



# Fortnightly Agri Update

6 August 2014

## Still searching for a floor

Dairy prices tumbled further in last night's GDT auction. The headline trade weighted index was down 8.4%. Whole milk powder (WMP) prices were even weaker, dropping 11.5%.

This outturn signals a continuation of weakness in dairy prices we've seen of late. Since February, prices have now fallen 40%, with a 20% fall over the last three auctions alone. Last night's result was certainly weaker than we had anticipated. While we had allowed for another 4% drop in prices in our payout calculations, the size of last night's drop clearly exceeded this.

As best we can tell, there were also few clear signs of an imminent turnaround in sentiment in last night's auction. For WMP, buyers were only willing to pay fractionally more to secure product at later delivery dates. It's also difficult to justify the move because of changes in volumes on offer. While volumes of key products, SMP, WMP and AMF were well up on the previous event, such a lift was well signalled, and compared to the same time last year, volumes were well down.

As we have noted in previous *Fortnightly Agri Updates*, you can't just pin the most recent bout of weaker prices over the last month or two on the outlook for global supply. Demand has become an increasingly important driver. Chinese demand (or lack of) in particular has been a key reason for the fall in prices. Strong buying earlier in the year, combined with softer end demand by Chinese consumers, left Chinese wholesalers over stocked, meaning they haven't needed to enter the market.

Over time, this imbalance will work its way through the system. Stocks will be run down and we anticipate a recovery in the Chinese consumer sector on the back of an improved outlook for the economy and housing market. As this happens wholesalers will be forced to re-enter the market to fill their requirements, and we expect prices to rise. However just how long this process takes remains a key uncertainty in the outlook. Our forecasts incorporate a strong rebound in prices in late 2014.

While it is clear that farmers hoping for a recovery (or at least stabilisation) in prices will have been disappointed by this latest outturn, they will be heartened to see currency markets finally starting to sit up and take notice of slumping dairy prices. The immediate reaction to last night's auction saw the NZD/AUD fall around 0.2 cents. Over a longer horizon the NZD has fallen from above 88c against the USD, earlier in July to well below 85 cents at the time of writing. We think the NZD could fall further yet. Our forecasts have the NZD/USD averaging 83 cents over the remainder of the year

## Implications for the payout

This fall in auction prices creates a clear risk that the 2014/15 milk price payout will be below our current forecast, which sits at \$6. We'd prefer to see another auction before formally cementing in a new forecast. There is still a lot of water to go under the bridge before the end of the 2014/15 season and as we've seen, commodity prices can be volatile in both directions. But the downside risks to this forecast are clear. The further dairy prices fall, the more difficult it is for prices to stage a rebound of the magnitude we have factored into our forecasts, particularly in the absence of usual catalysts such as drought, rocketing grain prices or some other disruption to the outlook for supply.

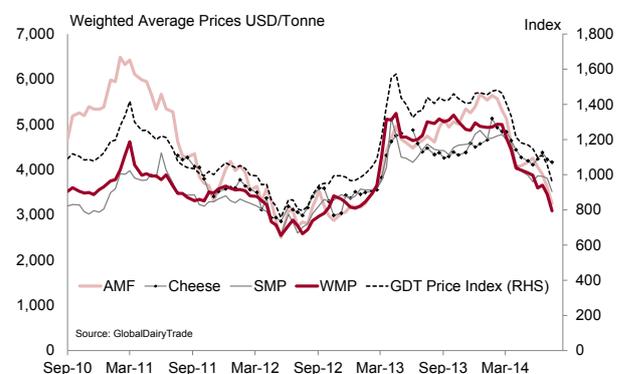
### GlobalDairyTrade Auction Results, 6 August

	Change since last auction	Price USD/Tonne
Anhydrous Milk Fat (AMF)	6.0%	\$3,457
Butter Milk Power (BMP)	-10.1%	\$3,852
Butter	-9.6%	\$2,800
Skim Milk Powder (SMP)	-6.5%	\$3,264
Whole Milk Powder (WMP)	-11.5%	\$2,725
Cheddar	-10.2%	\$3,742
GDT Price Index	-8.4%	

### Payout Forecast Table

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

### GDT auction prices



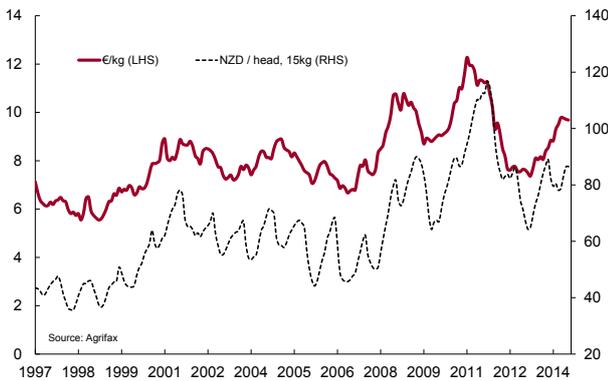
**Anne Boniface**  
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## Lamb

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

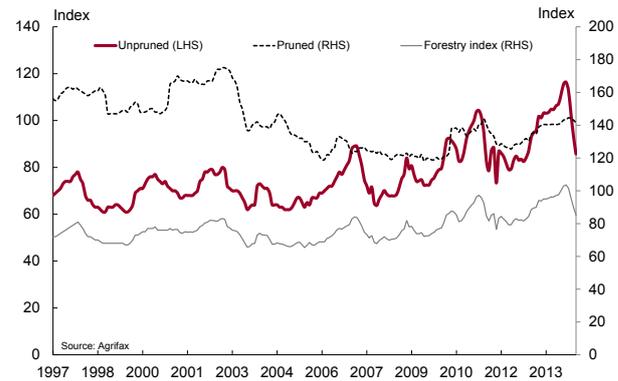
Lamb prices have been broadly stable over the last couple of months. Demand for NZ exports in traditional markets such as the UK appears to have remained relatively buoyant, despite a strong lift in domestic slaughter there. Coupled with solid demand from emerging markets, this has supported prices. 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	Above Average	↘

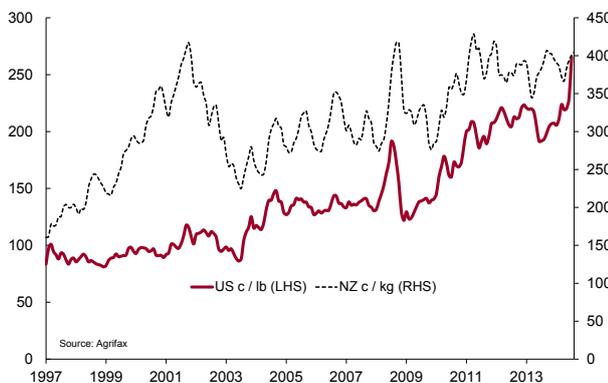
Like dairy prices, log prices have been a bellwether of Chinese demand. Unpruned log prices fell another 8% on the Agrifax measure in July, and are now down 26% from their March highs. The slowing housing market in China has weighed on demand, leaving middlemen caught with unexpectedly large inventories. There have been anecdotal reports that these inventories are now starting to stabilise. If this trend continues it should provide some support to prices going forward though a significant recovery in the prices is likely to rely on an improved Chinese housing market.



## Beef

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

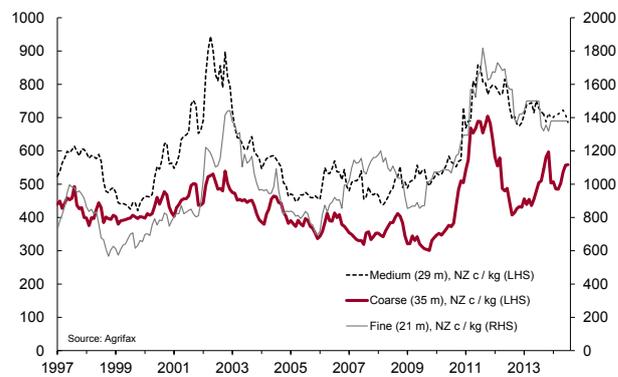
Beef prices have headed even higher in the last few weeks, as tight US supplies continue to dominate markets. USDA data shows that on July 1st this year, cattle inventories were at their lowest level since this particular survey began in 1973. While production is expected to grind higher on the back of record prices, improved pasture conditions and lower feed costs, this will take time. In the meantime, producers in Australia and New Zealand remain well placed to fill the gaps.



## Wool

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

Coarse wool prices remained broadly unchanged 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 globally continues. 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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