



# Fortnightly Agri Update

18 January 2017

## Cautious start

It's been a lacklustre start to the year for dairy prices, after last year's remarkable rebound that saw global prices rise more than 50% over the second half of the year. Dairy prices rose 0.6% in last night's auction, only partly reversing the 3.9% fall in early January. Whole milk powder prices have fallen 8% this year, reversing the gains from November and December and taking prices back just under \$3,300/tonne. To us, markets looked to have run a bit ahead of fundamentals through the latter part of last year, so some retracement hasn't come as a surprise. We think prices will ease a bit further in coming months, as global supply begins to stabilise. We're forecasting a farm gate milk price of \$6.20 for this season, which should be well above break-even levels for most farmers.

New Zealand's milk production has been and will remain a crucial influence on global prices. An unusually wet spring in many parts of the North Island impacted pasture quality and saw the New Zealand season off to a very poor start, with milk production down nearly 4% in the first half of the season (through to November). While some retrenchment in supply was expected this year due to a smaller national herd and reduced reliance on supplementary feed, the extent of deterioration was a surprise and in turn, helped to underpin higher dairy prices.

But we are less pessimistic than many about how the full season will shape up. We're forecasting nationwide production to be down 3-4% this season. This compares to Fonterra's widely-publicised forecast for its own milk collections to be down 7%. Part of the difference in forecasts reflects Fonterra's declining market share, as well as Fonterra being overweight in the North Island which suffered the largest declines in spring production (Fonterra's collections in the season to November and December were down 5.7% and 5.5% respectively). But domestic conditions have improved after the wet spring, and this will help support production in early 2017. Fonterra's production in December fared much better than October and November, and heading into the new year daily collections looked to be tracking at similar levels to last year. That said, conditions have been drying out rapidly in some areas of the Northern and Eastern North Island, and if dry conditions became more widespread this could weigh heavily on late season production.

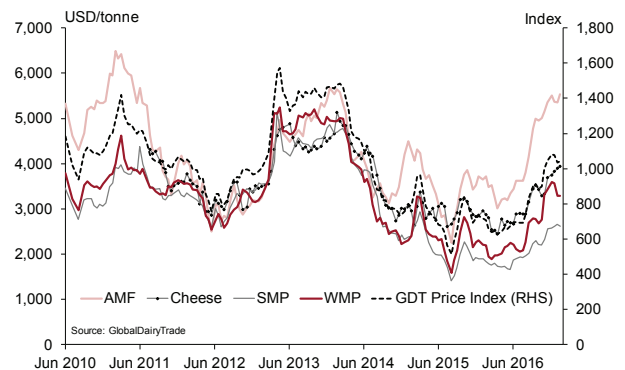
Look further afield, supply has continued to tighten in other key dairy exporters. European production in November was down 3.1% on a year earlier, a similar pace of decline seen in the previous two months. But this year, there will be fewer incentives for farmers to reduce production, with prices up strongly and with the European Commission no longer paying farmers to reduce production. Of the "big four" exporters, production has been down the most in Australia. Production fell 10.3% in the season to October, as farmers struggled with poor weather conditions and low farm gate prices. But it hasn't all been one-way traffic. US production continues to grow strongly, with production in November 2.4% higher than a year earlier.

A recovery in demand, especially from China, has also been an important factor supporting higher prices. China's imports of WMP

in the year to November were up 18%, after a particularly soft patch in 2015 as excess inventories were worked through. Whether demand can keep pace as more supply finds its way onto the market this year remains to be seen. But for now, things are looking positive. China's economy gained some momentum through the latter part of 2016, and the Chinese authorities will be determined to keep growth trucking along ahead of November's important National Congress. Although stimulus will more directly prop up the industrial sectors, this should provide some support to employment and household demand more broadly. But as always, high levels of debt and need for reform place grey clouds over the Chinese outlook further out, with the election of Donald Trump as the US President creating an additional source of risk.

**Sarah Drought**  
Economist

## Global Dairy Prices



## GlobalDairyTrade Auction Results, 18 January 2017

	Change since last auction	Price index USD/Tonne
Anhydrous Milk Fat (AMF)	3.7%	\$5,528
Butter	1.6%	\$4,382
Butter Milk Power (BMP)	-10.1%	\$2,783
Cheddar	1.3%	\$3,940
Lactose	-1.7%	\$813
Rennet Casein	4.9%	\$6,470
Skim Milk Powder (SMP)	-1.6%	\$2,612
Whole Milk Powder (WMP)	-0.1%	\$3,283
GDT Price Index	0.6%	

## Payout Forecast Table

	2016/17		2017/18
	Fonterra	Westpac	Westpac
Milk Price	\$6.00	\$6.20	\$6.50

# Beyond the farm gate

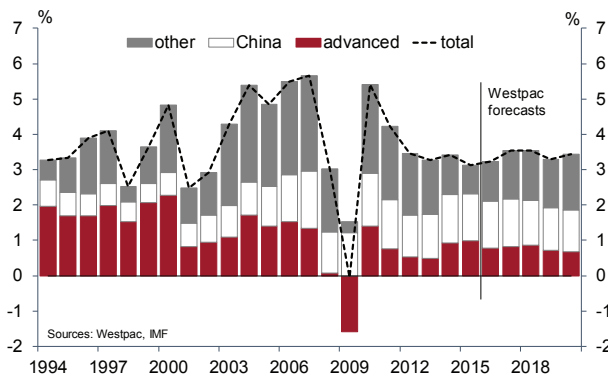


## Global Growth

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

The main event on the global stage has been the election of Donald Trump. While the new administration's policies are still taking shape, announcements to date, including increased infrastructure spending, imply a sizeable boost to US demand and inflation. This has resulted in upwards pressure on US and global term interest rates. However, it will be some time before any new policies can be implemented, and there is the risk that markets are disappointed. Global economic activity more generally is expected to remain modest. Many developed economies continue to face lingering softness in both domestic demand and investment spending. However, we are seeing some more positive signs emerging in China, while Australian growth is expected to firm.

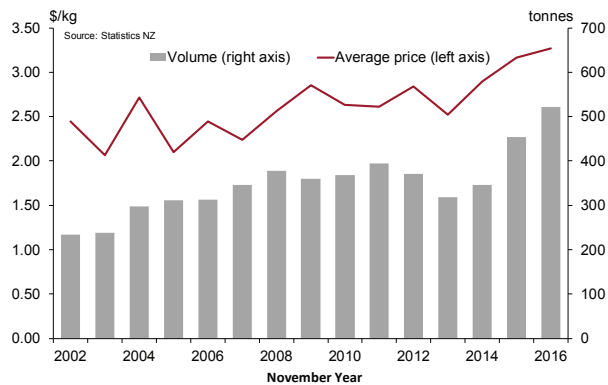
## Contributions to global growth



## 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 have risen strongly over the past two years, on the back of robust consumer demand and the success of new gold cultivars developed following Psa bacterial virus. Although the pace of volume growth will be more gradual from here, the industry should continue to perform strongly provided it can maintain its comparative advantage in meeting the tastes and preferences of Asian markets in particular.

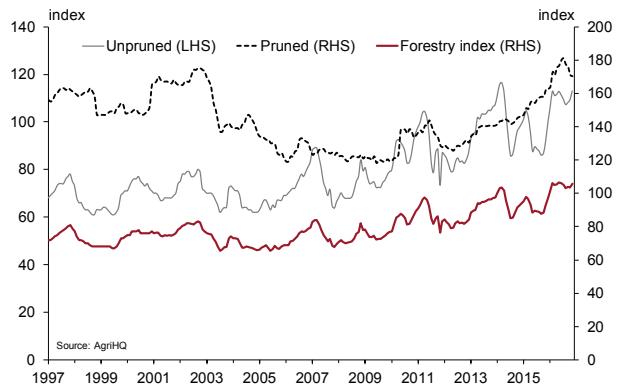


NB: Trend arrows indicate direction of change in world prices.

## Forestry

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

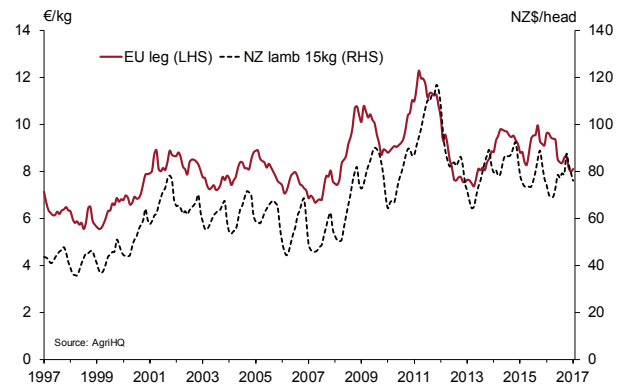
2016 was a bumper year for the forestry sector. NZ's booming construction sector continued to underpin high prices in the domestic market, while improved demand from China saw log export prices hover at elevated levels and export volumes surge. Reports of stable inventories in China will help underpin export prices in the near term. In addition, as the Chinese government heads towards the all-important 19th National Congress they will be determined to keep public investment growing rapidly, and this in turn will help to support log demand. However, at the same time, such high prices are likely to encourage an increase in global supply which will eventually have a moderating influence on prices.



## Lamb

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

Relatively tight supplies of lamb, especially from New Zealand, are helping to underpin in-market lamb prices. New Zealand's spring 2016 lamb crop was down 1.3% according to Beef and Lamb New Zealand, which was the smallest crop in over 60 years. In addition, slow lamb growth due to cool and damp spring conditions resulted in very low levels of lambs processed in Oct-Dec, although there will be some catch-up in early 2017. Australia saw solid growth in lamb exports through the end of 2016, although poor lambing conditions will weigh on exports in 2017. At the same time, the demand picture remains murky. Although demand from China for some of the cheaper cuts of sheepmeat has been more positive recently, the implications of Brexit are already creating challenges in the UK market. The substantially weaker pound has eroded the competitiveness of New Zealand's lamb exports, making our exports more expensive and UK lamb exports to Europe cheaper. And further out, market access is uncertain.



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