

Fortnightly Agri Update

19 April 2017



Comeback

Dairy prices rose further in last night's GlobalDairyTrade auction, with the overall price index up 3.1%. Prices have more or less recovered from their steep drop in the early March auction, although they're still 6% below the peak reached at the end of last year.

The latest uptick in prices follows speculation that the recent heavy rains and flooding in New Zealand could hurt pasture growth, and hence milk production over the end of this season and into the start of next season. At this stage it's difficult to tell how next season will be affected – pasture could recover quickly if we have some mild weather over the next few months. But for now, as long as it's a risk to production, it makes sense to factor that risk into today's prices.

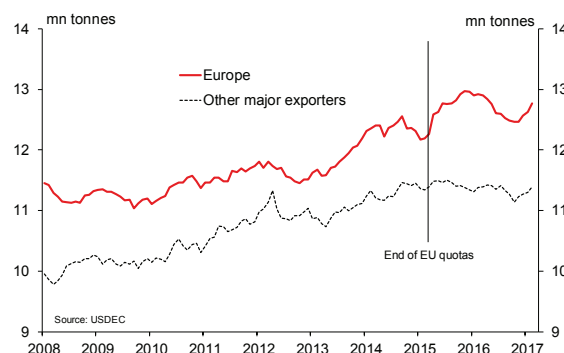
As the world's biggest exporter of dairy products, New Zealand's milk volumes are often a swing factor for international dairy prices. But we're not as dominant as we used to be. A decade of high prices has encouraged other countries to invest in their dairy industries' capacity. The result is that, compared to a decade ago, they now have more scope to adjust their output in response to changes in dairy prices.

Europe in particular has become much more of a swing factor in recent years. Since the region's production quota system was removed in April 2015, milk production has gone through some significant shifts. Output initially surged, driving dairy prices down to below break-even levels. This in turn led to a pullback in production over 2016, which helped to lift international prices again.

The European industry is now changing course again. With prices back above break-even levels for the average dairy

farmer, milk production has lifted quite strongly in recent months. After adjusting for seasonal patterns, we estimate that European milk production has risen from 12.5m tonnes of liquid milk in November to 12.8m tonnes in February.

Global milk production

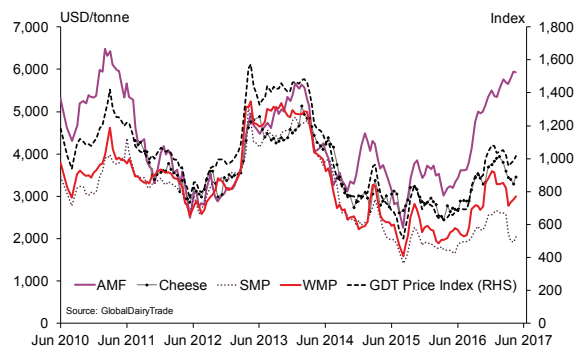


That increase in the flow of milk from Europe is equivalent to about one-sixth of New Zealand's output – that is, far greater than any plausible weather-related shortfall in NZ production. And it's likely that much of that increase in European production will be destined for the export market, where it will compete with NZ products either directly or indirectly (NZ focuses more on producing whole milk powder while Europe has a greater focus on skim milk powder and fat products, but buyers have some room for substitution between products).

It's not clear to what extent the market has picked up on the fact that milk production among the major exporters is

growing again. But we see this as something that is likely to cap international dairy prices over coming months – and if New Zealand gets a run of decent weather, we’d expect to see prices fall back later this year. So for now we’re comfortable with our outlook for a farmgate milk price of \$6.10/kg for next season, similar to the \$6.00/kg expected for the current season.

Dairy prices



GlobalDairyTrade Auction Results, 19 April 2017

	Change since last auction	Price index USD/Tonne
Anhydrous Milk Fat (AMF)	-0.5%	\$5,930
Butter	2.9%	\$4,892
Butter Milk Power (BMP)	n.a.	\$1,720
Cheddar	6.0%	\$3,462
Lactose	1.2%	\$935
Rennet Casein	-3.8%	\$6,020
Skim Milk Powder (SMP)	7.1%	\$2,044
Whole Milk Powder (WMP)	3.5%	\$2,998
GDT Price Index	3.1%	

Payout Forecast Table

	2016/17		2017/18
	Fonterra	Westpac	Westpac
Milk Price	\$6.00	\$6.00	\$6.10

Michael Gordon

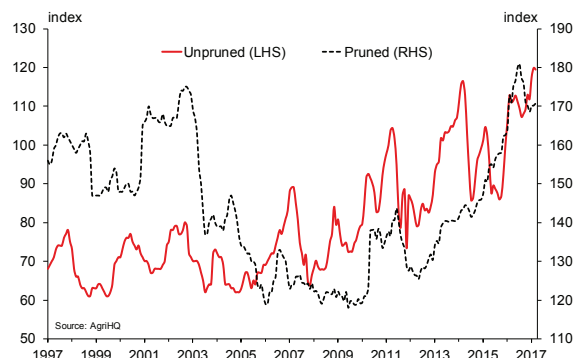
Acting Chief Economist

Beyond the farm gate

Forestry

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

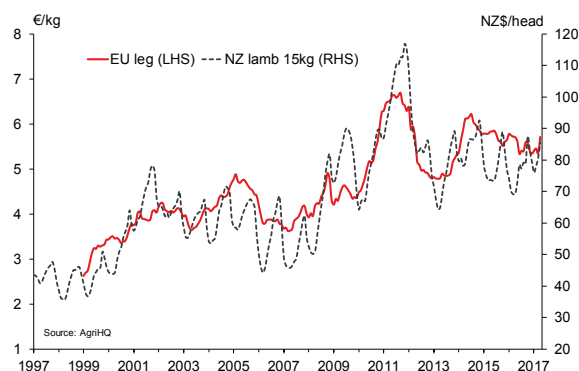
Log prices have continued to push higher this year. AgriHQ's log price index in March was 4% higher than a year earlier, and over 25% above the 10-year average. Strength in New Zealand construction continues to underpin high prices in the domestic market, with China boosting the global demand for logs. Chinese demand for logs is expected to remain a key driver through this year as the Chinese government aims to present a strong economy ahead of November's National Congress. However, Chinese demand may falter next year, and combined with rising global supply (encouraged by high log prices), export prices are likely to come under some downward pressure heading into next year.



Lamb

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

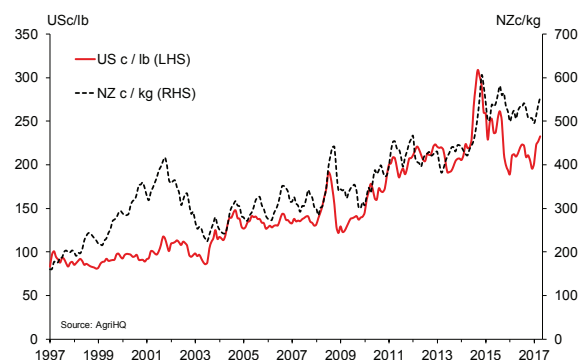
Constrained Australasian supply continues to dominate global lamb markets. While New Zealand's lamb slaughter has been improving, cumulative season throughput in mid-March was still down 8% from a year earlier. As a result, processors have been competing strongly to secure volume, with schedule prices improving over the past few months to be up 19% year-on-year. Tight supply is underpinning higher prices in offshore markets. Within Europe, leg prices in the UK have outperformed, and are 30% higher than a year ago (although the high NZD/GBP continues to weigh on NZD returns). However, further price gains might start having detrimental effects for long-term demand, and there is also significant uncertainty about the future state of UK demand as Brexit negotiations progress. Meanwhile, China's demand for sheepmeat has continued to strengthen, boosting the NZD price for lamb flaps, which are nearly 50% higher than a year ago.



Beef

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

Global beef prices have increased recently, on the back of constrained beef supply. A key factor driving supply from NZ is the recent pick-up in the farmgate milk price, leading to a preference for herd building. The United States, the world's largest beef producer, has sustainably increased production over time. The United States Department of Agriculture (USDA) expects a 5% rise in beef production in 2017. The summer barbeque season continues to drive the demand for U.S. beef imports, with Australia and NZ contributing to 23% of total foreign exports (excluding U.S.). Concurrently, supply from Australia, NZ's biggest competitor in the U.S. market, has continued to tighten over the last four years. This might see NZ play a bigger role in beef exporting within Australasia.



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

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