



# Fortnightly Agri Update

7 September 2016

## A solid start to spring

Last night saw another solid lift in dairy prices. The headline GlobalDairyTrade index was up 7.7%. However, unlike recent auctions, the increase wasn't driven by whole milk powder (WMP). Instead skim milk powder and AMF prices led the charge, rising 10% and 15.4% respectively. In contrast WMP lagged the pack, rising a more modest 3.7%. That's a bit weaker than the 8% or so lift the futures market had been pointing to. The recently confirmed support package from the European Commission to support the region's dairy farmers, discussed below, will also have helped support SMP prices in the near term.

Fundamentals have (not unexpectedly) moved in favour of dairy producers over the last month or so, with improved demand coinciding with lower milk supply from key global exporters. In Australia, milk production has dropped dramatically, to be down 10% in July compared to a year ago as farmers there respond to the sharp reduction in farmgate milk prices which occurred late in the 2015/16 season. But perhaps most importantly, EU milk production has also slowed materially, down 1.5% in June from a year earlier. The €500m support package for European farmers, which includes €150m aid to be paid EU to farmers for reducing milk production as well as extending private storage aid facilities, will further dampen EU milk production (if fully utilised, the payments to farmers for reducing milk production would lead to a 1.1 million tonne reduction in supply).

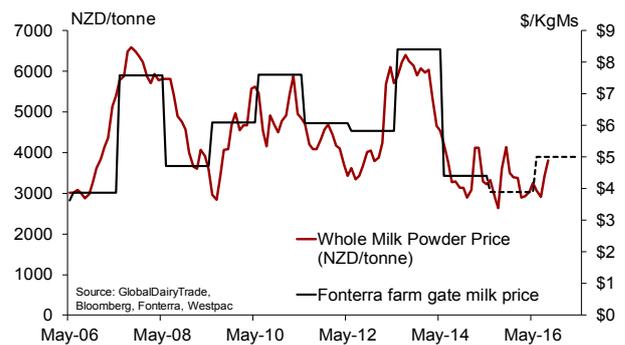
Closer to home, early signs for the 2016/17 are promising in many regions as spring breaks around New Zealand. July production (for what it's worth) was broadly on par with a year ago. While we expect domestic production to eventually be down around 3% this season on the back of reduced spending on supplementary feed and reduced herd size, weather and pasture conditions will play a critical role. With farmers reducing their use of supplementary feed and getting back to basics with their farming methods in an effort to keep costs to a minimum, pasture conditions will likely be an important swing factor for New Zealand production this season.

But while another lift in dairy prices is certainly good news for New Zealand dairy farmers, the strength in the NZ dollar is taking some of the shine off the improvement for New Zealand dairy farmers. The NZD/USD jumped again last night on the back of disappointing US data, rising to 0.7422. Looking ahead, we expect the USD to strengthen (and therefore the NZD/USD to depreciate) as the Federal Reserve begins to raise interest rates from December. But expectations of Fed interest rates hikes have ebbed and flowed of late. And there is clearly the risk that once again expectations of Fed rate hikes are pushed back, which will likely see the NZD stay stronger for longer.

We continue to forecast a farm gate milk price of \$5 this season (Fonterra is forecasting \$4.75). However, this view remains contingent on a partial retracement of the recent lift we have seen in dairy prices later in the season as we suspect the magnitude of the recent gains have been overdone relative to new news on the supply front. We remain conscious of upside risk to this forecast if there is no such retracement in the next few months. Fonterra will confirm the 2015/16 farm gate milk price (currently forecast to be \$3.90) when it announces its annual results on the 22 September.

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Senior Economist

## Whole milk powder prices and farm gate milk price



## GlobalDairyTrade Auction Results, 7 September 2016

	Change since last auction	Price index USD/Tonne
<b>Anhydrous Milk Fat (AMF)</b>	15.4%	\$4,769
<b>Butter Milk Power (BMP)</b>	6.8%	\$2,070
<b>Butter</b>	14.9%	\$3,764
<b>Skim Milk Powder (SMP)</b>	10.0%	\$2,224
<b>Whole Milk Powder (WMP)</b>	3.7%	\$2,793
<b>Cheddar</b>	9.0%	\$3,436
<b>GDT Price Index</b>	7.7%	

## Payout Forecast Table

	2015/16	2016/17	
	Fonterra	Fonterra	Westpac
<b>Milk Price</b>	\$3.90	\$4.75	\$5.00

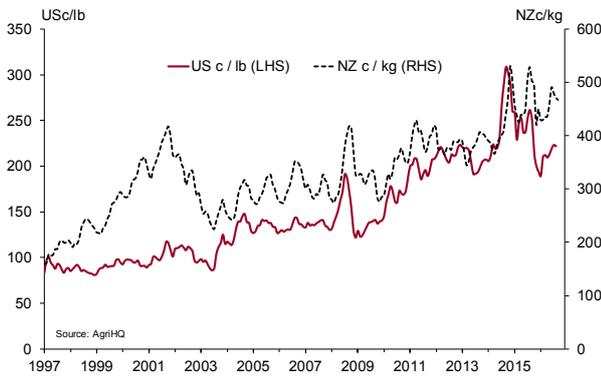
# Beyond the farm gate



## Beef

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

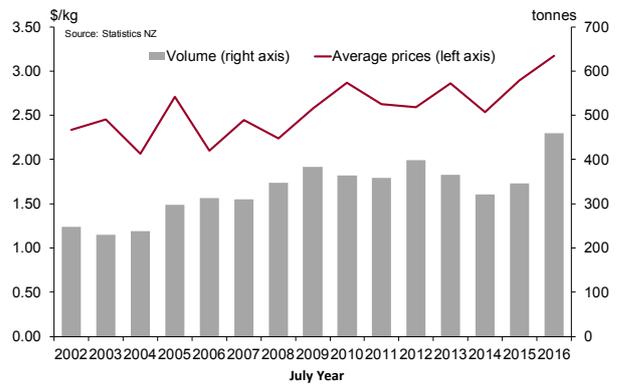
Over the near term, international beef prices are likely to be underpinned by relatively tight global supply as beef exports from Australia, and to a lesser extent New Zealand, contract. However, we are more pessimistic on prices further down the track. Increasing US supply, combined with the likely 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.

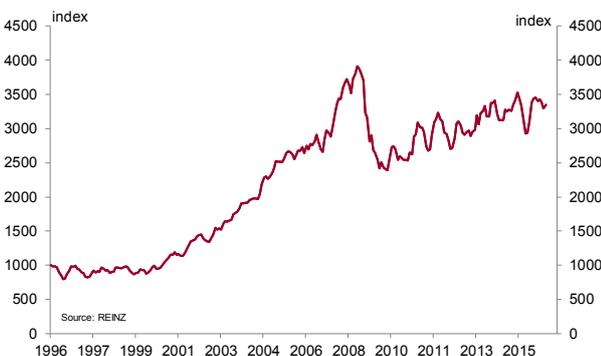


## Land prices

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

The REINZ farm price index showed that overall farm prices picked up a little in July, leaving them broadly steady over the past year. Underlying the recent pick up in overall farm prices was a sharp increase in the price of dairy farms sold in July compared to June. However, this was on low volumes and we'll have to watch to see if such buoyancy is sustained. On a per hectare basis, prices for horticulture land have continued to moderate after a very strong run over the last 6 months. Prices per hectare for other farm types have been broadly stable in recent months.

## REINZ farm price index

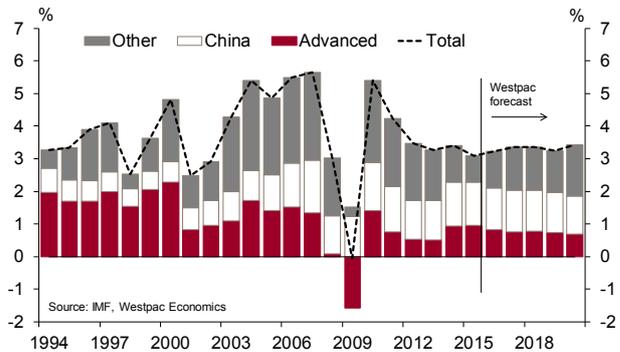


## Global Growth

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

Global growth remains subdued, and the UK's decision to exit the European Union has skewed the risks to the downside. US growth is disappointingly slow in the first half of the year. However, recent labour market data combined with comments from Fed Chair Yellen has markets again thinking that it is likely the Fed will hike rates again by year. When it happens (we think December is most likely) we expect this will put upward pressure on the US dollar and see the NZD/USD depreciate. Chinese GDP growth has held up but not without considerable help from policy makers.

## Contributions to global growth



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

# Contact the Westpac economics team

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