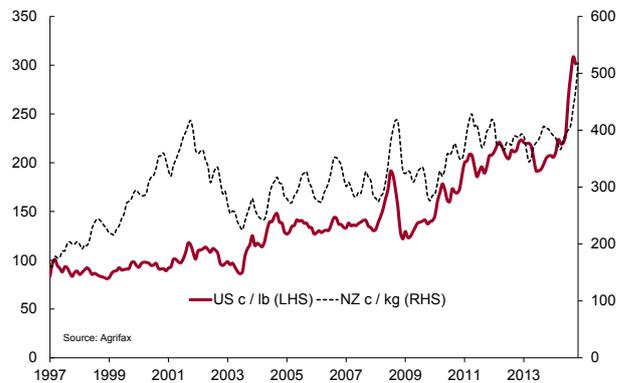
World prices for logs have stabilised in the last few months, and with a weaker New Zealand dollar in that time, local currency prices have rebounded by 7.5% according to the Agrifax forestry price index. We suspect that prices have stabilised because harvesting has pulled back to match demand – in contrast to dairy, where global milk production has continued to rise this year even as demand has slowed. The Chinese housing market is still in a slowdown phase, although policymakers have recently taken steps to revitalise demand by lowering mortgage rates and loosening mortgage restrictions. Solid growth in housing construction in both New Zealand and Australia should continue to support domestic demand for forestry products.



Beef

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

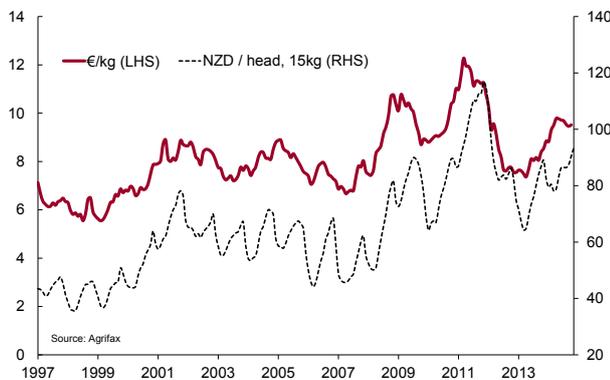
US beef prices have receded from their highs in the last few weeks. US supplies became extremely tight over the peak summer demand period, but imports (particularly from Australia) have helped to fill the gap. The US autumn cow slaughter is now getting under way, although record-low cattle inventories at the start of the season (going back to the start of the USDA's survey in 1973) should limit the extent to which prices fall.



Lamb

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

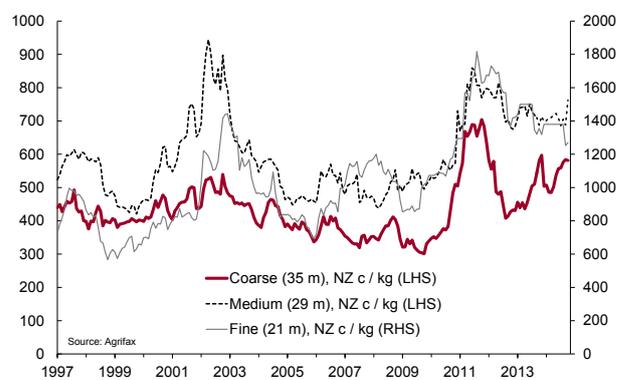
Global lamb production is adequate to meet demand at the moment. UK slaughter numbers and weights have improved on last year, and Australian lamb production is also running substantially above year-ago levels, although this may detract from supplies later in the year. Slower growth in China, and weaker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



Wool

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

The ongoing lift in coarse wool prices has been joined by a jump in medium wool prices in recent weeks. Locally and internationally, supplies remain tight with New Zealand supplies at auction running behind last year's levels.



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

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