

## Fortnightly Agri Update

2 November 2016

**Bursting higher**

Last night's GlobalDairyTrade auction outcome will go some way to further boosting optimism in the rural sector. Overall prices were up 11.4%, but the real scene-stealer was the almost 20% lift in whole milk powder prices to \$US 3,317/tonne. This was much stronger than expected and took prices back to mid-2014 levels. As a result, we have revised up our farm gate milk price this season to \$5.80.

After several auctions when prices remained broadly stable, markets seem to have reacted strongly to Fonterra's revised production estimates for the 2016/17 season. In particular, Chinese bidders were notably more active in the latest auction, crowding out buyers from other regions. This suggests a genuine concern about being left short of stock is helping drive prices higher.

Fonterra has been drawing attention to the poor October milk flows in parts of the upper North Island. The catalyst for the downward revisions to local production has been too much rain during October in key dairying regions including the Waikato, Northland and Bay of Plenty. Consequently, Fonterra is now expecting to collect 7% less milk this season than last. This is flowing through to reduced offerings on the GDT platform. Forecasts of WMP on offer for the next 12 months are 5% lower than a couple of weeks ago.

Forecasting milk flows is a challenge. Ultimately it will be a combination of dairy prices, number of cows and pasture growth. However, we don't think NZ milk production will be down as much as Fonterra suggest. Fonterra is underweight in the South Island, and there, milk production was running well ahead of last year in September, and farmers have enjoyed good conditions through October. South Island milk production accounts for a little over 40% of NZ production. And while NZ milk flows are highly seasonal and peak in October, the month still only contributes 14% of production for the entire season.

What's more, the recent lift in prices will encourage farmers to lift production. While it is clearly too late to increase stock numbers, some farmers will be able to adjust feed regimes to lift production to some extent over the remainder of the season.

But just how much do changes in NZ's milk production influence international dairy prices? After all, while NZ is a significant player in the market for traded dairy products, we're only a bit player when it comes to global milk production.

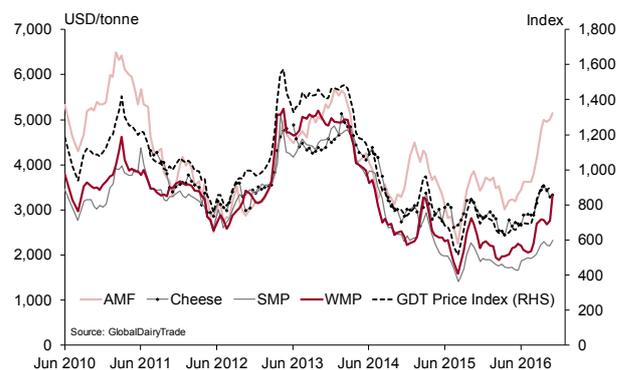
There's no easy answer. In the short term, changes in volumes (or expected volumes) can clearly influence the prices achieved in fortnightly GDT auctions – last night's auction was a case in point. However, over a longer horizon, it is ultimately the global milk supply which should be the main factor determining global prices. And on this front, what's going on within swing dairy producers such as Europe and the US (who can shift between their domestic and export markets) is key.

On this front, European milk production was down 1.6% year on year in August. However, looking ahead into next year, there is likely to be fewer incentives to cut production. Prices are rising, and the European Commission's payments to reduce milk production will

cease. In the US, milk production continues to grow, up 2.3% on a year ago in September with the USDA also revising up its forecast for the remainder of the year. Domestic demand remains relatively strong. Of the big 4 global dairy exporters, production is down most sharply in Australia, off 11.3% for the season to September. But while production is now falling globally, we're sceptical that the pace of decline will be maintained into next year as producers respond to the higher prices on offer.

So while we see a risk of downward pressure on dairy prices as we head into next year, last night's big jump in prices comes at a critical time in the season for determining the 2016/17 farm gate milk price. Consequently, we've upgraded our 2016/17 farm gate milk price forecast to \$5.80 (previously \$5.30).

**Anne Boniface**  
Senior Economist

**Global Dairy Prices****GlobalDairyTrade Auction Results, 2 November 2016**

	Change since last auction	Price index USD/Tonne
Anhydrous Milk Fat (AMF)	2.6%	\$5,146
Butter	4.0%	\$4,146
Butter Milk Power (BMP)	-5.4%	\$2,248
Cheddar	0.9%	\$3,332
Lactose	-4.0%	\$755
Rennet Casein	-4.8%	\$6,025
Skim Milk Powder (SMP)	6.5%	\$2,329
Whole Milk Powder (WMP)	19.8%	\$3,317
GDT Price Index	11.4%	

**Payout Forecast Table**

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

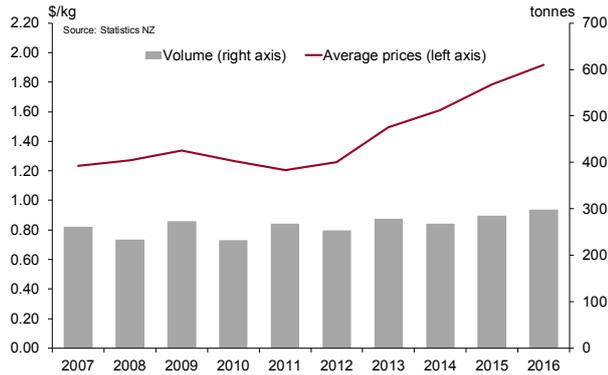
# Beyond the farm gate



## Apples

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

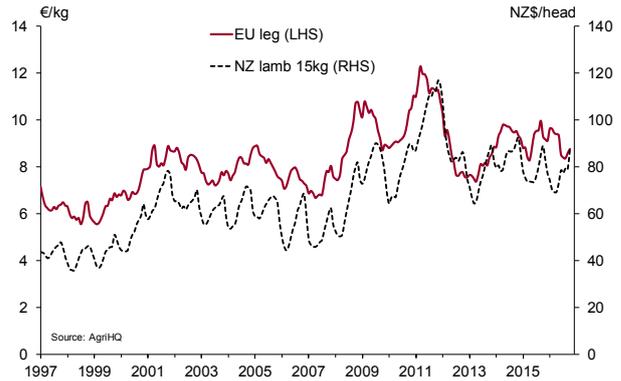
Trade figures for the year to September highlighted the ongoing strength in apple export prices, on the back of improving volumes. Anecdotes suggest that volumes may be down for the coming year due to wet weather, though this would help to underpin prices.



## Lamb

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

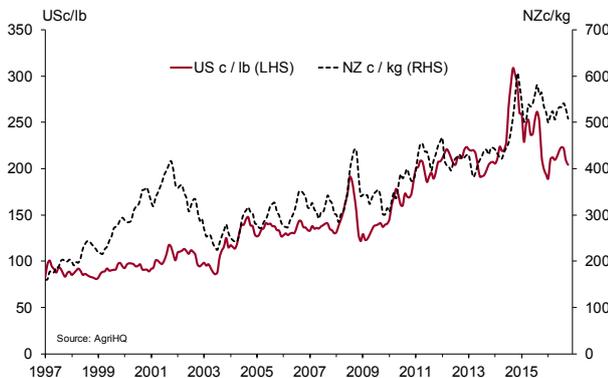
Relatively tight supplies in NZ and Australia should help keep a floor under lamb prices this season. However, beyond this the outlook is gloomier. Demand from the UK is likely to suffer as the Brexit vote weighs on growth and income prospects, and the weaker pound makes NZ lamb exports more expensive.



## 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.

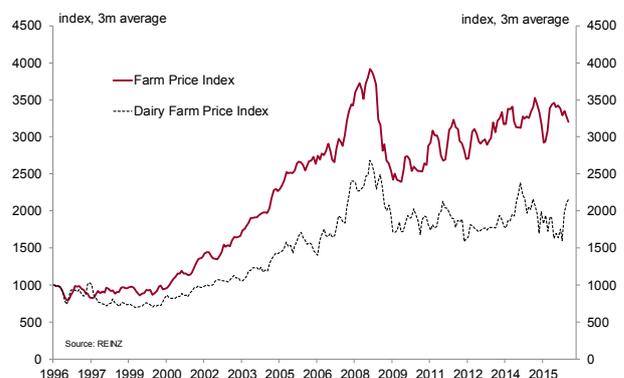


## Land prices

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

The REINZ farm price index showed a further easing in prices in September, though they are still up almost 10% on the same time last year. Within this, dairy farm prices have continued to rebound, and are now 18% higher than a year ago. The improved outlook for farmgate milk prices is likely to have been a factor behind the bounce in the last few months. But we are cautious that this is on the back of very low turnover, and goes against the grain of anecdotes which have generally been anticipating softer prices for dairy farms in particular.

## REINZ farm price index



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

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