



Fortnightly Agri Update

21 September 2016

Easing off the accelerator

Dairy prices took their foot off the accelerator in last night's GlobalDairyTrade auction, with the headline index edging up 1.7%. Within this, whole milk powder prices (WMP) were flat (down 0.2% to \$2,782) while skim milk powder and AMF recorded modest increases (up 3% and 4.6% respectively). This result was a clear disappointment to the futures market which had been hinting at another double digit price gain.

It's likely that NZ production will remain a crucial influence on global prices this season. And to date, this season has started off on a fairly firm footing in many parts of the country. Fonterra's season to date milk collections are running almost 4% behind the same period last season (to the end of August). But this needs to be kept in context. Milk collections over the three months to August only comprise less than 10% of milk collected over the season. In addition, Fonterra has been losing share of the local milk supply.

Weather and pasture conditions over the next few months will be even more important than usual in determining domestic production. NZ farmers have gone back to basics in an effort to trim costs as much as possible given the low payout environment of the last couple of seasons. That's meant cutting back on spending on supplementary feed and relying on pasture growth to drive production. Consequently, we'll be keeping a close eye on how the NZ season is progressing over the coming months.

While last night's result was broadly in line with our expectations, the key assumption underpinning our \$5 farm gate milk price forecast for 2016/17 remains that we see a partial retracement of the recent big run up in WMP prices over the coming months. If this doesn't happen, there remains significant upside risk to our \$5 farm gate milk price forecast.

For Fonterra, it appears that last night's auction was enough to crystallise the upside risk to their own payout forecast. They announced an upgrade today to \$5.25 (previously \$4.75). We look forward to receiving further information on last season's milk price calculation (allowing us to update our own methodology) with the release of Fonterra's Annual report tomorrow.

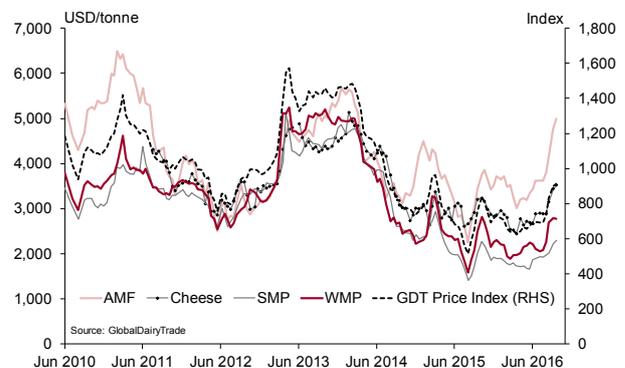
But while international dairy prices have improved significantly in recent months, the strong NZ dollar continues to take the gloss off farm gate earnings. Not only for NZ dairy farmers, but also for agricultural exporters more generally. The Kiwi remains well above 70c against the USD, despite the RBNZ last month strongly signalling that they are likely to cut rates further from here. We expect the RBNZ will repeat this message in tomorrow's OCR Review, but leave the OCR unchanged at 2%. We do, however, expect when push comes to shove in November, that they will cut the OCR to 1.75%.

However, the fortunes of the NZD/USD probably hinge more on the outlook for interest rates in the US at the moment. In contrast to the RBNZ, the Federal Reserve is widely expected to raise rates in the coming months. When it does (we think December is the most likely timing), this should give the USD a boost and take some of the heat out of the NZ dollar. This would come as a welcome development to NZ exporters across the board.

Anne Boniface

Senior Economist

Global Dairy Prices



GlobalDairyTrade Auction Results, 21 September 2016

	Change since last auction	Price index USD/Tonne
Anhydrous Milk Fat (AMF)	4.6%	\$4,998
Butter Milk Power (BMP)	7.0%	\$2,276
Butter	3.6%	\$3,892
Skim Milk Powder (SMP)	3.0%	\$2,293
Whole Milk Powder (WMP)	-0.2%	\$2,782
Cheddar	2.2%	\$3,518
GDT Price Index	1.7%	

Payout Forecast Table

	2015/16	2016/17	
	Fonterra	Fonterra	Westpac
Milk Price	\$3.90	\$5.25	\$5.00

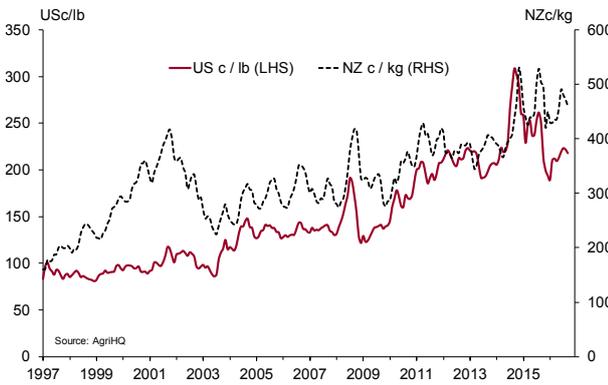
Beyond the farm gate



Beef

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

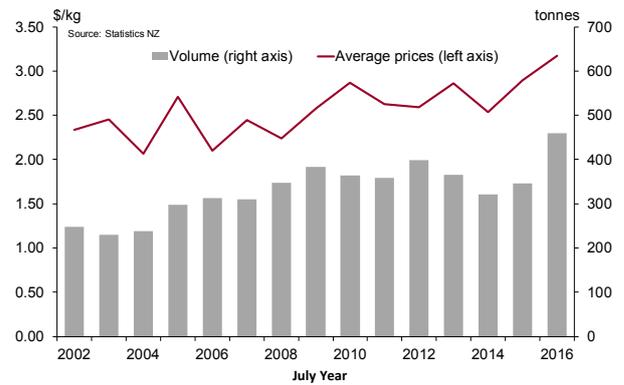
Over the near term, international beef prices are likely to be underpinned by relatively tight global supply as beef exports from Australia, and to a lesser extent New Zealand, contract. However, we are more pessimistic on prices further down the track. Increasing US supply, combined with the likely re-emergence of Brazilian exports into key markets is likely to increase competition for New Zealand's beef exporters and weigh on prices.



Kiwifruit

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

The horticulture sector, and kiwifruit in particular, has been a standout performer amongst New Zealand agricultural exporters of late. Export volumes and prices are both up strongly on the back of robust consumer demand and the success of new cultivars developed following PSA leading to record returns to growers. Zespri expects to sell 82 million trays of Green and 47 million trays of SunGold this season, with the gold variety in particular likely to see solid demand from key markets.

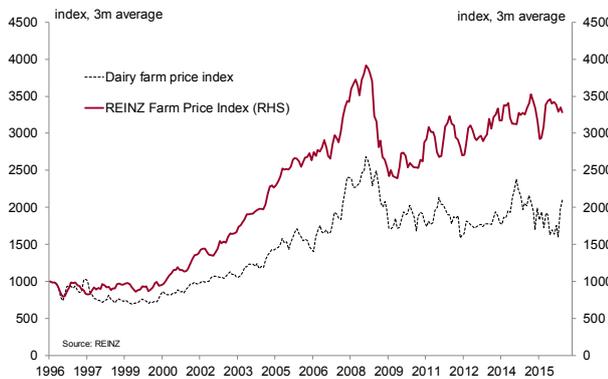


Land prices

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

The REINZ farm price index showed prices easing in August, but 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 it sustained in the coming months.

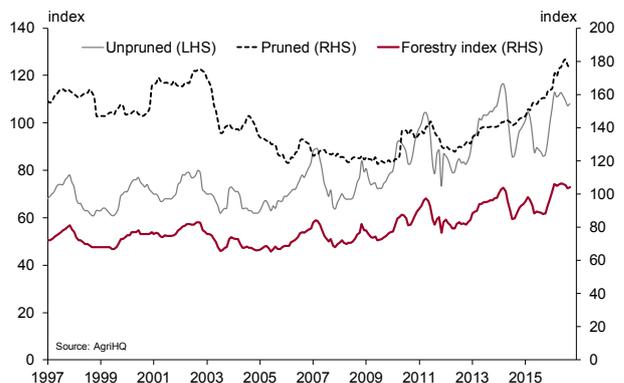
REINZ farm price index



Forestry

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

After easing in August, log prices improved a little in September on the back of a small lift in export prices. While domestic demand continues to be supported by the rampant construction sector, export prices have been surprisingly resilient. Reports of lower than usual inventories are likely to be one factor supporting NZ log prices in China.



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

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