



# Fortnightly Agri Update

20 July 2016

## The wood for the trees

We've been sceptical of forestry prices being able to maintain their current levels in recent months. However, prices have largely defied our predictions of a moderation. In this fortnight's Agri Update, we take a look at what has been supporting log prices to date, and whether this is likely to persist.

New Zealand log prices improved over the second half of 2015. And, according to the AgriHQ forestry price index, have remained at these elevated levels for much of 2016, with an improvement in both pruned and unpruned prices. That's been somewhat surprising given slower growth in China in particular (which takes the lion's share of New Zealand's log exports) and a stubbornly high NZ dollar.

Indeed, export volumes to China have fallen. Trade data shows that total annual log export volumes were flat in the year to May 2016, while the volume of exports to China over the same period were down 10%. That's probably helped inventories remain at reasonable levels, despite signs of slower demand.

New Zealand's main competition in the Chinese market comes from US and Russian log exporters. US exports in particular may become less competitive in the Chinese market on the back of the stronger US dollar. Gradually strengthening US domestic construction activity should also stoke domestic demand for US logs.

Other significant log export markets, such as Korea and India, have also been faring better than China and could potentially provide some offset for weaker demand from China. India's GDP growth is forecast to improve to 7.7% this year (from 7.3% last year) while growth in South Korea is expected to stabilise at around 2.5% this year. This compares to our forecasts of China's GDP growth slowing from 6.9% in 2015 to 6.4% this year.

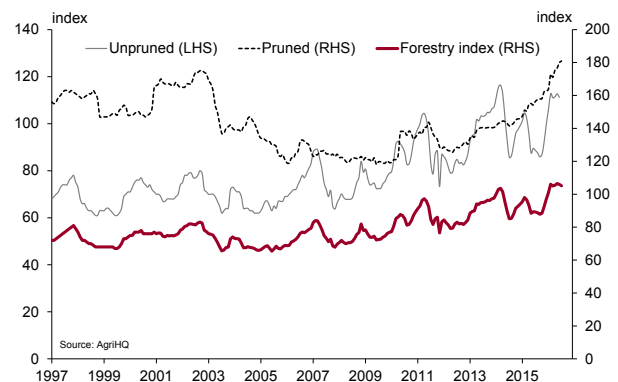
But while there are likely to be some partial offsets from non-Chinese demand, on balance it's difficult to envision log prices being able to maintain their current high levels as growth in China continues to slow. Consequently, we would expect prices to ease a little.

On the domestic front, the story has been much clearer. NZ residential construction activity continues to go from strength to strength, supporting domestic demand for logs. While post-quake residential building in Canterbury has levelled off, this has been more than offset by a pickup in residential construction activity in other parts of the country (most notably in Auckland). Nationwide consent issuance in May was 16% higher than a year ago, spurred by strong population growth and the buoyant housing market. That said, there have been signs in recent months that uncertainty about the Auckland Unitary Plan could be leading some developers to hold off new projects until things become clearer. Nonetheless, construction activity is still forecast to grow strongly over the next couple of years.

Of course an important factor affecting the returns of exporters of all persuasions is the NZD. The last week has brought some relief on this front, and our forecasts are for the NZ dollar to decline further yet this year. The NZ dollar raced to above 73c earlier in the month, but over the last week or so, has fallen back to around 70c as markets have factored in a greater chance of the RBNZ reducing the OCR in August (and potentially beyond). With the Federal Reserve in the US expected to tighten policy again in December, we think the NZD/USD could reach 68c by the end of this year and the low 60c level by the end of 2017.

**Anne Boniface**  
Senior Economist

## Log prices



## GlobalDairyTrade Auction Results, 20 July 2016

	Change since last auction	Price index USD/Tonne
Anhydrous Milk Fat (AMF)	0.2%	\$3,628
Butter Milk Power (BMP)	-0.5%	\$1,565
Butter	-5.0%	\$2,687
Skim Milk Powder (SMP)	-1.1%	\$1,927
Whole Milk Powder (WMP)	1.9%	\$2,079
Cheddar	1.1%	\$1,927
GDT Price Index	0.0%	

## Payout Forecast Table

	2015/16		2016/17	
	Fonterra	Westpac	Fonterra	Westpac
Milk Price	\$3.90	\$4.25	\$4.25	\$4.60

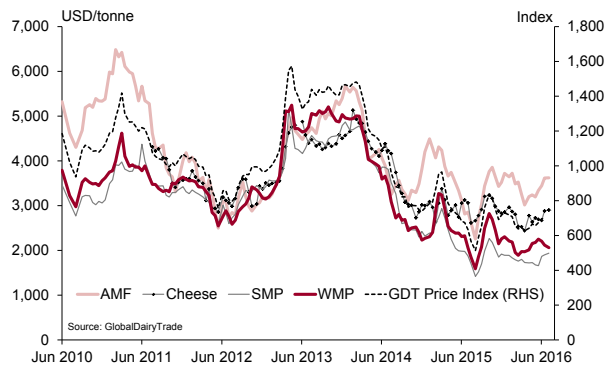
# Beyond the farm gate



## Dairy

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

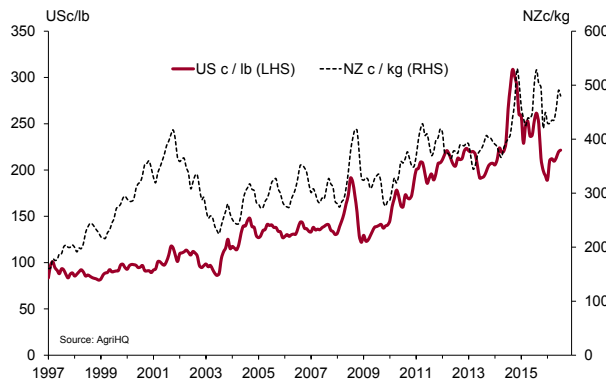
Dairy prices were flat overall in last night's GlobalDairyTrade auction. In the underlying detail, whole milk powder (WMP) prices (the biggest influence on Fonterra's farm gate milk price) halted their recent run of declines. WMP prices rose 1.9% to US\$2,079/tonne. In contrast skim milk powder prices took a breather, falling 1.1% to US\$1,927/tonne after rising almost 17% over the last three auctions. Last night's rise in WMP prices doesn't completely reverse the recent weaker outturns, but it does support our view that prices are likely to remain near current levels for much of 2016, before gradually improving late in the year and into next year. We don't anticipate a quick turnaround in fortunes in the dairy sector. Prices have been low for an extended period, giving many buyers ample opportunity to be well stocked. And while we expect growth in global milk supply to slow in response to lower prices over the coming months (a new EU support package announced this week partly aimed at encouraging European farmers to cut milk production could also help at the margin in the near term), this process will take time. While we continue to forecast a \$4.60 milk price payout for the current season, we are conscious of downside risks emerging to our forecast, particularly from the strong NZ dollar.



## Beef

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

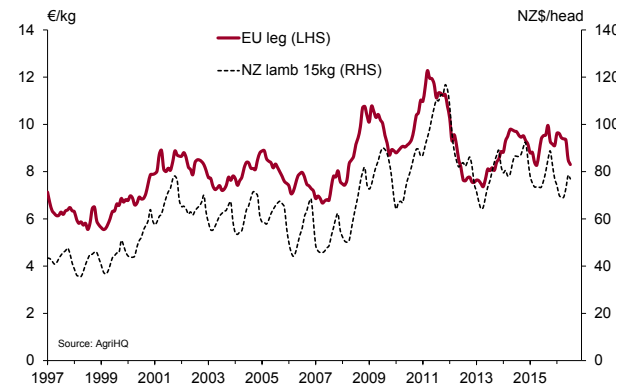
Over the medium term, international beef prices are likely to be underpinned by relatively tight global supply as beef exports from Australia, and to a lesser extent New Zealand, contract. However, this will be balanced against increasing domestic supplies in the US, with changes to market access for Brazil's chilled beef exporters an important wild card that could influence prices.



## Lamb

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

Over the medium term, we 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.

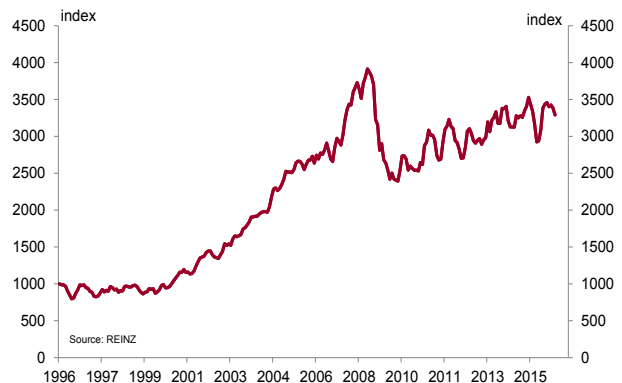


## Land prices

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

The REINZ farm price index moderated a little further in June, and is 4% lower than a year ago. However, dairy farm prices have been much weaker, falling further in June (albeit on low volumes). The REINZ dairy farm price index is now 18% below a year ago and 33% below its 2014 peaks. On a per hectare basis, prices for horticulture land have moderated over the last couple of months after a very strong run over the last 6 months.

## REINZ farm price index



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

# Contact the Westpac economics team

---

**Michael Gordon**, Acting Chief Economist +64 9 336 5670

**Satish Ranchhod**, Senior Economist +64 9 336 5668

**Anne Boniface**, Senior Economist +64 9 336 5669

**David Norman**, Industry Economist +64 9 336 5656

**Sarah Drought**, Economist +64 9 352 0057

**Any questions email:** [economics@westpac.co.nz](mailto:economics@westpac.co.nz)

## Disclaimer

---

### Things you should know

Westpac Institutional Bank is a division of Westpac Banking Corporation ABN 33 007 457 141 ('Westpac'). This information is correct as at 1 July 2016.

### Disclaimer

This material contains general commentary, research, and market colour. The material does not constitute investment advice. The material may contain investment recommendations, including information recommending an investment strategy. Reasonable steps have been taken to ensure that the material is presented in a clear, accurate and objective manner. Certain types of transactions, including those involving futures, options and high yield securities give rise to substantial risk and are not suitable for all investors. We recommend that you seek your own independent legal or financial advice before proceeding with any investment decision. This information has been prepared without taking account of your objectives, financial situation or needs. This material may contain material provided by third parties. While such material is published with the necessary permission none of Westpac or its related entities accepts any responsibility for the accuracy or completeness of any such material. Although we have made every effort to ensure the information is free from error, none of Westpac or its related entities warrants the accuracy, adequacy or completeness of the information, or otherwise endorses it in any way. Except where contrary to law, Westpac and its related entities intend by this notice to exclude liability for the information. The information is subject to change without notice and none of Westpac or its related entities is under any obligation to update the information or correct any inaccuracy which may become apparent at a later date. The information contained in this material does not constitute an offer, a solicitation of an offer, or an inducement to subscribe for, purchase or sell any financial instrument or to enter a legally binding contract. Past performance is not a reliable indicator of future performance. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The ultimate outcomes may differ substantially from these forecasts.

### Country disclosures

**Australia:** Westpac holds an Australian Financial Services Licence (No. 233714). This material is provided to you solely for your own use and in your capacity as a wholesale client of Westpac.

**New Zealand:** In New Zealand, Westpac Institutional Bank refers to the brand under which products and services are provided by either Westpac or Westpac New Zealand Limited ("WNZL"). Any product

or service made available by WNZL does not represent an offer from Westpac or any of its subsidiaries (other than WNZL). Neither Westpac nor its other subsidiaries guarantee or otherwise support the performance of WNZL in respect of any such product. The current disclosure statements for the New Zealand branch of Westpac and WNZL can be obtained at the internet address [www.westpac.co.nz](http://www.westpac.co.nz). For further information please refer to the Product Disclosure Statement (available from your Relationship Manager) for any product for which a Product Disclosure Statement is required, or applicable customer agreement. Download the Westpac NZ QFE Group Financial Advisers Act 2008 Disclosure Statement at [www.westpac.co.nz](http://www.westpac.co.nz).

**China, Hong Kong, Singapore and India:** This material has been prepared and issued for distribution in Singapore to institutional investors, accredited investors and expert investors (as defined in the applicable Singapore laws and regulations) only. Recipients in Singapore of this material should contact Westpac Singapore Branch in respect of any matters arising from, or in connection with, this material. Westpac Singapore Branch holds a wholesale banking licence and is subject to supervision by the Monetary Authority of Singapore. Westpac Hong Kong Branch holds a banking licence and is subject to supervision by the Hong Kong Monetary Authority. Westpac Hong Kong branch also holds a license issued by the Hong Kong Securities and Futures Commission (SFC) for Type 1 and Type 4 regulated activities. This material is intended only to "professional investors" as defined in the Securities and Futures Ordinance and any rules made under that Ordinance. Westpac Shanghai and Beijing Branches hold banking licenses and are subject to supervision by the China Banking Regulatory Commission (CBRC). Westpac Mumbai Branch holds a banking license from Reserve Bank of India (RBI) and subject to regulation and supervision by the RBI.

**UK:** The contents of this communication, which have been prepared by and are the sole responsibility of Westpac Banking Corporation London and Westpac Europe Limited. Westpac (a) has its principal place of business in the United Kingdom at Camomile Court, 23 Camomile Street, London EC3A 7LL, and is registered at Cardiff in the UK (as Branch No. BR00106), and (b) authorised and regulated by the Australian Prudential Regulation Authority in Australia. Westpac is authorised in the United Kingdom by the Prudential Regulation Authority. Westpac is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request. Westpac Europe Limited is a company registered in England (number 05660023) and is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.

# Disclaimer continued

---

This communication is being made only to and is directed at (a) persons who have professional experience in matters relating to investments who fall within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "Order") or (b) high net worth entities, and other persons to whom it may otherwise lawfully be communicated, falling within Article 49(2)(a) to (d) of the Order (all such persons together being referred to as "relevant persons"). Any person who is not a relevant person should not act or rely on this communication or any of its contents. The investments to which this communication relates are only available to and any invitation, offer or agreement to subscribe, purchase or otherwise acquire such investments will be engaged in only with, relevant persons. Any person who is not a relevant person should not act or rely upon this communication or any of its contents. In the same way, the information contained in this communication is intended for "eligible counterparties" and "professional clients" as defined by the rules of the Financial Conduct Authority and is not intended for "retail clients". With this in mind, Westpac expressly prohibits you from passing on the information in this communication to any third party. In particular this communication and, in each case, any copies thereof may not be taken, transmitted or distributed, directly or indirectly into any restricted jurisdiction. This communication is made in compliance with the Market Abuse Regulation (Regulation(EU) 596/2014).

**U.S.:** Westpac operates in the United States of America as a federally licensed branch, regulated by the Office of the Comptroller of the Currency. Westpac is also registered with the US Commodity Futures Trading Commission ("CFTC") as a Swap Dealer, but is neither registered as, or affiliated with, a Futures Commission Merchant registered with the US CFTC. Westpac Capital Markets, LLC ("WCM"), a wholly-owned subsidiary of Westpac, is a broker-dealer registered under the U.S. Securities Exchange Act of 1934 ('the Exchange Act') and member of the Financial Industry Regulatory Authority ('FINRA'). This communication is provided for distribution to U.S. institutional investors in reliance on the exemption from registration provided by Rule 15a-6 under the Exchange Act and is not subject to all of the independence and disclosure standards applicable to debt research reports prepared for retail investors in the United States. WCM is the U.S. distributor of this communication and accepts responsibility for the contents of this communication. All disclaimers set out with respect to Westpac apply equally to WCM. If you would like to speak to someone regarding any security mentioned herein, please contact WCM on +1 212 389 1269. All disclaimers set out with respect to Westpac apply equally to WCM.

Investing in any non-U.S. securities or related financial instruments mentioned in this communication may present certain risks. The securities of non-U.S. issuers may not be registered with, or be subject to the regulations of, the SEC in the United States. Information on such non-U.S. securities or related financial instruments may be limited. Non-U.S. companies may not be subject to audit and reporting standards and regulatory requirements comparable to those in effect in the United States. The value of any investment or income from any securities or related derivative instruments denominated in a currency other than U.S. dollars is subject to exchange rate fluctuations that may have a positive or adverse effect on the value of or income from such securities or related derivative instruments.

The author of this communication is employed by Westpac and is not registered or qualified as a research analyst, representative, or associated person under the rules of FINRA, any other U.S. self-regulatory organisation, or the laws, rules or regulations of any State. Unless otherwise specifically stated, the views expressed herein are solely those of the author and may differ from the information, views or analysis expressed by Westpac and/or its affiliates.

## Investment Recommendations Disclosure

Investment Recommendations for Financial Instruments covered by MAR are made in compliance with Article 20 MAR. Westpac does not apply MAR Investment Recommendation requirements to Spot Foreign Exchange which is out of scope for MAR.

Unless otherwise indicated, there are no planned updates to this Investment Recommendation at the time of publication. Westpac has no obligation to update, modify or amend this Investment Recommendation or to notify the recipients of this Investment Recommendation should any information, including opinion, forecast or estimate set out in this Investment Recommendation change or subsequently become inaccurate.

Westpac will from time to time dispose of and acquire financial instruments of companies covered in this Investment Recommendation as principal and act as a market maker or liquidity provider in such financial instruments.

Westpac does not have any proprietary positions in equity shares of issuers that are the subject of an investment recommendation.

Westpac may have provided investment banking services to the issuer in the course of the past 12 months.

Westpac does not permit any issuer to see or comment on any investment recommendation prior to its completion and distribution.

Individuals who produce investment recommendations are not permitted to undertake any transactions in any financial instruments or derivatives in relation to the issuers covered by the investment recommendations they produce.

Westpac has implemented policies and procedures, which are designed to ensure conflicts of interests are managed consistently and appropriately, and to treat clients fairly.

The following arrangements have been adopted for the avoidance and prevention of conflicts in interests associated with the provision of investment recommendations.

- (i) Chinese Wall/Cell arrangements;
- (ii) physical separation of various Business/Support Units;
- (iii) Strict and well defined wall/cell crossing procedures;
- (iv) a "need to know" policy;
- (v) documented and well defined procedures for dealing with conflicts of interest;
- (vi) reasonable steps by Compliance to ensure that the Chinese Wall/Cell arrangements remain effective and that such arrangements are adequately monitored.