

Fortnightly Agri Update

18 November 2015

Dairy debt

Dairy prices continued to fall in the most recent GlobalDairyTrade auction. Recent disappointing auction results have prompted us to lower our farmgate milk price forecast to \$4.50. This will leave many NZ dairy farmers facing a second consecutive season operating with negative cashflows. This has the RBNZ on high alert for any risks difficulties in the dairy sector pose for the wider NZ financial system.

Today's auction didn't provide much in the way of good news for NZ dairy farmers. The headline index fell 7.9% with whole milk powder (WMP) prices down 11%. This move, combined with the disappointing auction results of the previous few events have prompted us to downgrade our payout forecast for the current season to \$4.50.

This forecast is still contingent on some improvement in prices over the remainder of the season. This is something we continue to regard as likely – despite the direction of recent price moves. New Zealand dairy farmers are yet to feel the full brunt of an El Niño weather pattern but milk production (for Fonterra farmers at least) is already running 4% behind last season thanks largely to early culling of stock and reduced spending on supplementary feed. Fonterra continues to expect it will be down 5% over the full season. Reflecting this, and a change in mix of product offerings (amongst other things), Fonterra has continued to tweak its forecast of WMP offered on the GDT platform and expect to offer 5% less via this platform over the next 12 months than it was projecting a fortnight ago. While this appeared to do little to support prices in last night's auction, if El Niño does hit milk production, we suspect it will lead to a bounce in prices, albeit a temporary one.

If we're right with our payout forecast (and there remains a lot of water to go under the bridge in still volatile international markets), many farmers will be facing a second consecutive year where cashflows are below breakeven levels.

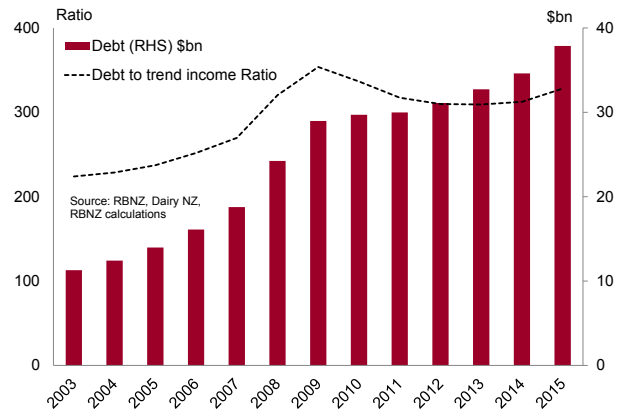
That's something the RBNZ is keeping a close eye on, and was an important topic of discussion in the November *Financial Stability Report*. One of the purposes of this half yearly document is to report on risks to the NZ financial system. And right now one of those risks is clearly dairy sector debt in the current low dairy price environment.

The RBNZ points out that the dairy sector is (unsurprisingly) becoming increasingly stretched in the current period of low international prices, with some farmers plugging cash shortfalls by borrowing more. Debt in the sector has already climbed by around 10% over the last year. The RBNZ reports that retail banks are working with customers experiencing difficulty with an eye on

the medium term outlook (when prices are expected to recover). However, there is no escaping that higher debt levels will in turn probably add to farmers' costs in future seasons. Fonterra's interest free loan offer where they are offering to support shareholders to the tune of 0.50c per Kg of share-backed milk solids produced from 1 June to 31 December 2015 will help and reduce the amount borrowed from retail banks. Still, increasing debt is a strategy that can last only so long.

Anne Boniface
Senior Economist

Bank loans to the dairy sector



GlobalDairyTrade Auction Results, 18 November

	Change since last auction	Price index USD/Tonne
Anhydrous Milk Fat (AMF)	-5.9%	\$3,430
Butter Milk Power (BMP)	-1.0%	\$1,825
Butter	5.6%	\$2,709
Skim Milk Powder (SMP)	-8.1%	\$1,851
Whole Milk Powder (WMP)	-11.0%	\$2,148
Cheddar	-5.0%	\$2,874
GDT Price Index	-7.9%	

Payout Forecast Table

	2014/15	2015/16		2016/17
	Fonterra	Fonterra	Westpac	Westpac
Milk Price	\$4.40	\$4.60	\$4.50	\$5.20

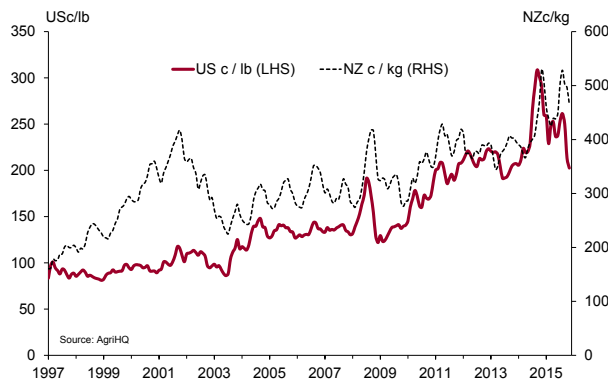
Beyond the farm gate



Beef

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

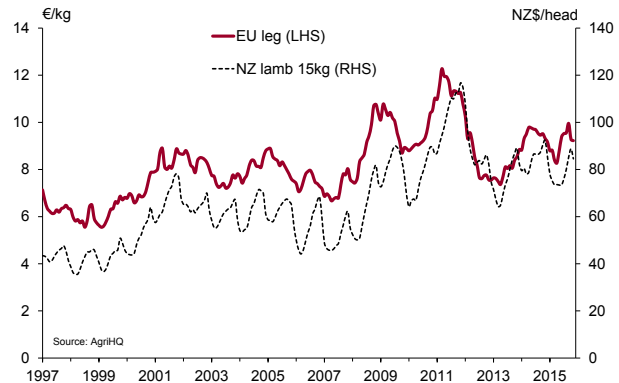
With both New Zealand and Australia rapidly approaching their tariff-free import quotas, US buyers have substantially lowered their prices for delivery over the end of this year. In addition, strong early season cow culling locally, and ample supply from Australia have weighed on imported beef prices in the US. However, Australian shipments to the US are showing signs of slowing from record levels.



Lamb

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

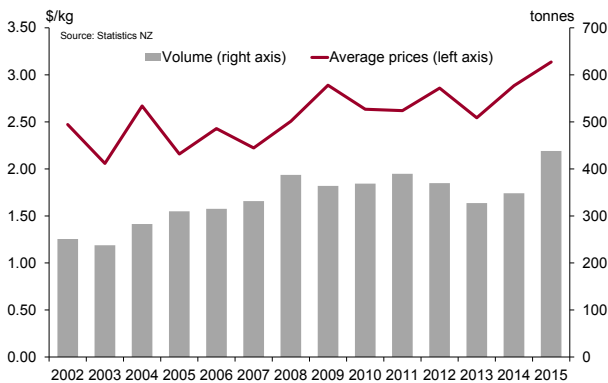
Returns in the European market have been undermined by the recent gains in the New Zealand dollar. Demand from China has picked up in recent months, although prices here are typically lower than what is available in other markets.



Kiwifruit

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

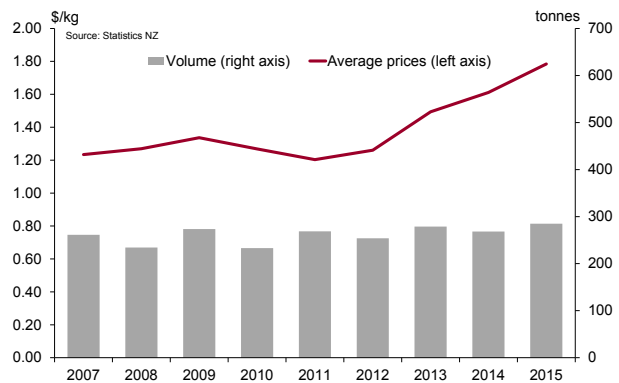
As export shipments wind down, the season has ended on a strong note, with higher average prices despite a strong lift in volumes of both green and gold varieties. The likely El Niño weather pattern this summer will present a challenge to the industry.



Apples

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

Trade figures up to September show that prices improved further in the latest season, on broadly steady volumes. El Niño presents a substantial risk for next season; the previous El Niño in 1997-98 caused substantial issues with fruit quality.



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

Westpac economics team contact details

Dominick Stephens, Chief Economist
+64 9 336 5671

Michael Gordon, Senior Economist
+64 9 336 5670

Satish Ranchhod, Senior Economist
+64 9 336 5668

Anne Boniface, Senior Economist
+64 9 336 5669

David Norman, Industry Economist
+64 9 336 5656

Any questions email:
economics@westpac.co.nz

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