

Fortnightly Agri Update

2 March 2016

A brief look at beef?

Dairy prices bounced 1.4% higher in last night's GlobalDairyTrade auction, underpinned by a 5.5% lift in whole milk powder prices.

While any improvement in dairy prices will be welcomed by the embattled dairy sector, there remain few signs of a marked turnaround in the fundamentals which have pushed dairy prices to such low levels. In particular, global milk supply remains plentiful, with supply from Europe growing particularly strongly.

But while the dairy sector struggles with the implications of strong growth in supply, supply conditions in international beef markets are expected to remain relatively tight this year.

Locally, fear of an El Niño induced drought, low dairy prices, and relatively attractive beef prices encouraged a big lift in cattle slaughter last year. Slaughter spiked sharply in September (in seasonally adjusted terms). While low dairy prices mean pressure is likely to remain on dairy farmers over the coming year (with some likely to turn to stock liquidation as a temporary way of supporting cash flow) it's unlikely we'll see a similar sized bounce in dairy cow culling this season.

Consequently, local beef supplies are expected to tighten this season. Beef and Lamb NZ expect cattle slaughter to decline 8.5% in 2015/16. While this is drop is coming off a relatively high slaughter level in 2014/15, it still implies tighter supplies of NZ beef on international markets in the coming months.

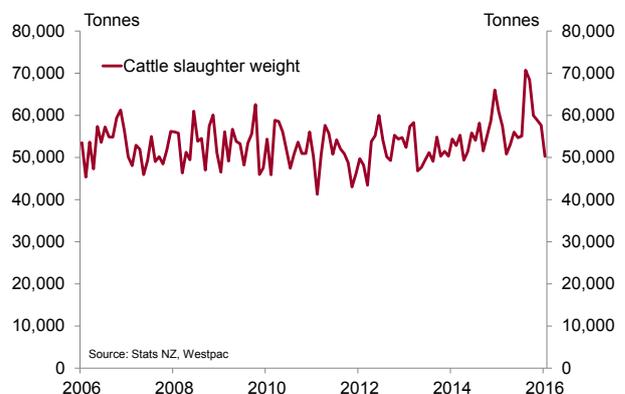
Supplies are expected to contract even more sharply in Australia, New Zealand's biggest competitor in the key US market. Australian beef exports are expected to fall sharply this year. This follows several years of very strong exports as farmers reduced stock numbers on the back of a sustained period of very dry weather in key beef producing regions. While the average weight of cattle slaughtered is expected to lift, this won't be enough to fully offset an expected 16% decline in adult cattle slaughter in 2016 according to Meat and Livestock Australia (MLA). MLA is forecasting export volumes (beef and veal combined) to be down 18% in 2016. And they expect Australian cattle numbers to fall even further in 2017, to the lowest since 1993.

But while NZ producers may face less competition from Australian exports in US markets, it's not all plain sailing. The US Department of Agriculture expects US beef supply to grow 1.7% in 2016. And there is also potentially more competition from South American producers in this market. Hurdles to fresh beef exports from Brazil entering the US market continue to be removed, and the US is expected to finally start importing fresh beef from Brazil in 2016.

Of course all this talk about supply risks ignoring the equally fundamental demand side of the equation. Broadly, as for other commodities, we expect demand from China to remain relatively soft this year as the economy continues to slow. In contrast, the outlook for US consumers is expected to brighten this year as households benefit from big drops in fuel prices. However, substitute proteins such as chicken and pork remain very

attractive for US consumers in particular.

So while beef prices, like other commodities, may well remain under pressure in the near term, over a long horizon the outlook remain relatively positive. Although we don't expect prices to get back to the lofty heights of 2014, relatively tight global supplies should ensure prices remain supported near current levels over the medium term.

Total NZ Cattle Kill (seasonally adjusted)**GlobalDairyTrade Auction Results, 2 March 2016**

	Change since last auction	Price index USD/Tonne
Anhydrous Milk Fat (AMF)	-8.3%	\$3,254
Butter Milk Power (BMP)	-2.9%	\$1,452
Butter	-0.5%	\$2,811
Skim Milk Powder (SMP)	1.3%	\$1,802
Whole Milk Powder (WMP)	5.5%	\$1,974
Cheddar	-0.7%	\$2,528
GDT Price Index	1.4%	

Payout Forecast Table

	2015/16		2016/17
	Fonterra	Westpac	Westpac
Milk Price	\$4.15	\$4.00	\$4.60

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Correction

Our last fortnightly Agri Update contained an error. New Zealand milk production in the 2014/15 season was around **21 billion litres** (not 2.1 billion litres). Apologies for any confusion caused.

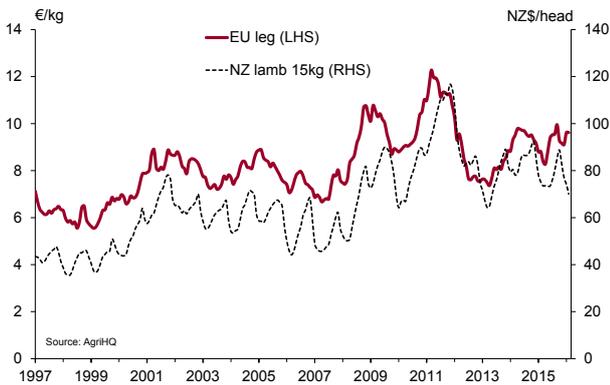
Beyond the farm gate



Lamb

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

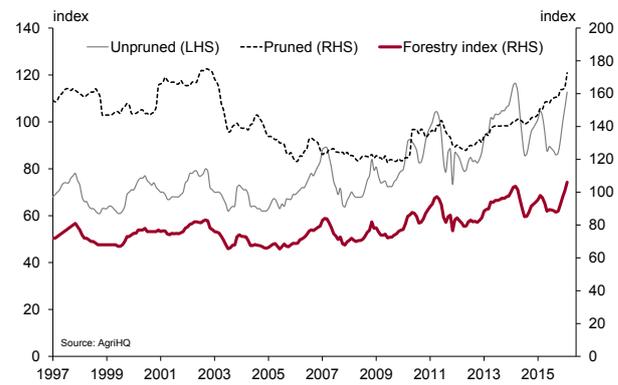
We continue to expect relatively tight supplies in NZ and Australia to underpin lamb prices this year. However, expectations of weaker growth in China and the Middle East (on the back of sharply lower oil prices) are likely to prove a headwind to any significant improvement in prices. Exports into the UK continue to compete with high volumes of domestic lamb.



Forestry

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

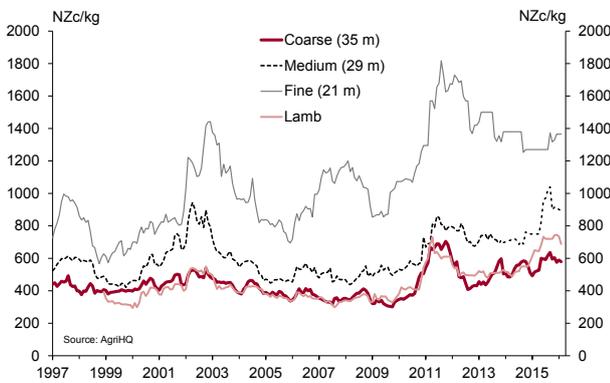
In contrast to our expectations, log prices rose further in February, however sentiment in export markets now seems to be becoming more negative. We remain sceptical that higher prices in China will be maintained in the face of anticipated softening in demand, but we acknowledge that tighter supplies locally seem to be supporting prices in the interim. And while China continues to take the lion's share of NZ log exports, recent anecdotes point to improved demand from India. The domestic outlook remains favourable. We expect construction activity to pick up strongly over the first half of 2016, which should support domestic prices



Wool

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

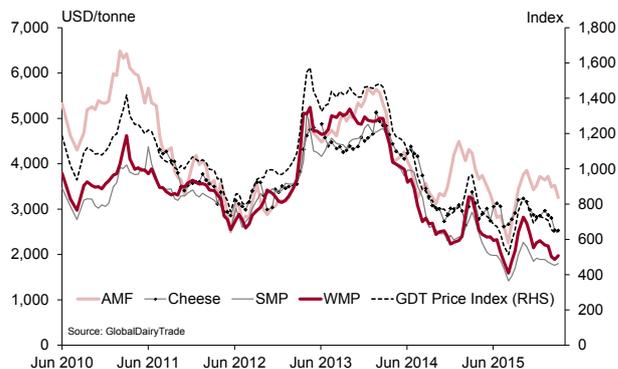
AgriHQ report reduced buyer demand in the most recent wool auctions late last year. Looking ahead, we expect subdued growth in China to continue to weigh on demand. Sharply lower oil prices will also make synthetic substitutes for wool relatively cheaper. While prices have held up relatively well to date, they could come under pressure in 2016.



Dairy

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

Dairy prices were up a modest 1.4% in last night's GlobalDairyTrade auction – the first rise in prices this year. Whole milk powder prices were up more strongly, climbing 5.5% to \$US 1,974. But while any improvement in prices will be welcomed by the embattled dairy sector, the global supply backdrop is likely to continue to keep prices under pressure for some time yet. Eventually, low prices will induce a supply response, but even then growing European stockpiles still have to find their way onto markets. Consequently, we continue to expect prices to bump around near current levels until late 2016 before gradually improving. We remain broadly comfortable with our farm gate milk price forecasts of \$4.00 this season and \$4.60 in 2016/17.



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

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