

#### Westpac forecasts of Fonterra milk price

	2012/13	2013	3/14	2014/15
	Final	Fonterra	Westpac	Westpac
Milk Price	\$5.84	\$8.30	\$8.30	\$6.70

#### A friendlier global environment.

Another fortnight, another round of positive news concerning global prices for New Zealand's key export products. Fonterra's latest GlobalDairyTrade auction registered a 2.4% increase in prices overall. Lamb schedules are improving off a low base. Beef prices are still high. And forestry returns have risen a little further over the past month.

Last week Fonterra revised its forecast of the 2013/14 milk price to a record \$8.30/kg of milk solids. This matched Westpac's own forecast of \$8.30, which was issued on 5 September. And if GDT auction prices continue to rise, there is still the possibility of another upward revision.

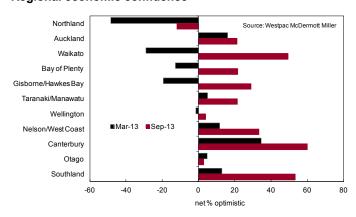
This will go down as the biggest upside surprise on the milk price since 2008. At the start of the season, global milk prices were extremely high and the New Zealand dollar was below 80 cents against the US dollar, so Fonterra was being paid roughly \$9.00/kg for milk. But we expected milk prices to fall over course of the season as New Zealand supply recovered from drought, emerging market economies slowed, and the New Zealand dollar rose. All of these things came to pass, but milk prices simply defied gravity.

We can point to some specific reasons for the strength of global soft commodity prices. Demand in traditional markets such the US and Europe has firmed a little, and China's economic data has improved over the past month or two. But the biggest influence seems to be changing consumption patterns in China. The current Chinese slowdown reflects a rotation of growth away from investment and towards consumption, so households are moving up the food quality ladder. And the Chinese government's inquiry into the retail price of milk powder will have benefited wholesalers – the resulting reduction in retail prices has boosted end demand for dairy products.

The income boost to New Zealand Inc is clear. In the dairy sector alone, the improvement in milk price combined with our expectation of a 5% lift in production volumes will mean \$4.5bn more revenue this year compared to last – equivalent to 2% of New Zealand's GDP. The beef and forestry sectors will be seeing analogous improvements in revenue. We expect this income improvement to filter through rural New Zealand over the coming year, and judging by the Westpac McDermott Miller Regional Economic Confidence survey, households in many regions agree.

But New Zealand's surprisingly strong export prospects have also pushed the New Zealand exchange rate higher, against both the US dollar and the Australian dollar. We have long been forecasting a return to 83 cents against the US dollar, and that level has already been reached. The risk is that the exchange rate goes even higher from here.

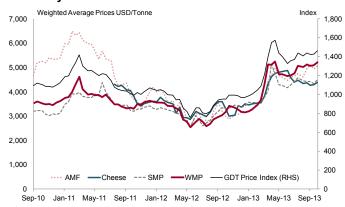
## Regional economic confidence



#### Global Dairy Trade Auction Results, 2 October 2013

	Change since last auction	Price USD/Tonne
Anhydrous Milk Fat (AMF)	2.7%	\$5,062
Butter Milk Power (BMP)	2.7%	\$4,695
Butter	0.1%	\$3,915
Skim Milk Powder (SMP)	3.9%	\$4,491
Whole Milk Powder (WMP)	2.3%	\$5,208
TWI (All Products)	2.4%	

#### **GDT Dairy Auction Prices**



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Chief Economist

See overleaf for sector outlooks.

1 October 2013

# Beyond the farm gate

#### Beef

Current price level compared to 10 year average		Next 6 months
Trend	High	<b>→</b>

The strong run for beef continues unabated, with US-dollar prices still steady at a high level. We expect this situation to remain in place over the coming six months. US slaughter levels are low, limiting the global supply of beef. Meanwhile, demand for New Zealand beef should get a boost from Indonesia's recent decision to allow more imports. However, the recent rise in the New Zealand dollar – which we expect will be maintained – will erode returns in New Zealand dollar terms.

#### Lamb

Current price level compared to 10 year average		Next 6 months
Trend	Average	<b>^</b>

After the lows of last year, lamb prices are steadily pushing higher and can now be described as "average" rather than "below average". We expect lamb prices to continue rising over the next six months as demand recovers in Europe, Chinese consumption rises, and supplies out of Australia and New Zealand remain constrained. However, the strong New Zealand dollar and the damage wrought by this year's drought mean that times remain relatively tough for the industry.

## Wool

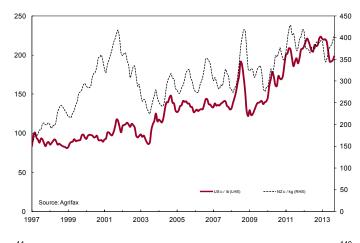
	Current price level compared to 10 year average	Next 6 months
Trend	Above Average	Coarse ↑ Fine/Medium ↓

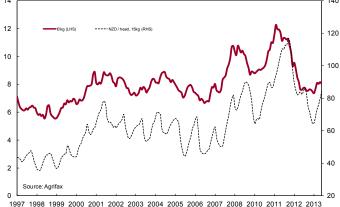
The wool market has split, with coarse wool prices continuing to firm while fine and medium wool prices head in the opposite direction. Coarse wool prices have risen 25% since April, in line with the improving housing market in the US. As the US housing market recovers further, the rise in coarse wool prices is expected to continue. On the other hand, the outlook for fine and medium wool prices is subdued – fine prices are down 12% since April. With demand for end products weak, particularly in Europe, prices may fall further.

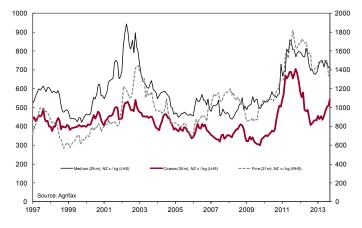
#### **Forestry**

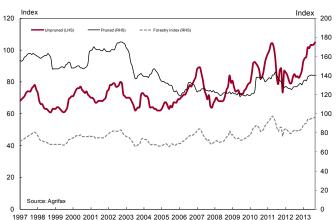
Current price level compared to 10 year average		Next 6 months
Trend	High	•

Forestry prices defied gravity once again in September, with the forestry price index up another 1%. Until recently, the driving force was the recovery in the US housing market. But now, prices in China have begun to firm as well. This is in line with the modest improvement we've registered elsewhere in the Chinese economy. On top of this, New Zealand domestic demand is rapidly strengthening as the residential construction industry winds up. These factors are expected to keep forestry prices high by historical standards, although we are doubtful that prices can sustain the levels they reached in September.









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

2 October 2013

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