



Fortnightly Agri Update

19 October 2016

Soggy underfoot

The recent spell of wet weather hasn't just been a headache for those looking to entertain children over school holidays. It's also dampened milk production in some regions. This reduction in local supply has supported dairy prices, and consequently we've upgraded our farm gate milk price forecast to \$5.30.

Last night's GlobalDairyTrade auction saw prices improve a little. The headline index was up a modest 1.4% with mixed results for the products on offer. There was a 2.9% lift in whole milk powder (WMP) while skim milk powder was broadly flat (down 0.3%).

A key catalyst for the lift in prices in last night's auction was the reduced offerings by Fonterra on the GDT platform. Fonterra offered around 5% less WMP in last night's auction than it had previously forecast. In addition, it sharply reduced its offerings over the November and early December events, with its 12 month forecast reduced by around 3%.

Fonterra blamed the reduced volumes on the recent wet weather which has led to less milk being collected in some regions, most notably the Waikato where it reported early October volumes running 10% below the same period last year. The Waikato region accounts for around 23% of New Zealand's milk production. And while other regions haven't been as adversely affected, it still underscores the point we have been making. That is, on the back of cost cutting across the sector and a back to basics approach to farming, weather and pasture conditions will play a critical role in New Zealand's production this season. And that applies to wet weather as well as dry. The latest data from DCANZ show nationwide milk production was down 3% in August compared to 2015. And while the situation on farm is likely to improve as the weather warms up, the reduced Fonterra offerings over the coming auctions should help underpin prices to a greater extent than we had previously anticipated.

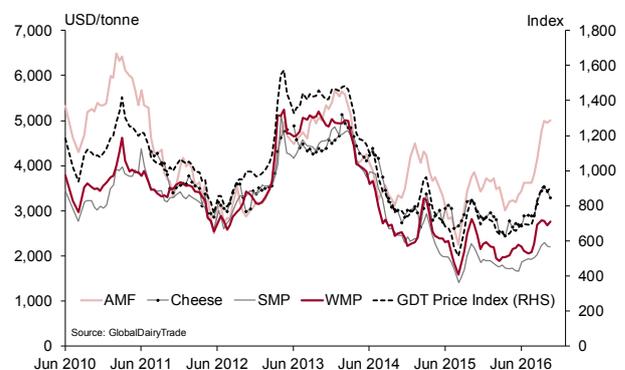
But while the reduction in volumes certainly supported prices in last night's auction, the demand side of the equation still seems a bit soggy. In the past, fears of reduced production in New Zealand have induced a much sharper lift in prices. This could reflect expectations of an improved outlook for NZ production when the sun comes out, but it could also signal a softer demand backdrop more generally. Indeed, futures markets have overestimated the willingness of buyers to bid up prices in the last three auctions.

We have long been clear that our \$5 milk price forecast was predicated on prices partially retracing their recent big run up. Although late September and early October auctions have hinted at this occurring, and last night's auction wasn't as strong as

it potentially could have been, they still provided enough of an indication for us that prices are set to remain higher than we assumed over the next few months. Consequently, we have upgraded our farm gate milk price forecast for this season to \$5.30. This is broadly in line with Fonterra's current forecast of \$5.25.

Anne Boniface
Senior Economist

Global Dairy Prices



GlobalDairyTrade Auction Results, 19 October 2016

| | Change since last auction | Price index USD/Tonne |
|---------------------------------|---------------------------|-----------------------|
| Anhydrous Milk Fat (AMF) | 1.1% | \$5,007 |
| Butter | 2.6% | \$3,984 |
| Butter Milk Power (BMP) | 0.2% | \$2,583 |
| Cheddar | -3.7% | \$3,290 |
| Lactose | 5.6% | \$780 |
| Rennet Casein | -4.5% | \$6,286 |
| Skim Milk Powder (SMP) | -0.3% | \$2,204 |
| Whole Milk Powder (WMP) | 2.9% | \$2,760 |
| GDT Price Index | 1.4% | |

Payout Forecast Table

| | 2016/17 | | 2017/18 |
|-------------------|----------|---------|---------|
| | Fonterra | Westpac | Westpac |
| Milk Price | \$5.25 | \$5.30 | \$6.10 |

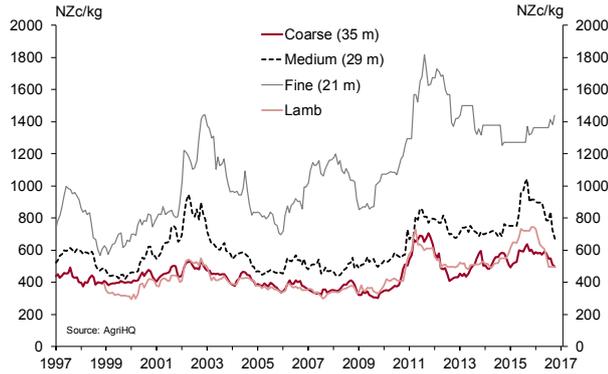
Beyond the farm gate



Wool

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

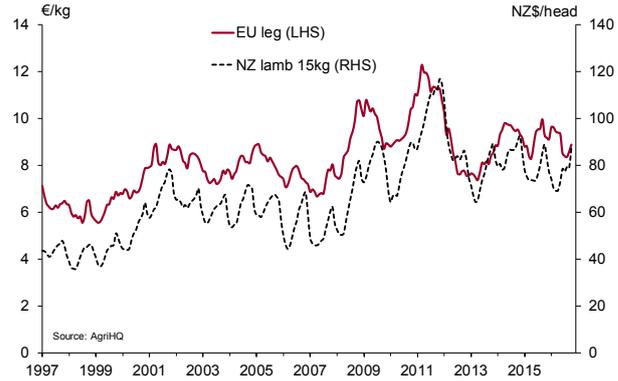
Wool demand remains subdued and prices have continued to soften. The soft Chinese growth backdrop, combined with low (though no longer rock bottom) oil prices making synthetic substitutes relatively attractive, have weighed on demand. Prices are likely to remain soft in the near term.



Lamb

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

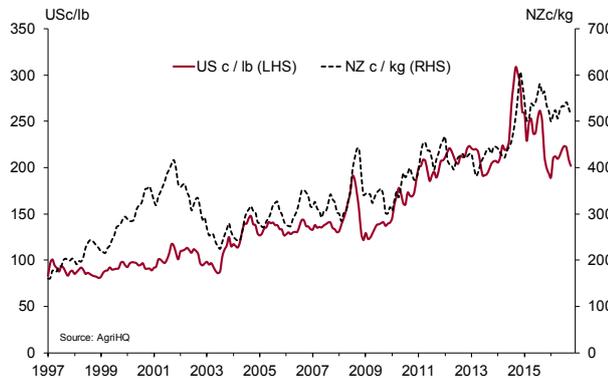
Relatively tight supplies in NZ and Australia should help keep a floor under lamb prices this season. However, beyond this the outlook is gloomier. Demand from the UK is likely to suffer as the Brexit vote weighs on growth and income prospects and the weaker pound makes NZ lamb exports more expensive.



Beef

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

In contrast to broader global protectionist sentiment which currently seems to be sweeping the globe, trade barriers in beef markets have been falling. China has announced the removal of a 13-year ban on some US beef products (implemented over mad cow concerns back in 2003). The US has also eased import restrictions, with the first fresh beef exports shipped from Brazil recently. While the removal of trade barriers is generally viewed as a positive development for NZ exporters, it also increases competition for NZ beef exporters into key markets. Supply out of NZ and Australia remains very tight. Meat and Livestock Australia expect Australian adult cattle slaughter to be down 21% in 2016, and a further 2% in 2017.

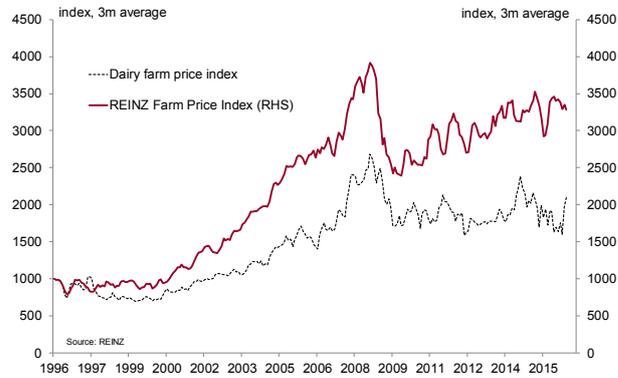


Land prices

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

The REINZ farm price index showed prices easing in August. Overall farm prices are now around 4% higher than a year ago. Within this, dairy farm prices performed particularly strongly, and are now 6% higher than a year ago. It's difficult to know what's driven the improvement. This has come hand in hand with low volumes and goes against the grain of anecdotes which have generally been anticipating softer prices for dairy farms in particular. We would be surprised to see this sustained in the coming months.

REINZ farm price index



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

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