



Fortnightly Agri Update

18 February 2015

Dry run

Dairy prices rose another 10% in last night's GlobalDairyTrade auction, including a 13.7% rise in whole milk powder prices. Prices have now recaptured almost 30% of the fall that we saw over the course of last year. The market has clearly got the message: drought will curtail New Zealand's milk production over coming months, and by extension will have a significant impact on the volume of dairy products that are available for international trade.

As we've noted before, the previous drought in 2013 ended up being a net positive for industry-wide revenue, as the spike in world dairy prices outstripped the fall in volumes. We've been reluctant to assume anything more than a revenue-neutral impact from this year's drought, for a number of reasons – stronger growth in the global milk supply and concerns about the strength of demand in some major markets. But the last two auction results raise the risk in our minds that history could repeat after all.

To be clear, the drought in New Zealand isn't the only factor in play at the moment; there are some encouraging strands of detail coming from international markets as well. First, there are tentative signs that the growth in Northern Hemisphere milk production was flattening out by the end of 2014, a delayed response to the fall in prices. Dry conditions in Australia are also starting to put a dent in milk production.

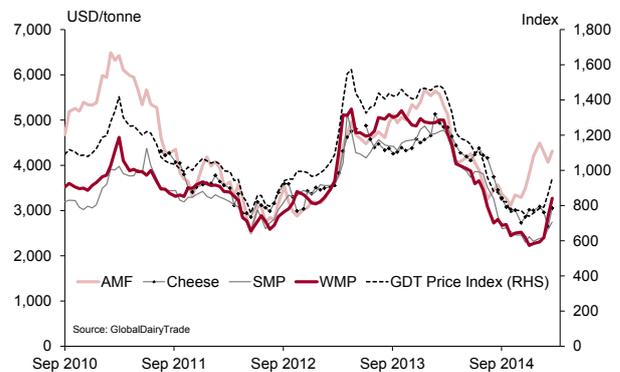
Second, there are indications that Chinese demand is normalising again. New Zealand's exports of whole milk powder to China went ballistic in late 2013 and early 2014, helping to push prices to fresh highs. That seems to have resulted in overstocking by Chinese buyers, with the result that exports to China were distinctly sub-par through most of 2014. However, the most recent trade figures (for December) showed that milk powder exports to China were back to something that could reasonably be considered 'on trend'. Admittedly it's only one month of data, but it bears watching.

Still, some of the reasons for caution on milk prices remain. The European Union is on track to remove quotas on milk production from April this year. The market has known about this for some time, so arguably it should already be factored into today's prices, but it remains to be seen how just vigorously European dairy farmers will respond after the removal.

Then there's Russia's ban on food imports from many Western countries (though not New Zealand). The one-year ban will presumably lapse in August, as originally stated. But we have to consider the risk that the ban is extended, though we can't really shed any light on the odds of this happening – the reasons for imposing the ban in the first place go beyond the realm of economics.

Consequently, we're sticking for now with our forecast of a \$5.00/kg milk price from Fonterra this season; while a case could be made for nudging it higher after last night's auction, it would only amount to fine-tuning at this stage. Note that Fonterra is expected to hold a board meeting in either late February or early March, and an update on the milk price forecast could follow. The rule of thumb is that Fonterra makes an announcement once its milk price forecast has changed by 30c or more, so any announced upgrade in the next few weeks would be to at least \$5.00/kg.

GDT auction prices



GlobalDairyTrade Auction Results, 18 February

	Change since last auction	Price USD/Tonne
Anhydrous Milk Fat (AMF)	6.4%	\$4,314
Butter Milk Power (BMP)	1.9%	\$2,674
Butter	1.1%	\$3,823
Skim Milk Powder (SMP)	5.7%	\$2,744
Whole Milk Powder (WMP)	13.7%	\$3,272
Cheddar	16.8%	\$3,054
GDT Price Index	10.1%	

Payout Forecast Table

	2013/14		2014/15		2015/16
	Fonterra	Fonterra	Westpac	Westpac	Westpac
Milk Price	\$8.40	\$4.70	\$5.00	\$6.40	

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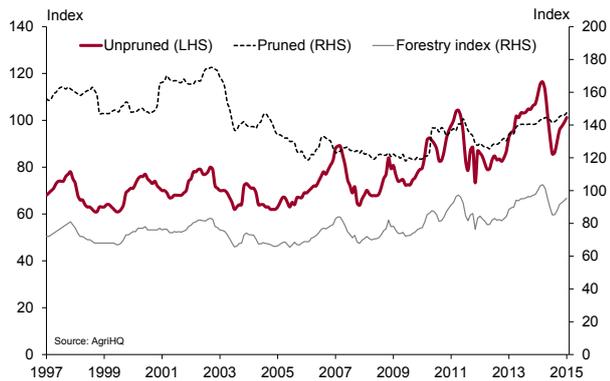
Beyond the farm gate



Forestry

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

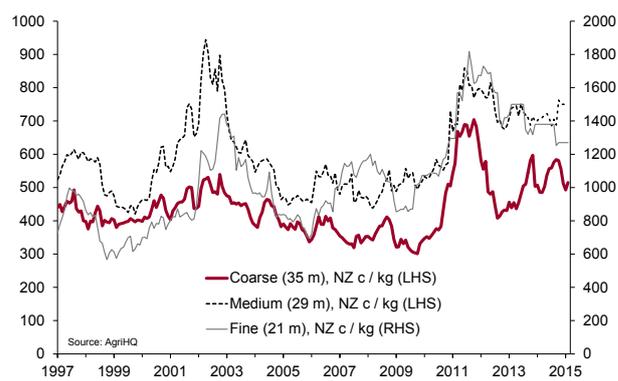
Average prices have rebounded by 12% over the last six months according to the Agrifax forestry price index. However, much of this gain has come from a lower New Zealand dollar and falling transport costs, with world prices for logs steady. There are very tentative signs that steps by Chinese policymakers to revitalise their housing market are having some impact. Housing construction in New Zealand remains on a strong upward trend, albeit from low levels in recent years.



Wool

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

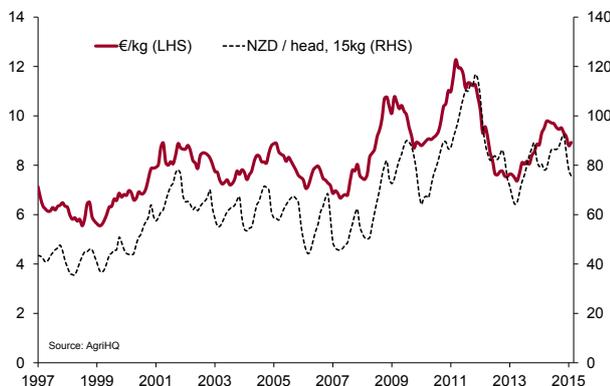
Wool prices have been mixed across grades recently, with no clear direction. Competition from oil-derived synthetic materials is likely to emerge as a challenge to wool prices over the course of this year, with the recent drop in world oil prices being one of the most dramatic in history.



Lamb

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

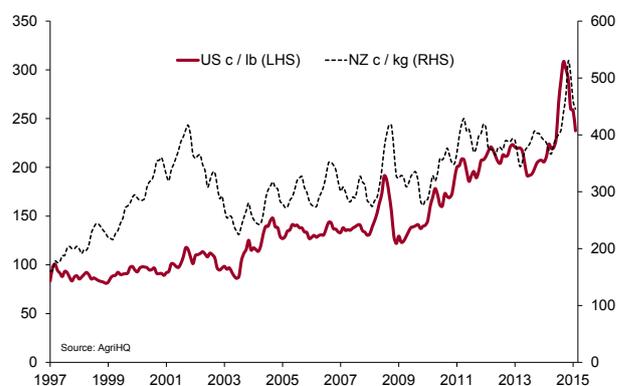
Dry conditions have led to early slaughter in many parts of the country, putting pressure on processors' capacity and pushing down schedule prices. The impact on prices from here will depend crucially on how much rain falls, and where, over the next month or two.



Beef

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

Port disputes in the US have reportedly led to a backlog of imported beef products, putting pressure on storage capacity and lowering the prices they can garner. Once these disputes are resolved, prices are likely to return to relatively high levels, with US beef supply still not in a position to gear up quickly.



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

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