



Fortnightly Agri Update

16 November 2016

Meat and wool on the hoof

We published our latest Industry Insights, covering the meat and wool sector, on 8 November.¹ The report highlighted the importance of the sector to the New Zealand economy, but also a number of challenges and opportunities that are ongoing or emerging.

The meat and wool sector is the largest primary sector and employs more than 100,000 full-time equivalent workers (FTEs), or double the number of workers in dairy. It accounted for \$8.1 billion in exports in the year to August 2016. While exports have risen by \$1 billion in the last four years, predominantly in beef, the sector also faces a number of challenges. These include:

- falling sheep numbers, and resultant processing overcapacity reducing profitability for processors
- overall export weakness for products other than beef, with gains in that product at risk in the United States market
- the growth in international competition from countries trading meat and wool products, the rise in synthetic fibres, and growth in popularity of cheaper protein sources like chicken
- the rise in non-tariff barriers and emerging risks to free trade
- increasing compliance and regulatory costs.

But it is not all bad news. Opportunities for growth exist if the industry is able to seize them, and will be driven by higher prices for their products, and by lower costs of production, rather than by volume increases.

One of the biggest weaknesses, and thus opportunities, for the sector, is the lack of a coherent New Zealand “brand” internationally. New Zealand’s grass-fed livestock sell at a discount rather than at a premium, and are highly commoditised. A more concerted effort is required to “tell the story” of New Zealand meat and wool, and to create preferences for our products in the way some other sectors have.

A second opportunity is to better ensure products sell to the highest paying market. China has different preferences for meat cuts compared to Europe, for example, and is willing to pay more for them, so it makes sense to sell those cuts to China. There are also new alternative uses for certain co-products, including pharmaceuticals.

Finally, vertical integration, particularly in wool, as well as scale and commercialisation of family farms are required to adopt technology and other cost-cutting measures to make production cheaper.

A number of trends are emerging or expected to continue in the sector. We expect to see:

- further reduction in sheep numbers
- a long-needed reduction in meat processing overcapacity
- some roll-back in the current strength of beef exports, and the signs are that this is already beginning to materialise
- ongoing challenges in accessing capital due to poor returns in the sector and difficulty in getting Overseas Investment Office

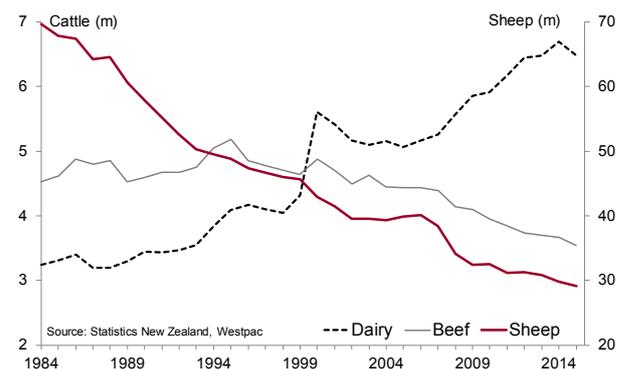
approval for offshore investment

- anti-trade sentiment and protectionism continuing to grow, resulting in the use of non-tariff barriers to restrict trade
- rising compliance costs and regulation with regard to environmental, health and safety, animal welfare, and worker relations
- a change in overseas markets for wool, to access these New Zealand will need to increasingly undertake textile manufacturing.

David Norman

Industry Economist

Change in livestock by category



GlobalDairyTrade Auction Results, 16 November 2016

	Change since last auction	Price index USD/Tonne
Anhydrous Milk Fat (AMF)	4.4%	\$5,348
Butter	1.1%	\$4,193
Butter Milk Power (BMP)	13.3%	\$2,623
Cheddar	11.0%	\$3,697
Lactose	4.6%	\$787
Rennet Casein	0.6%	\$6,040
Skim Milk Powder (SMP)	9.8%	\$2,562
Whole Milk Powder (WMP)	3.2%	\$3,423
GDT Price Index	4.5%	

Payout Forecast Table

	2016/17		2017/18
	Fonterra	Westpac	Westpac
Milk Price	\$5.25	\$5.80	\$6.10

¹ <http://www.westpac.co.nz/assets/Business/Economic-Updates/2016/Bulletins-2016/Industry-Insights-Meat-and-Wool-November-2016.pdf>

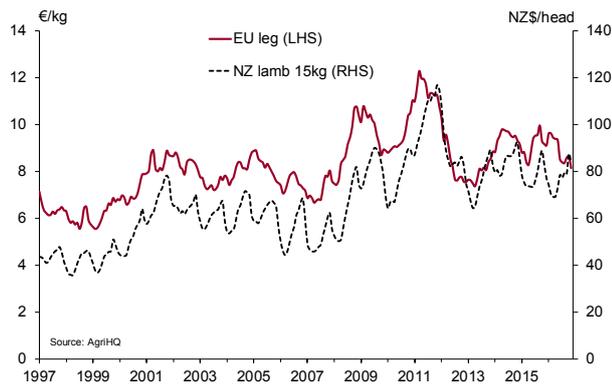
Beyond the farm gate



Lamb

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

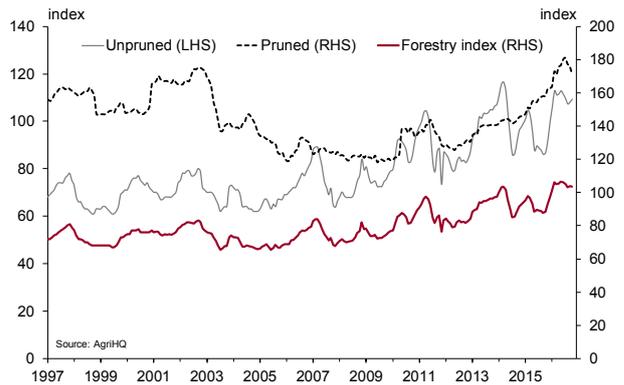
Beef and Lamb NZ's latest outlook predicts NZ lamb export volumes to fall 1.8% in the year ended 2017, reflecting a 2.4% predicted fall in the lamb crop. In the other major international lamb exporter, Australia, lamb slaughter is expected to remain broadly unchanged levels 2017. But while international supplies are likely to remain relatively tight, demand conditions are soft, with Brexit implications lingering as the key downside risk.



Forestry

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

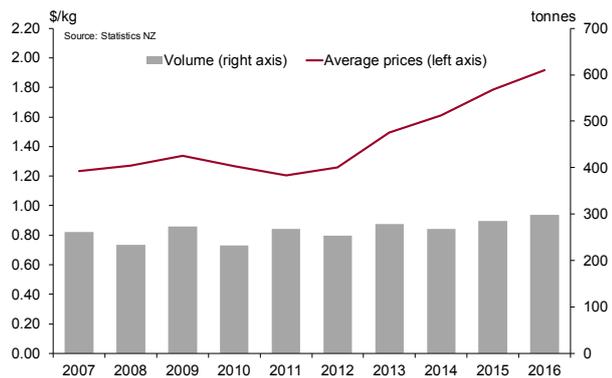
Forestry prices remain elevated. Log prices have benefited from improved demand from China (NZ's largest log export market) complemented by improved demand from India and Korea. Looking ahead, we don't expect prices to persist at current levels indefinitely. High log prices are likely to encourage an increase in international supply, while slower Chinese growth could see demand soften.



Apples

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

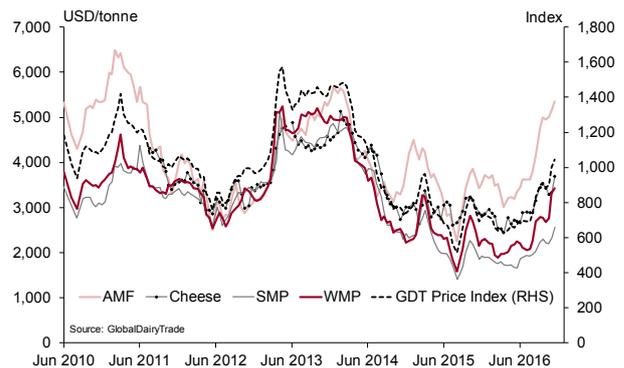
Trade figures for the year to September highlighted the ongoing strength in apple export prices, on the back of improving volumes. Anecdotes of wet weather suggest that volumes may be down for the coming year, though this would help to underpin prices.



Dairy

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

Dairy prices continued to rise in last night's GlobalDairyTrade auction. Supply offered for auction has continued to decline, reflecting reduced local milk supply due to wet weather. Parts of the North Island, including the Waikato, have been particularly affected. This is amplifying the usual seasonal reduction in supply on the GDT platform. Volumes sold in last night's auction were down 14% on the fortnight before, and Fonterra expects to offer around significantly less product over the coming couple of months compared to the same period a year ago. But with higher prices offering incentives to lift production, we remain sceptical that the drop in nationwide milk production this season will be as severe as the almost 7% decline Fonterra is forecasting. But while tighter supply is likely to be part of the reason for the big improvement in prices we've seen this season, perhaps more pleasing for farmers will be sustained signs of improving Chinese demand. Similar to last week, there was again strong buying interest out of China in last night's auction. This gives us some confidence that higher prices are more likely to be sustained and suggests upside risk to our current farm gate milk price forecast of \$5.80 /KgMs.



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

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