



Fortnightly Agri Update

5 August 2015

New depths

Dairy prices took another pounding in last night's GlobalDairyTrade auction. The overall price index was down 9.3%, reaching its lowest level since 2002. As in the previous auction, prices for several contract periods were 'limit down' (meaning they didn't rise above their starting price, which for Fonterra is 15% below the previous auction). This implies that the downward pressure on prices is likely to spill over into the next auction as well.

As bad as this result was, it was no worse than what we were bracing for. Hence, we can now confirm a further downgrade to our forecast of the farmgate milk price this season, from \$4.30 to \$3.70 per kilo of milksolids. Our latest quarterly *Economic Overview*, which will be released next week, has been prepared with this milk price forecast in mind, and will explore the consequences for the wider economy.

Note that Fonterra will be updating its own milk price forecast following this Friday's board meeting, and a significant downgrade from its initial forecast of \$5.25/kg will be necessary. We don't have a particular view on what number they will announce this week, but we will be interested in Fonterra's perspective on the global dairy market.

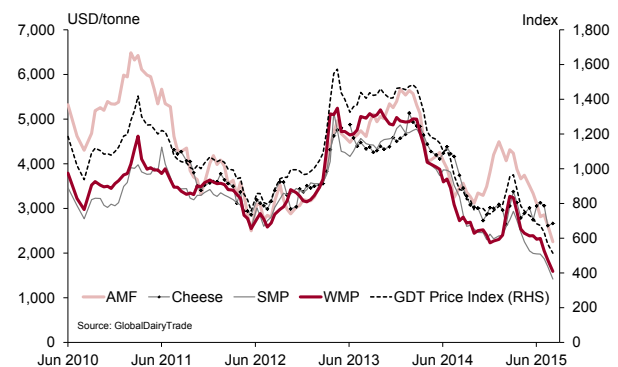
In this issue of the *Fortnightly Agri Update* we're also providing our first estimate of the farmgate milk price for the 2016/17 season. We're assuming a price of \$5.20/kg, which would be an improvement on current conditions, but still below the average of \$5.80/kg over the past ten years. Of course, there's still a huge degree of uncertainty around how dairy prices perform over the current season, and that goes doubly so for next season.

So what's the case for expecting an improvement in prices next season? Once again, we return to our checklist of the four factors needed to rebalance the international dairy market: a moderation in milk production, a stabilisation in Chinese demand, a reduction in China's stockpiles, and an end to Russia's trade ban.

All four of these factors are still weighing on prices at the moment, and it's overly simplistic to pick on just one factor. Nevertheless, in terms of what has changed recently, we would highlight the first of these factors: specifically, European dairy farmers have cranked up their milk production significantly following the removal of the quota system in April. While the intention to do so has been known for some time, the surge in production has come at just the wrong time. It's well recognised that current milk prices are below production costs for much of Europe, and the latest GDT prices imply that an increasing share of Europe's milk production will be sold into 'intervention', effectively taking it off the international market and perhaps helping to establish a floor for prices elsewhere.

Notably, overseas industry bodies such as the USDA are forecasting global milk production to grow by only about 1% this year. That implies a strong belief that dairy farmers around the world will respond to price signals and slow down over the second half of this year. If that view is correct, it would go quite some way towards realigning supply with demand. That realignment was in fact already under way, until the recent surge in European production.

NZD and commodity prices, adjusted for inflation



GlobalDairyTrade Auction Results, 5 August

	Change since last auction	Price index USD/Tonne
Anhydrous Milk Fat (AMF)	-11.7%	\$2,253
Butter Milk Power (BMP)	-5.1%	\$1,700
Butter	-6.1%	\$2,293
Skim Milk Powder (SMP)	-14.4%	\$1,419
Whole Milk Powder (WMP)	-10.3%	\$1,590
Cheddar	0.2%	\$2,663
GDT Price Index	-9.3%	

Payout Forecast Table

	2014/15	2015/16		2016/17
	Fonterra	Fonterra	Westpac	Westpac
Milk Price	\$4.40	\$5.25	\$3.70	\$5.20

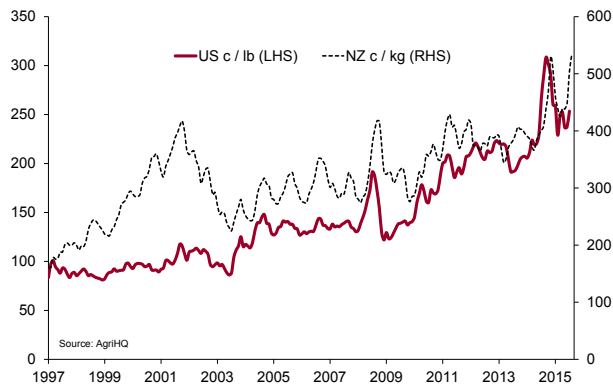
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Beef

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

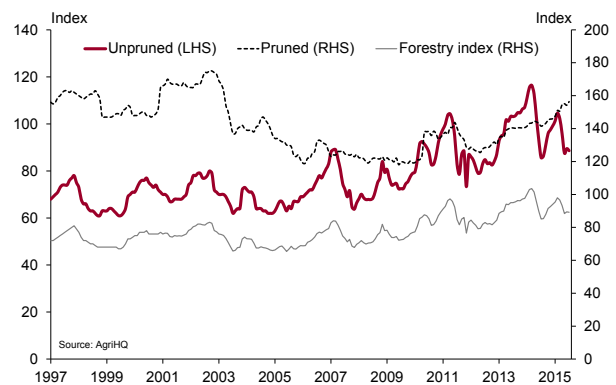
Beef prices in the US remain at high levels, although the supply of imported beef seems sufficient to prevent a repeat of last summer's price spike. However, the weaker New Zealand dollar has lifted domestic schedule prices right back to last year's highs, and we expect a further decline in the currency over the rest of this year.



Forestry

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

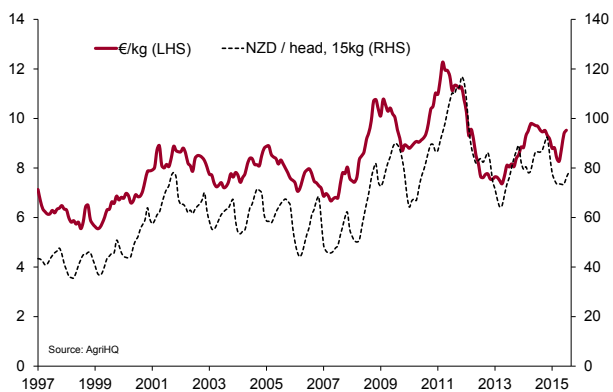
Unpruned log prices remained near their recent lows in July, whereas pruned log prices rose to a 12-year high. The weaker NZD will go some way towards restoring the competitiveness of New Zealand's log exports. Demand for housing construction materials is holding steady nationwide, although the centre of growth is clearly shifting from Christchurch to Auckland.



Lamb

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

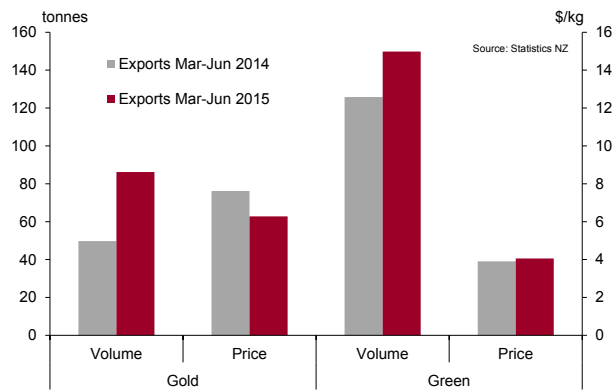
Chilled lamb prices in Europe have held up reasonably well, although global supply appears to remain ample. The weaker New Zealand dollar will help to support returns.



Kiwifruit

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

With kiwifruit exports hitting their seasonal peak, the current season is shaping up to be a very positive one. Gold kiwifruit have rebounded strongly from the Psa virus, though the sharp lift in volumes has not surprisingly been partly offset by lower prices. By contrast, the strong lift in green kiwifruit volumes has not had a detectable impact on prices so far this season.



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

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