

Fortnightly Agri Update

5 October 2016

Spring lamb

As lambing finishes around the country, we take a look at some of the factors influencing international lamb markets, and assess the outlook for lamb prices over the coming months.

Beef and Lamb NZ's early estimates are that the 2016 lamb crop is likely to be down almost 3% on last season's numbers. The drop in numbers is a combination of fewer breeding ewes and, in some regions the impact of facial eczema. Final numbers will be influenced by weather at lambing which by most accounts has been relatively favourable. While there have been the inevitable cold snaps and widespread wet weather, in the main farmers seem reasonably happy with lambing outcomes.

New Zealand is not the only major exporter likely to see lamb flocks contract this season. The Australian Bureau of Agricultural and Resource Economics and Sciences expect Australia's lamb production to fall by 1% on last season. However, they also anticipate significant ewe retention with the adult sheep kill forecast to fall 20%.

So while relatively tight lamb supplies in NZ and Australia this season should keep a floor under prices, the demand outlook is not looking quite as supportive in some of NZ's key markets. Demand in the UK in particular remains under a cloud following the Brexit vote.

The implications of Brexit remain relatively uncertain, with a few details on timing only now starting to emerge. This week the British PM, Theresa May, confirmed that the Government would begin the formal process of leaving the EU by the end of March next year. While optimists would like to view Brexit as an opportunity to negotiate more favourable trade agreements with both the UK and the EU, in reality it's unlikely to be smooth sailing – either from the perspective of agricultural exports, or indeed more widely. There's a risk the wave of protectionist sentiment currently sweeping the globe may play into the hands of British sheep farmers who are already riling against the “unacceptably high” level of NZ lamb imports. They would like to see tighter controls on NZ lamb entering the UK market, and are wary of Australia's reported attempts to use Brexit to support their case for increased access. At the same time, British farmers will be wanting to ensure their own access to their biggest export markets in the EU remain as free from barriers as possible.

But there are issues for further down the track. The most immediate impact of the Brexit vote has been a sharply weaker pound. The NZD/GBP has risen to 0.5662 – close to a post-float high. This is likely to weigh on farm gate returns.

In other markets, developments are more mixed. The prospect of chilled meat access to China is a positive development, although numerous hoops still need to be jumped though. And

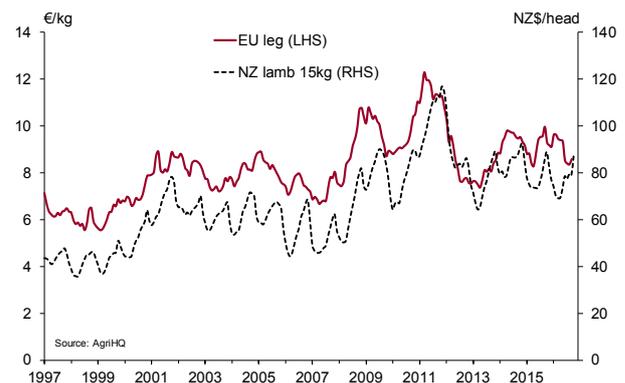
while exports have softened noticeably (lamb exports to China in the year to August were down around 10%), and we expect growth in the Chinese economy, the market still offers immense opportunities over a longer horizon.

On balance, we expect to see international lamb prices to broadly head sideways over the next year (albeit with seasonal variation). Farm gate returns are likely to remain under pressure from the strong NZ dollar.

Anne Boniface

Senior Economist

Lamb Prices



GlobalDairyTrade Auction Results, 5 October 2016

| | Change since last auction | Price index USD/Tonne |
|--------------------------|---------------------------|-----------------------|
| Anhydrous Milk Fat (AMF) | -1.0% | \$4,954 |
| Butter Milk Power (BMP) | 9.3% | \$2,408 |
| Butter | -0.3% | \$3,891 |
| Skim Milk Powder (SMP) | -3.9% | \$2,209 |
| Whole Milk Powder (WMP) | -3.8% | \$2,681 |
| Cheddar | -2.3% | \$3,430 |
| GDT Price Index | -3.0% | |

Payout Forecast Table

| | 2016/17 | | 2017/18 |
|------------|----------|---------|---------|
| | Fonterra | Westpac | Westpac |
| Milk Price | \$5.25 | \$5.00 | \$6.10 |

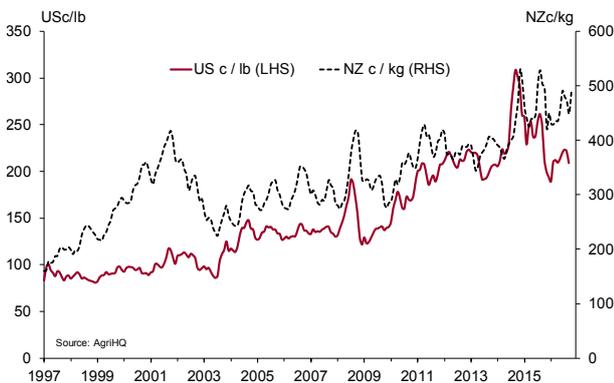
Beyond the farm gate



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 of late. Most recently, China has announced that it has lifted a 13-year ban on some US beef products (implemented over mad cow concerns back in 2003). The move follows the resumption of Brazilian beef exports to China last year. The US has also eased import restrictions on Brazilian beef, with the first fresh beef exports shipped 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.

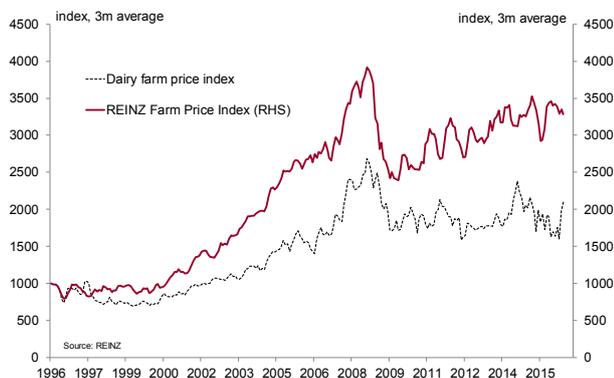


Land prices

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

The REINZ farm price index showed prices easing in August. 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



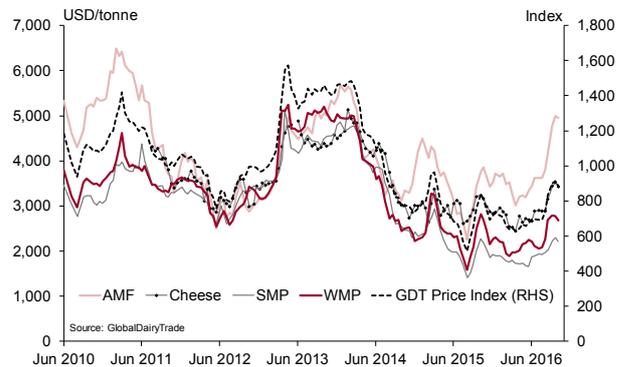
Dairy

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

Dairy prices fell 3% in last night's GlobalDairyTrade auction. This was the first fall we've seen in the headline GDT index since July. Prices for most products on offer fell, including an almost 4% fall in the all-important whole milk powder (WMP) price. We had been sceptical that WMP prices would be able to maintain the heights they reached in September, and the last couple of auction results lend some support to this view.

While the fundamentals have certainly moved in favour of milk producers, with milk supply falling in key exporting regions, the recent improvement in prices will likely dampen the signal to reduce production further. In addition, much will depend on how the NZ production season progresses. Pasture conditions will be key as many NZ farmers have taken a back-to-basics approach as they look to cut costs. For now, we continue to assume some further moderation in world dairy prices over the coming months. However, if this doesn't happen, there remains upside risk to our current \$5 milk price forecast.

With the final payout for 2015/16 season confirmed by Fonterra (\$3.90 milk price plus a 40c dividend), we have also published an opening forecast for the 2017/18 season. While there is clearly much uncertainty over prices at this horizon, it's useful to have a line in the sand. We've forecast a \$6.10 milk price on the assumption we have a stronger starting point for dairy prices in the 2017/18 season, along with a gradual improvement in prices. We also expect to see the NZD/USD trend lower, toward the mid-60 cent range.



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

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