



Fortnightly Agri Update

16 September 2015

Limits to growth

Beef exports have been one of our most consistently strong performers in recent years, with a steady uptrend in both prices and volumes. However, we see some looming constraints to this growth.

Beef is relatively unusual among our major agricultural exports in that China is not the dominant market (though it has grown rapidly in the last few years). Instead, around half of our beef exports go into the US, where the economy's slow but steady recovery has lifted demand for beef. Meanwhile, successive years of drought have led to a decline in US beef cattle numbers, leading to an increased reliance on imports.

New Zealand and Australia have benefited substantially from the US supply shortfall in recent years. New Zealand's lean beef is particularly desirable, as it can be ground together with US beef to achieve a certain overall fat content.

Unfortunately, the US beef trade is still subject to protectionism. New Zealand's export quota is limited to 213,402 tonnes per calendar year; a minimal tariff is applied to exports within that quota, but any exports that exceed the quota will attract a hefty tariff of 26.4% of their value.

Due to the strong growth in volumes to date, it is almost certain that the quota will bite this year, reportedly for the first time since 2004. We calculate that, in the absence of any changes, the out-of-quota tariff will apply to all beef exports that arrive in the US in December (and possibly earlier for some, as the quota is allocated to individual exporters).

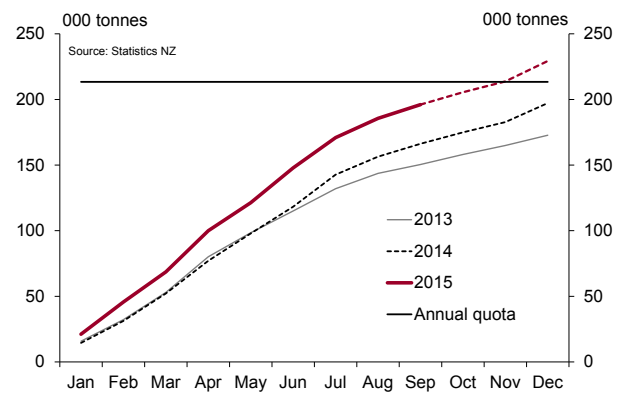
It is possible to avoid some of the tariff by diverting product to other markets over the next few months. But we're talking around 5% of New Zealand's total annual beef exports, so it's a substantial amount of product to be redirected, and would likely garner lower prices than would otherwise be available in the US.

And even once the next calendar year rolls around, the constraint to growth will remain. High beef prices and the accelerated cull of dairy cows suggest that New Zealand's beef production could be even higher next year, and exports to the US are likely to hit quota levels even sooner.

So what's the remedy? The best outcome would be trade reform. We don't know what the TPPA has in store for the beef industry, but the reduction or removal of the tariff would allow for significant growth in the volume of New Zealand's beef exports to the US. Of course, other signatories to the TPPA would receive similar treatment, so increased competition from other exporters would dampen US prices to some degree. But that in itself would also help to spur US demand for beef, relative to other types of meat.

The other option is to develop other markets. Again, the reduction of trade barriers via the TPPA would help this process along. The emerging economies on South-East Asia offer significant growth potential, as does China given its size. But each market will have different requirements; a one-size-fits-all approach to marketing and distribution won't work here.

NZ beef exports to the US



GlobalDairyTrade Auction Results, 16 September

	Change since last auction	Price index USD/Tonne
Anhydrous Milk Fat (AMF)	13.7%	\$3,440
Butter Milk Power (BMP)	-1.9%	\$1,719
Butter	13.3%	\$3,108
Skim Milk Powder (SMP)	17.0%	\$1,992
Whole Milk Powder (WMP)	20.6%	\$2,495
Cheddar	10.7%	\$3,206
GDT Price Index	16.5%	

Payout Forecast Table

	2014/15	2015/16		2016/17
	Fonterra	Fonterra	Westpac	Westpac
Milk Price	\$4.40	\$3.85	\$4.30	\$5.20

Michael Gordon
Senior Economist

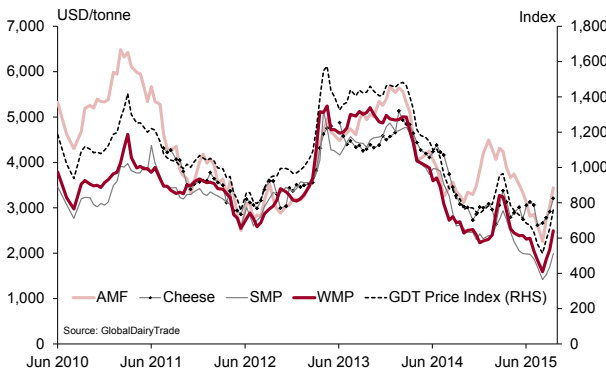
Beyond the farm gate



Dairy

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

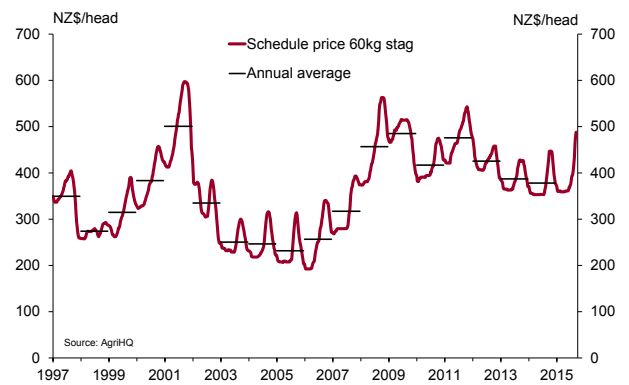
World dairy prices rose a further 16.5% in the latest GlobalDairyTrade auction, after Fonterra issued a further warning that milk production will be lower for this season. Production is likely to slow of its own accord given the low payout outlook, but the potential impact of El Nino over summer will be the biggest determinant. Overseas milk production remains up on year-ago levels.



Venison

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

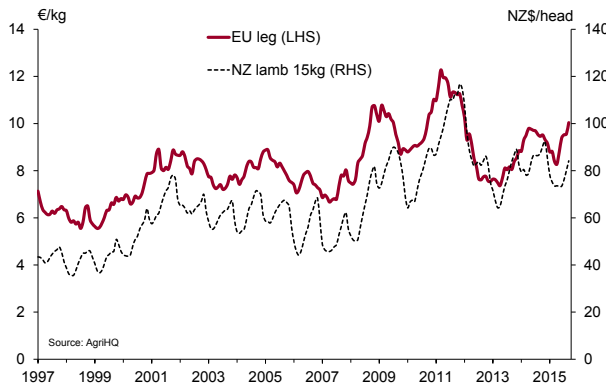
As schedule prices approach their seasonal peak, they are running around 16% higher than a year ago, suggesting a change of fortunes for the industry after several years of declining prices and flat export volumes. The US export market has grown rapidly in the last two years and is now the second-largest after Germany.



Lamb

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

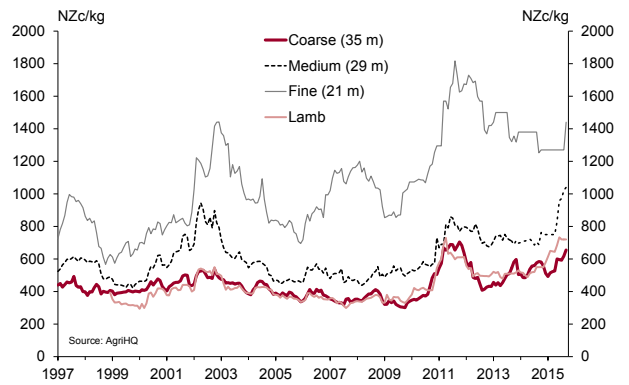
Chilled lamb prices in Europe have held up reasonably well, although global supply appears to remain ample. The weaker New Zealand dollar will help to support returns.



Wool

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

Wool prices have risen further across most grades, supported by growing demand from China. However, growing concerns about the pace of economic growth in China mean that it is unclear how long these prices will be sustained.



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

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