

Fortnightly Agri Update

2 October 2014

Another dive

Dairy prices took another dive in last night's GlobalDairyTrade auction. The headline TWI index fell 7.3%, dragged down by a surprising 10% fall in Whole Milk Powder (WMP) prices. Both WMP and the headline TWI measure have now roughly halved from their February highs.

This outturn was considerably weaker than expected, particularly because of the sharp fall in WMP. Last night's move was one of the bigger falls in any single auction that we've seen since dairy prices began tumbling back in February, and follows a period of relative stability in WMP prices over July and August.

It's difficult to identify a particular catalyst for the drop in dairy prices in last night's auction, the factors weighing on dairy prices of late have shown few signs of abating. Global milk production continues to grow strongly and, closer to home, spring conditions for New Zealand farmers around much of the country have been favourable, with early season production running ahead of last year. Russia's ban on food imports from a number of Western countries remains in place and it certainly doesn't look as if Chinese wholesalers have been hurrying back into the market to replenish stocks. What's more, sentiment around growth prospects in China has become more downbeat of late.

Indeed it's the change in mood around China which has probably been weighing on commodity prices more broadly recently. Prices for other agricultural commodities have also been falling, along with a number of hard commodities and oil (see chart).

If there is a silver lining for dairy farmers (and other NZ exporters) it's that the NZ dollar has been responding to deteriorating export prices. But it hasn't just been weaker commodity prices driving the Kiwi lower. Sentiment around the US dollar has become much more buoyant of late as markets have become more constructive about US economic conditions and brought forward expectations of interest rate hikes by the Federal Reserve. Add to that a step up in rhetoric from the Reserve Bank about the "unjustified and unsustainable" level of the currency (along with confirmation they put their money where their mouth is in August by intervening in the currency market and selling New Zealand dollars) and we've seen the NZD/USD fall from a high above 88c back in July to current levels below 78c.

But while a lower currency helps soften the blow for farmers, it's not nearly enough to offset the fall in last night's auction. Consequently, we've revised down our payout forecast for the current season from \$5.30 to \$4.80. And while we've left it untouched today, we'll also be taking a long hard look at our \$6.60 forecast for the 2015/16 season over the next few weeks. Our core view remains that dairy prices will benefit from an improvement in Chinese demand early next year and that eventually lower prices will send a strong signal to producers around the globe to cut back production. However, for this season at least, this improvement is now likely to be later and weaker than we had previously pencilled in.

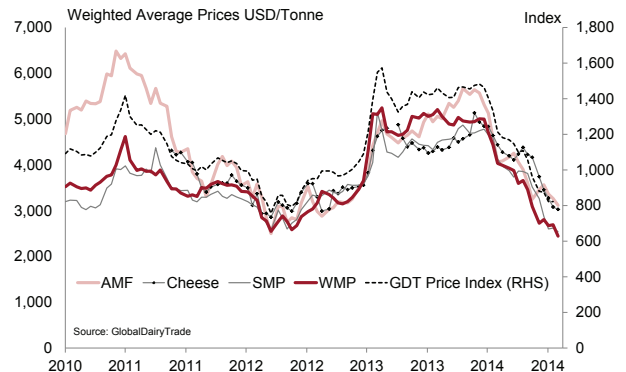
GlobalDairyTrade Auction Results, 2 October

	Change since last auction	Price USD/Tonne
Anhydrous Milk Fat (AMF)	-5.0%	\$3,117
Butter Milk Power (BMP)	-11.3%	\$2,723
Butter	-6.6%	\$2,514
Skim Milk Powder (SMP)	-2.7%	\$2,540
Whole Milk Powder (WMP)	-10.0%	\$2,443
Cheddar	-1.2%	\$3,028
GDT Price Index	-7.3%	

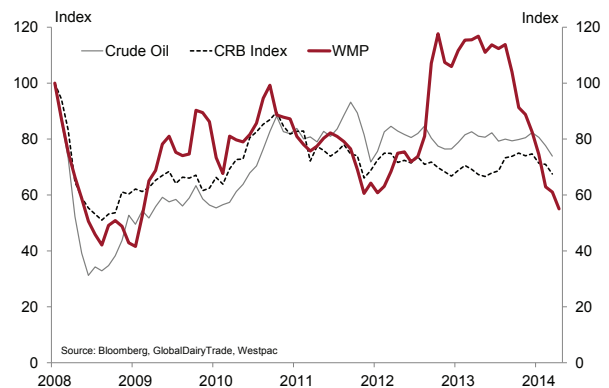
Payout Forecast Table

	2013/14	2014/15		2015/16
	Final	Fonterra	Westpac	Westpac
Milk Price	\$8.40	\$5.30	\$4.80	\$6.60

GDT auction prices



Commodity prices



Anne Boniface
Senior Economist

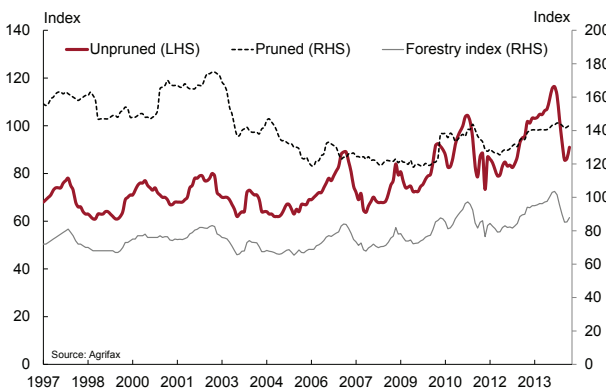
Beyond the farm gate



Forestry

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

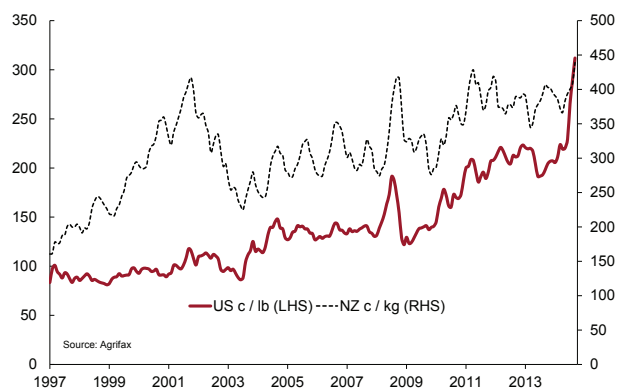
The Agrifax forestry price index rose 3% in September, driven by an improvement in unpruned log prices. Despite this change in direction, we don't anticipate a significant rebound in log prices for some time yet as weakness in the Chinese housing market continues to weigh on demand. That said demand conditions for forestry products in other export markets such as Australia and the US are more positive on the back of solid growth in residential construction. We also continue to expect the New Zealand construction sector to grow strongly for some time yet which should support domestic demand for forestry products.



Beef

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

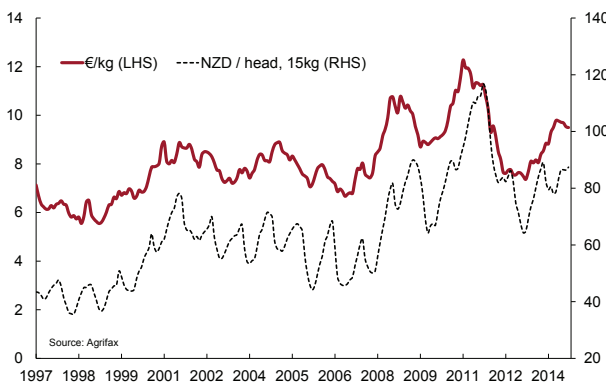
Beef prices have remained elevated in the last few weeks, as tight US supplies continue to dominate markets. USDA data shows that on July 1st this year, cattle inventories were at their lowest level since this particular survey began in 1973. While numbers are expected to grind on the back of record prices, improved pasture conditions and lower fed costs, this will take time. In the meantime, producers in Australia and New Zealand remain well placed to fill the gaps. Locally, favourable prices and climactic conditions helped support the first increase in beef cattle numbers since 2006/07 in Beef and Lamb New Zealand's 2014 stock survey. Beef cattle numbers were up 1.6% in the year, with the bulk of the increase coming from herds in the North Island.



Lamb

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

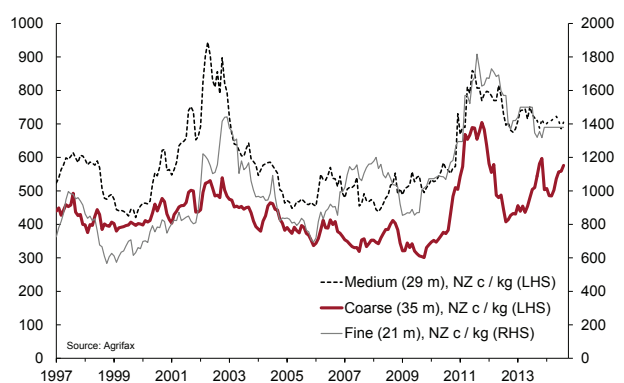
Slower growth in China (and associated weaker demand for luxury goods) along with closure of some tanneries in China may be a factor weighing on pelt prices locally according to reports. This could take some of the shine off lamb returns for farmers. However, we remain optimistic about lamb prices more generally on the back of tight global supplies. In particular Australian lamb production is expected to slow next season.



Wool

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

Coarse wool prices have improved a touch in the last month, helped by a weaker NZD. Locally and internationally, supplies remain tight with NZ supplies at auction running behind last year's levels. In their most recent forecasts, ABARES expects Australian wool production to reach a record low in the 2014/15 season on the back of a significant reduction in the national flock.



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

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