



Fortnightly Agri Update

3 August 2016

Low-hanging fruit

Last week, we published our latest Industry Insights report, covering the horticulture sector.¹ It showed that the horticulture sector in New Zealand is small in terms of direct employment, at around 39,000 FTEs, but is responsible for more than 7% of New Zealand's merchandise exports.

The sector is enjoying a period of exceptional growth across almost all subsectors. Total export revenues reached \$3.4 billion in the year to May 2016, and in the four years to May revenues from exports of our three most important horticulture products (by value) grew by 54% (kiwifruit), 105% (apples) and 158% (honey). But growth was not limited to these headliners. Blueberries (116%), onions (81%), and cherries (303%) have also done very well. Huge potential for further growth remains.

A number of factors have driven this recent success. Many product categories have increased yields by up to 50% through new on-farm practices, or growing different varieties. Marketing of individual varieties as brands has opened up new markets internationally, while trade with China and other parts of Asia has benefitted from freer trade, often aided by Free Trade Agreements. At the same time, huge changes are afoot, posing both opportunities and risks:

Increased consolidation and corporatisation is reducing the number of "front doors" in the sector. Scale increases financial viability by allowing uptake of better technology, more skilled management, and by mitigating risk across the business through geographic dispersion of growing capability. We expect to see more corporatisation across sub-sectors, especially in Manuka honey, as the cost to enter the sector rises.

Better technology is emerging, including know-how on planting and pruning; new varieties; digital technology to monitor ripeness, quality, and weather patterns to optimise production; more automation in sorting and packing; and better atmosphere control in refrigerated units. This gives us an advantage over competitors until such time as they catch up on the technology, so changes must remain ongoing. We expect more automation of sorting and packing, and the need to employ technology to further support corporatisation.

Exports are increasingly concentrated in fewer markets, most notably Australia and China, growing risks from a shock in one market. Over the short-term, we expect to see more export concentration in China, but opportunities in emerging markets like India and Indonesia may offer some diversification.

Debt is growing as land values rise on good returns of between 7% and 12% in some products. This could create financial strife for some growers if they have assumed that yields will stay this strong indefinitely. Nevertheless, at current returns, we expect to see further gains in land values, especially in kiwifruit and apples.

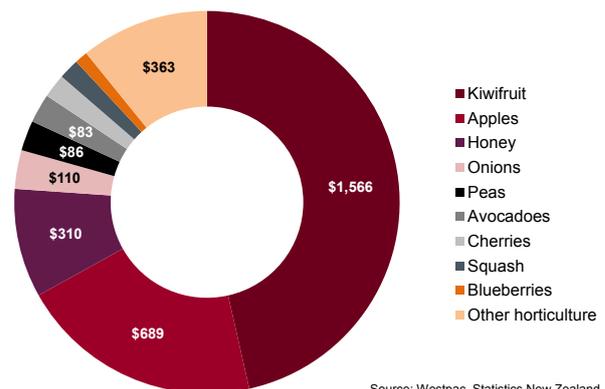
There is **potential for more non-tariff barriers**. Some industry sources were concerned that the current political environment globally may be turning away from free trade. Examples of

non-tariff barriers already in play include subsidies to local growers, changing relationships in markets where trade is driven by government-to-government negotiations, and the use of biosecurity regulations as a trade barrier.

There is a **risk of labour shortages**. Seasonal workers brought in from offshore are one way of tackling a shortage of workers in the sector. However, there are more structural concerns related to an ageing workforce, and access to skilled scientists and teachers to ensure New Zealand remains competitive. Without planning to attract and keep younger people in the sector, and to boost the number of technical experts in the sector, New Zealand risks falling behind.

David Norman
Industry Economist

Horticulture exports by product (\$m), year to May 2016



Source: Westpac, Statistics New Zealand

GlobalDairyTrade Auction Results, 3 August 2016

	Change since last auction	Price index USD/Tonne
Anhydrous Milk Fat (AMF)	4.7%	\$3,797
Butter Milk Power (BMP)	7.7%	\$1,661
Butter	6.6%	\$2,871
Skim Milk Powder (SMP)	2.1%	\$1,965
Whole Milk Powder (WMP)	9.9%	\$2,265
Cheddar	-0.8%	\$2,889
GDT Price Index	6.6%	

Payout Forecast Table

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

¹ <http://www.westpac.co.nz/assets/Business/Economic-Updates/2016/Bulletins-2016/Industry-Insights-Horticulture-July-2016.pdf>

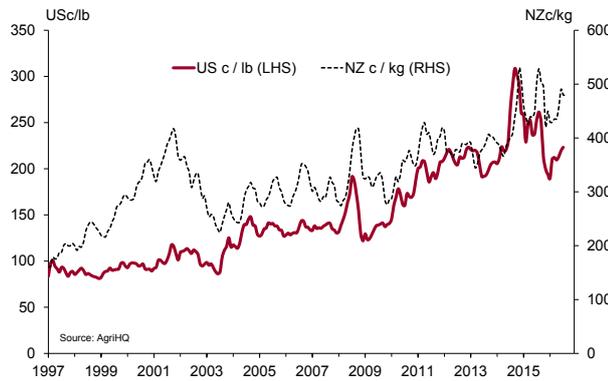
Beyond the farm gate



Beef

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

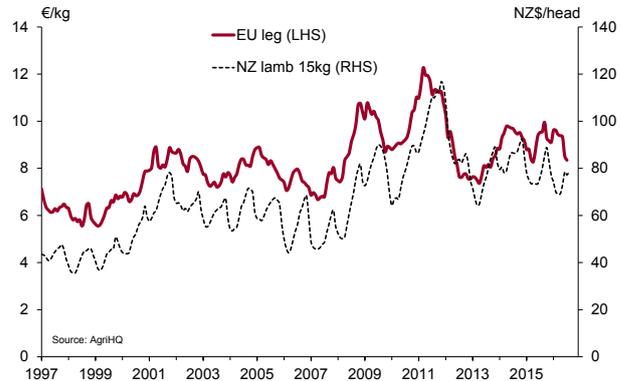
Over the medium term, international beef prices are likely to be underpinned by relatively tight global supply as beef exports from Australia, and to a lesser extent New Zealand, contract. However, this will be balanced against increasing US supply. Changes to market access for Brazil's chilled beef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



Lamb

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

Over the medium term, we continue to 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.

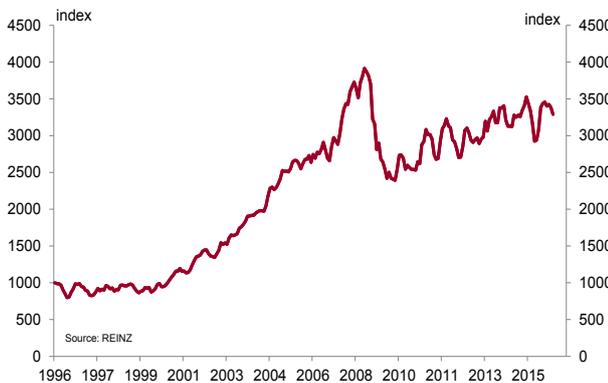


Land prices

	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.

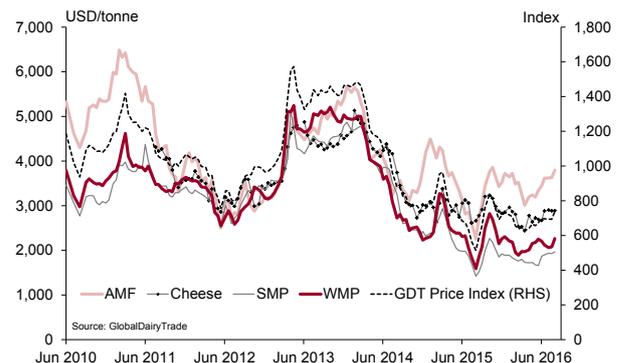
REINZ farm price index



Dairy

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

Dairy prices rose 6.6% in last night's GlobalDairyTrade auction, led by a 9.9% lift in whole milk powder prices. Most other products on offer also posted gains. The lift has been well signalled by the futures market over the last week. While the rise will undoubtedly be welcomed by farmers, we would caution against getting too carried away just yet and don't think the conditions are yet in place for a wholesale turnaround in the fortunes of the sector. Dairy prices have been very low for an extended period, giving buyers ample opportunity to stock up. And while there are certainly signs of slower growth in milk supply in major dairy exporters, including the EU, this slowdown is coming off a very high level. We had been cognisant of growing downside risks to our \$4.60 milk price forecast for the current season after slightly weaker whole milk powder prices and a much stronger NZ dollar over the last couple of months. However, today's outturn leaves us much more comfortable with our \$4.60 forecast for this season's farm gate milk price.



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

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