



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.

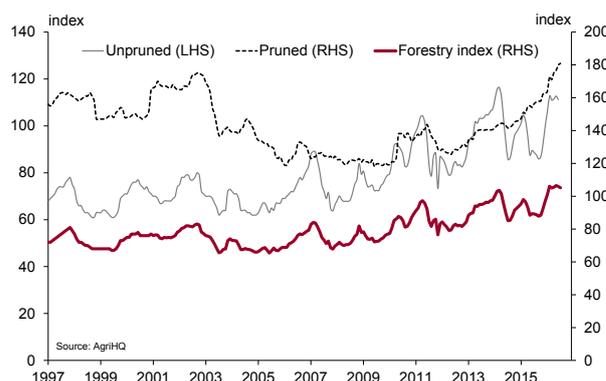
But while there are likely to be some partial offsets from non-Chinese demand, on balance it's difficult to envision log prices being able to maintain their current high levels as growth in China continues to slow. Consequently, we would expect prices to ease a little.

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

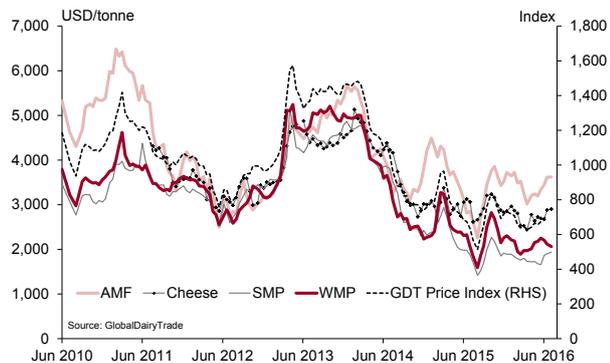
Beyond the farm gate



Dairy

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

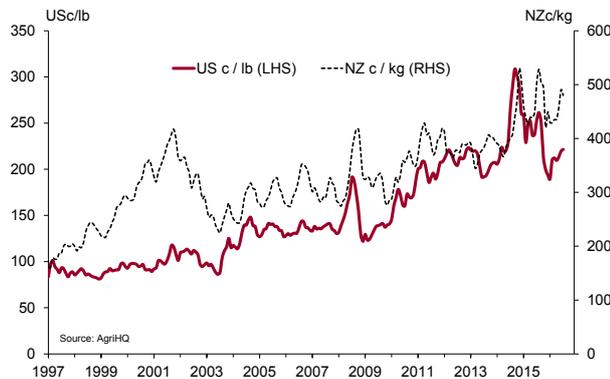
Dairy prices were flat overall in last night's GlobalDairyTrade auction. In the underlying detail, whole milk powder (WMP) prices (the biggest influence on Fonterra's farm gate milk price) halted their recent run of declines. WMP prices rose 1.9% to US\$2,079/tonne. In contrast skim milk powder prices 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	→

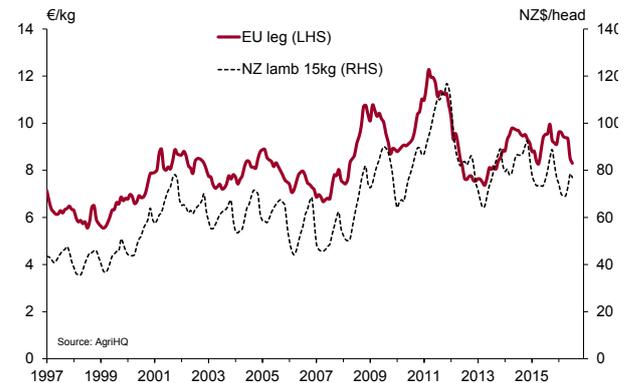
Over the medium term, international beef prices are likely to be underpinned by relatively tight global supply as beef exports from Australia, and to a lesser extent New Zealand, contract. However, this will be balanced against increasing domestic supplies in the US, with changes to market access for 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.

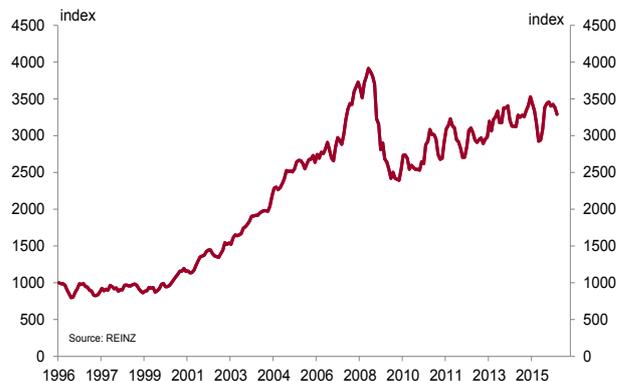


Land prices

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.

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