

## Fortnightly Agri Update

16 December 2015

## The sideways shuffle

Sheep and beef farmers haven't experienced the same degree of discomfort as their dairying counterparts over the last year. Rabobank's December rural confidence survey showed dairy farmers firmly in pessimistic territory while confidence amongst sheep and beef farmers for their own business actually improved a touch in the quarter. That's at least partly because beef and lamb prices have held up better than dairy prices. While dairy prices are over 20% below a 5 year average, lamb prices 8% below and beef prices 20% higher.

However, while the sheep and beef sector might not be as far into the doldrums as the dairy sector, the mood has softened of late as key prices have eased. In this *Fortnightly Agri Update* we delve into lamb markets, discuss recent trends and think about what the future might hold.

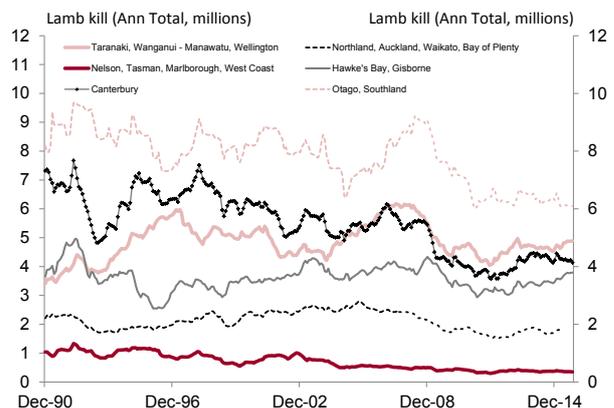
## Supply side

New Zealand sheep farmers are already responding to the well-publicised El Nino weather event which is predicted to lead to particularly dry conditions in the North and East of the country. Farmers have been fattening lambs as quickly as possible and selling stock early. There has also reportedly been weak demand for store lambs – particularly in the South Island where conditions have already dried out noticeably.

But while the timing of lamb slaughter might be earlier this season than usual (an early Easter this year also likely to be a factor) the total lamb crop is expected to be the smallest in almost 60 years according to NZ Beef and Lamb estimates. There are a number of factors driving the decline: fewer breeding ewes (partly due to very dry conditions in some regions last summer) and lower lambing percentages. This in turn is likely to translate to an 8% fall in export lamb slaughter according to Beef and Lamb NZ. While drought conditions aren't expected to persist indefinitely, if they do last well into autumn it could leave stock in poorer condition at mating, and put downward pressure on lambing percentages next season. Conversely, a quick improvement in pasture conditions could see ewes in better breeding condition but some farmers choosing to rebuild flocks, again putting downward pressure on supply.

Of course NZ isn't the only country exporting lamb. Australia also satisfies a big chunk of the world's appetite for lamb meat. There, predictions are for more favourable pasture conditions in the back half of 2015/16 season as El Nino conditions abate, encouraging flock rebuilding. Already there has already been some flock rebuilding going on in New South Wales where conditions have shown a noticeable improvement earlier in the year (and where lamb slaughter is down 9% with an even bigger decline in sheep slaughter numbers). The Australian Department of Agriculture and Water Resources is forecasting the sheep flock to increase by just over 1% to 71.2 million head in the year to June 2016 (this compares to NZ sheep numbers of 28.6m in June 2016). Flowing on from this, lamb exports are expected to fall by 3% in 2015/16.

## Lamb Kill by Region



So in a nutshell, supply conditions in both New Zealand and Australia expected to tighten in 2016, and we expect this to keep a floor under lamb prices. However, supply is only part of the equation. Equally important is the outlook for demand.

## Demand

Unfortunately for farmers, this half of the story is not quite so supportive for prices. The primary destinations for NZ lamb exports remain the UK and China. Together, these two markets account for around 38% of lamb exports (20% and 17.5% respectively). However, the characteristics of the two markets are quite different. The UK tends to import higher value cuts (including chilled product), while China's demand is concentrated in cheaper cuts of lamb.

In China, consumer demand is likely to remain subdued. The Chinese economy has slowed sharply this year, and is expected to slow further in 2016 (from an estimated 7% this year to 6.6% next year). And while the household sector hasn't been the primary catalyst for the deteriorating outlook, Chinese households are not immune from the effects of slower growth in other sectors of the economy.

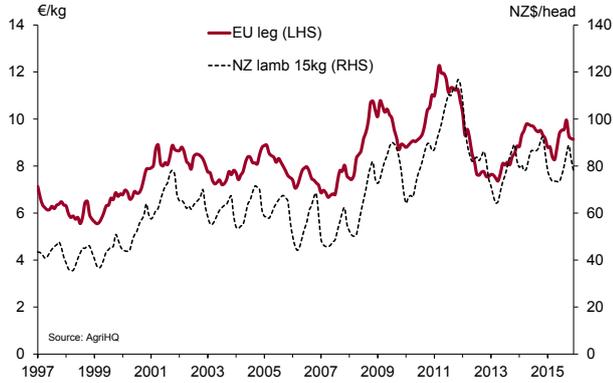
In contrast the outlook for the UK economy is more positive with domestic demand expected to remain firm over the year ahead. However in this market NZ exporters are facing stiff (and vocal) competition from local product. The strength of the Pound against the Euro has dented UK lamb exports to their traditional European markets, leading to local lobby groups to call on British supermarkets to stock British lamb suppliers ahead of imported NZ product. Most recently Tesco has been the target, accused of taking up too much valuable chiller space with NZ lamb. Such lobbying is not a new phenomenon (and of course British consumers would ultimately bear the brunt of any changes), but it does underscore the challenges NZ exporters are likely to face in this market over the coming year.



## On balance

So on balance, tight global supplies combined with muted growth in demand are expected to see lamb prices broadly track sideways in 2016 (abstracting from usual seasonal patterns). While that may not be great news for farmers, it means that the grass is likely to continue to look greener than on the dairying side of the fence.

### Lamb Kill by Region



### Anne Boniface

Senior Economist

### GlobalDairyTrade Auction Results, 16 December

	Change since last auction	Price index USD/Tonne
Anhydrous Milk Fat (AMF)	6.1%	\$3,721
Butter Milk Power (BMP)	-6.1%	\$1,564
Butter	9.0%	\$3,136
Skim Milk Powder (SMP)	0.2%	\$1,891
Whole Milk Powder (WMP)	1.8%	\$2,304
Cheddar	1.1%	\$2,856
GDT Price Index	1.9%	

### Payout Forecast Table

	2015/16		2016/17
	Fonterra	Westpac	Westpac
Milk Price	\$4.60	\$4.50	\$5.20

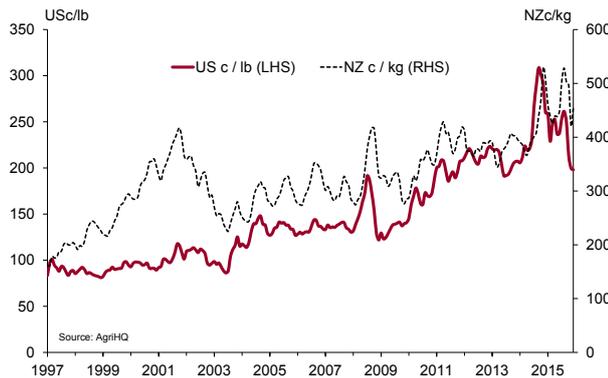
# Beyond the farm gate



## Beef

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

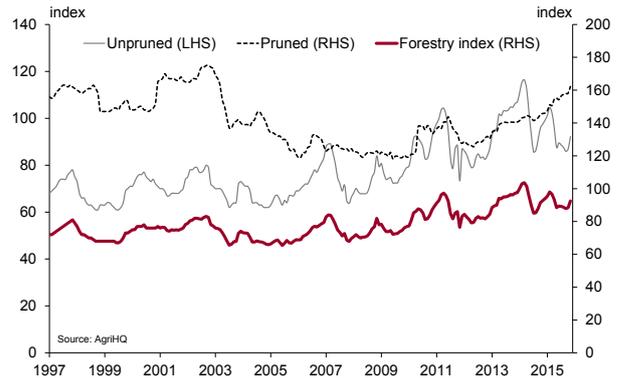
Australia is a key competitor for New Zealand beef exporters. This year, Australian beef export volumes have set new records as Australian producers responded to poor pasture conditions and high prices (cattle slaughter reached a 36 year high in 2014/15). However, going forward Australian cattle slaughter and beef production are expected to decline as pasture conditions improve and herds are rebuilt which should help underpin international beef prices.



## Forestry

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

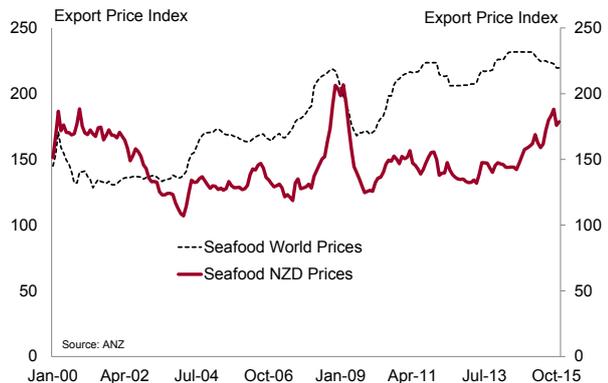
Log prices have improved noticeably in recent months, apparently as supplies in China have tightened. But with suppliers likely to respond to improved prices by lifting supply, and the soft Chinese economy (and weaker renminbi) likely to be a headwind to a sustained lift in demand for NZ logs for a while yet, we are sceptical that the recent spike in prices will be maintained.



## Seafood

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

The Ministry for Primary Industries released their half year update of their Situation and Outlook for Primary Industries forecasts this week. While seafood export volumes are expected to decline on the back of reduced catch limits for some species, they continue to expect solid growth in aquaculture production (and in particular mussels) over the next year. However, muted growth in demand in key export regions could weigh on prices for a time yet.

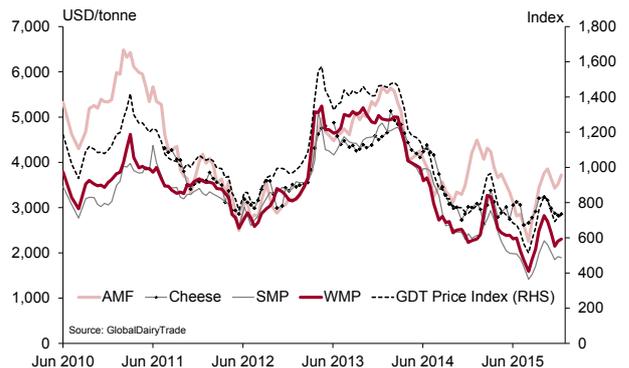


## Dairy

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

Last week Fonterra affirmed its \$4.60 farm gate milk price payout forecast for the current season. However, to achieve this, they will need to see a substantial lift in prices in the first half of 2016. On that regard, it's likely that they, like farmers, would have been disappointed by the modest lift in prices at last night's auction. Overall prices were up 1.9% including a 1.8% increase in whole milk powder (WMP) prices. However, the tone of the result was probably weaker than most had anticipated. The futures markets had been touting a 9% plus increase in WMP prices and leading up to the event Fonterra had once again revised down its forecast of product offered.

However, for now buyers don't seem to be too concerned about the expected contraction in NZ milk supply (which Fonterra now estimates will be 6% this season) and global milk supply appears to be more than enough to meet demand. Fonterra reports its milk collections were 3.5% lower in November than the same month last year, and 4.4% behind for the season to date. These comparisons could get even worse as the El Nino weather pattern leads to further deterioration in pasture conditions over summer.



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

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