



# Fortnightly Agri Update

7 October 2015

## Dairy prices on the rise

World dairy prices rose a further 9.9% in last night's GlobalDairyTrade auction. There were strong gains for whole milk powder (up 12.9%) and skim milk powder (up 13.4%), while cheese saw just a 0.5% rise and butter prices fell 2.3%. The overall price index is now up 63% from its low point just two months ago.

The global dairy market has reacted strongly to Fonterra's predictions of a drop in milk production this season. (As we've emphasised before, it's total milk volume that matters, not just the volume sold through the GDT channel.) The rebound in prices began after Fonterra's prediction in August that its milk collection would be down 2% for the season. Then, during the release of its annual results last month, Fonterra reported that its milk collection was down 5% for the season to date, and that it expected this shortfall to be maintained over the rest of the season.

To be clear, there have been good reasons to anticipate a drop in milk production. The prospect of a second season of low milk prices will have prompted farmers to make savings by de-stocking and cutting back on feed purchases. And in fact in the August livestock slaughter figures we saw the first significant jump in cow culling – more than double the same month last year.

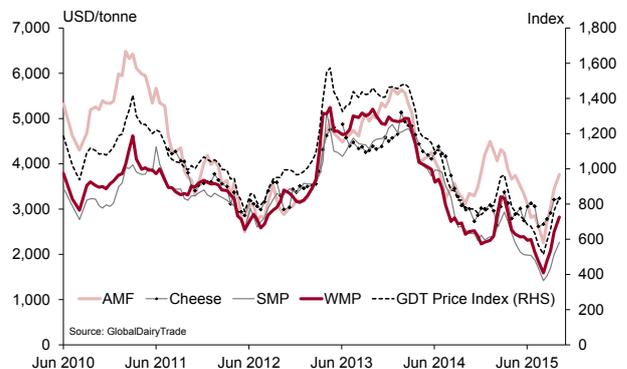
However, this will likely reflect decisions that were made on the basis of a \$3.85/kg milk price, as Fonterra was forecasting at the time. It's not obvious that farmers will be making the same kinds of decisions on the basis of a \$4.60/kg milk price – and even less so if Fonterra revises up its forecast further in the next month or two. In addition, we're seeing reports of improved pasture growth in recent weeks after a slow start to the spring. So we'd be wary of extrapolating full-season milk production based on the performance up to mid-September.

Nevertheless, it's the summer/autumn period that typically accounts for most of the variation in full-year production. And while meteorologists now say that an El Niño weather pattern this summer is a near-certainty, it's unknown how severe any resulting drought will be. We'll be taking a closer look at the potential impact in our next quarterly *Economic Overview* in November.

In light of the rebound in dairy prices to date, we have revised our forecast of the farmgate milk price for this season from \$4.30/kg to \$5.30/kg. The assumptions that underpin this forecast are: (1) a further modest bounce in the next couple of GDT auctions, given that momentum is clearly on their side, (2) an El Niño-induced drought of moderate severity, and (3) a pullback in prices early next year, once the drought threat has passed its peak. With global milk production still ample and demand subdued, we remain sceptical about a sustained rebound in dairy prices. Our milk price forecast of \$5.20/kg for next season remains unchanged.

Quick comment on the TPP: while the degree of access for dairy exports is disappointing, we shouldn't lose sight of the fact that the agreement as a whole provides significant tariff savings for New Zealand's exports – estimated at \$259m a year, compared to \$115m a year in the New Zealand-China Free Trade Agreement. Moreover, the experience of the China FTA shows that the gains overwhelmingly come from increased trade volumes. It's up to New Zealand's exporters to capitalise on the opportunities created by the TPP – which is why it's so hard to quantify the benefits in advance.

## NZD and commodity prices, adjusted for inflation



## GlobalDairyTrade Auction Results, 7 October

	Change since last auction	Price index USD/Tonne
Anhydrous Milk Fat (AMF)	9.9%	\$3,763
Butter Milk Power (BMP)	13.8%	\$1,945
Butter	-2.3%	\$3,037
Skim Milk Powder (SMP)	13.4%	\$2,267
Whole Milk Powder (WMP)	12.9%	\$2,824
Cheddar	0.5%	\$3,234
GDT Price Index	9.9%	

## Payout Forecast Table

	2014/15	2015/16		2016/17
	Fonterra	Fonterra	Westpac	Westpac
Milk Price	\$4.40	\$4.60	\$5.30	\$5.20

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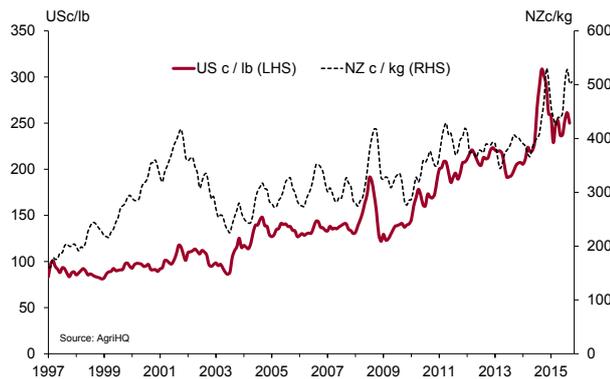
# Beyond the farm gate



## Beef

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

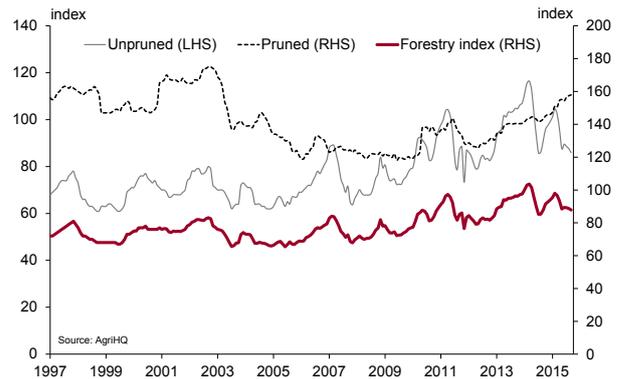
New Zealand's beef exports to the US are on track to exceed this year's quota by around 10%, in the absence of any changes. However, exporters are likely to take mitigating actions such as putting product into cold storage or selling into other markets. This could depress prices over the next few months, before rebounding early next year.



## Forestry

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

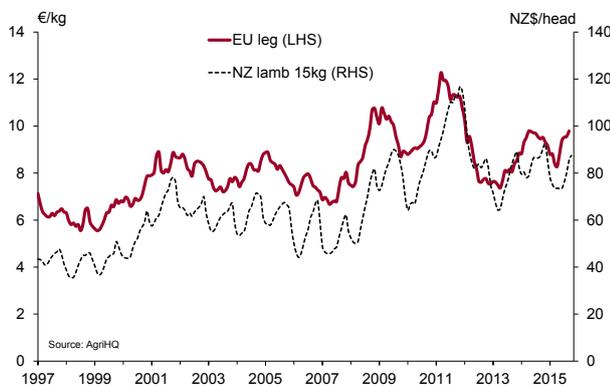
Unpruned log prices fell further in September, due to slow demand and high inventories in China. A pickup in Chinese house prices is enabling developers to sell off their existing holdings, but has yet to boost new construction. In contrast, domestic demand remains strong, with housing consents reaching an eight-year high in the year to August.



## Lamb

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

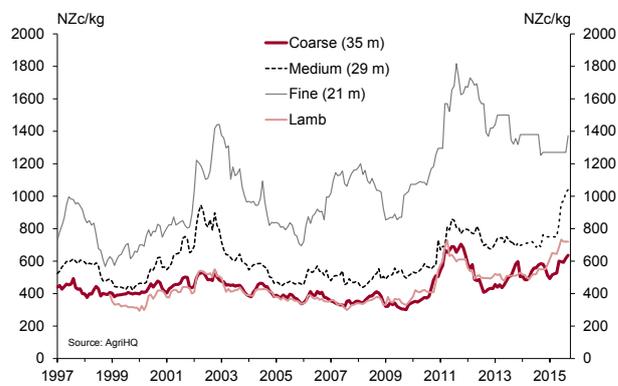
Lamb prices have improved in the last couple of months, with reports of a modest pickup in demand from the UK and China. The lower New Zealand dollar is providing an assist to returns.



## Wool

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

Wool prices have risen 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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