

## Fortnightly Agri Update

17 August 2016

**A marathon, not a sprint**

Dairy prices posted another solid performance in last night's GlobalDairyTrade auction. And while this good news will certainly bring a smile to the dial of many beleaguered dairy farmers, we would continue to sound a note of caution. While the fundamentals of supply and, more recently, demand certainly appear to be moving in a more favourable direction, we're still wary that we might see a partial retracement of the recent lift in prices. Despite this, stronger than expected developments have led us to upgrade our farm gate milk price forecast for this season to \$5.

It was a gold medal winning performance by whole milk powder prices in last night's global dairy trade auction. The headline GDT index was up an impressive 12.7%, led by a whopping 18.9% surge in whole milk powder (WMP) prices to \$US 2,695/tonne - an even stronger outturn than had been signalled by futures markets. Prices for other products on offer also rose, albeit more modestly. Skim milk powder was up 3% to \$US 2,028. AMF was up 8.4% to \$4,148.

Last night's result follows another strong outturn two weeks ago and means WMP prices have risen almost 30% in the last month, and are now back to levels last seen in October last year.

While the recent strength in prices is a welcome development, we'd continue to sound a note of caution. We have seen periods of strong gains in dairy prices followed by partial retracement. A year ago we saw solid price gains through August/September 2015 which partially retracted later in the season (in part as fears of an el Niño induced sharp drop in New Zealand production reversed later in the season).

That said, while we continue to tread cautiously, the fundamentals certainly appear to finally be shifting in favour of dairy producers more quickly than we had anticipated. A core tenement of the outlook for improving dairy prices over the course of the 2016/17 season has long been our view that global growth in supply would slow in response to very weak prices. And this is increasingly happening, most notably in Europe. After storming ahead following the abolition of milk production quotas in Europe in April 2015, in recent months, production has started to slow. EU milk collection increased 0.8% in May compared to a year earlier. That's well down from almost 10% annual growth back in February. Milk production has slowed most sharply in the UK, Croatia and Portugal, who have now produced less in the five months to May 2016 than they did in same period the year before.

But it's not just Europe where low milk prices are starting to bite. In Australia, milk production was down 2% in the 2015/16 season (which finished at the end of June) compared to 2014/15, with a particularly sharp contraction over the latter months of the season. In New Zealand, full season milk production for 2015/16 was down 1.6% on a year earlier with Fonterra expecting another 3% fall this season.

Of the 'big four' global dairy exporters, the only one bucking the trend of late has been the US. But even in the US, there are signs softer prices are likely to weigh on future production. Most recent US Department of Agriculture forecasts for milk production for the remainder of 2016 have been pared back on expected lower yield per cow (although we would also note milk production forecasts for 2017 have been upgraded, based on expected higher milk prices and lower feed costs). But while milk production in the US hasn't fallen as sharply as in some other parts of the world, the strong US dollar is making US dairy exports relatively less attractive. The USDEC notes that over the first half of this year, US dairy exports were equivalent to 13.3% of US milk solids, down from 14.5% in the first half of 2015.

Of course, the supply side of the global dairy market is only half the story. Equally important is what's happening on the demand front. There are signs that the recent step up in prices has coincided with improved demand from China. If sustained, this would clearly be a positive for New Zealand exporters.

Even with a relatively cautious interpretation of the lift in dairy prices over the last month, prices to date have been stronger than expected. Consequently, we have revised up our milk price forecast for this season from \$4.60 to \$5. We will be watching forthcoming GlobalDairyTrade auctions closely, and are conscious of upside risk to this forecast if there is no retracement in prices from current levels.

**Anne Boniface**  
Senior Economist

**GlobalDairyTrade Auction Results, 17 August 2016**

	Change since last auction	Price index USD/Tonne
Anhydrous Milk Fat (AMF)	8.4%	\$4,148
Butter Milk Power (BMP)	18.1%	\$1,983
Butter	14.1%	\$3,274
Skim Milk Powder (SMP)	3.0%	\$2,028
Whole Milk Powder (WMP)	18.9%	\$2,695
Cheddar	8.9%	\$3,157
GDT Price Index	12.7%	

**Payout Forecast Table**

	2015/16		2016/17	
	Fonterra	Fonterra	Westpac	Westpac
Milk Price	\$3.90	\$4.25	\$5.00	\$5.00

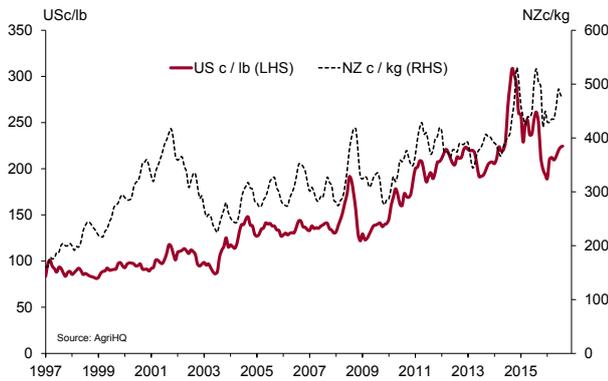
# Beyond the farm gate



## Beef

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

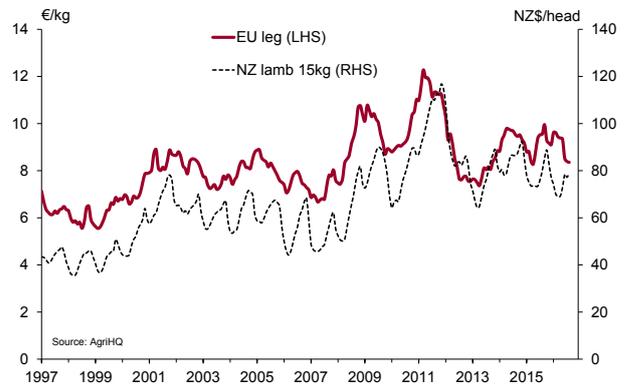
Over the medium term, international beef prices are likely to be underpinned by relatively tight global supply as beef exports from Australia, and to a lesser extent New Zealand, contract. However, this will be balanced against increasing domestic supplies in the US, with changes to market access for Brazil's chilled beef exporters an important wild card that could increase competition for New Zealand's beef exporters and weigh on prices. Earlier this month, the USDA announced it had agreed the rules for fresh beef exports from Brazil to the US with an initial quota of 60,000 tonnes.



## Lamb

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

Over the medium term, we continue to expect global lamb supplies to remain relatively tight. There has been a modest improvement in the demand outlook for lamb. The recent improvement in oil prices should help bolster incomes in the Middle East, and although the outlook for the Chinese economy remains soft, there are anecdotal reports of lower inventories supporting demand. However, the sharp fall in the value of the pound following the "Brexit" vote will make NZ lamb more expensive for British consumers, putting pressure on prices.



## Land prices

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

The REINZ farm price index showed that overall farm prices picked up a little in July, leaving them broadly steady over the past year. Underlying the recent pick up in overall farm prices was a sharp increase in the price of dairy farms sold in July compared to June. However, this was on low volumes and we'll have to watch to see if such buoyancy is sustained. On a per hectare basis, prices for horticulture land have continued to moderate after a very strong run over the last 6 months. Prices per hectare for other farm types have been broadly stable in recent months.

## REINZ farm price index

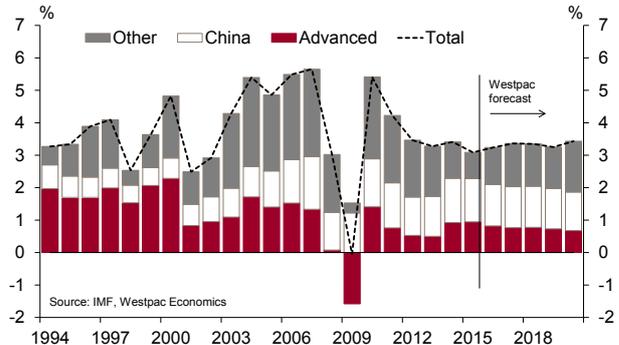


## Global Growth

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

Global growth remains subdued, and the UK's decision to exit the European Union has skewed the risks to the downside. Despite this, market measures of risk are at the lowest levels in a year, spurred on by continued loose monetary policy globally. The Bank of Japan, Bank of England, RBA and RBNZ have all eased policy recently. More solid employment data out of the US has started to shift market thinking back towards our view that the Fed will hike again by year end. Fed Chair Yellen's comments at the upcoming Jackson Hole conference will be a key event to watch in terms of the outlook for global interest rates.

## Contributions to global growth



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

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