

# Fortnightly Agri Update

19 July 2017



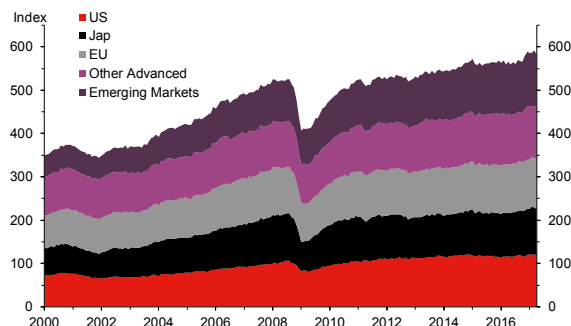
## Cloudy with a chance of trade

The future of globalisation and trade is a hot topic and poses interesting implications for small open economies like New Zealand. Globalisation is a trend that centres on increasing global economic integration. This centres on the premise that economic partnerships produce greater outcomes across multiple platforms for participants than isolation. Amongst these platforms, trade is the most prominent. Trade relies on the notion that the world's economies are able to competitively produce and sell goods and services on a global scale. This broadens the scope of potential economic growth and opens markets to opportunities beyond the limitations of borders. The gains from trade have had a profound effect across the entire global economic community, notably in terms of driving the need for productive efficiency, through technological innovation and investment.

### Global Trade Environment

However, with recent changes to the economic and political landscape in countries like the US and UK, the future of global integration and trade is rife with uncertainty. This uncertainty began with the US, electing Donald Trump as President whose campaign was largely based on nationalism geared towards stoking the protectionist sentiment that was running rampant following the Global Financial Crisis. It is true that politicians have found that it pays to pander to protectionist sentiment, and this has become a hurdle towards multi-lateral coordination, which has spread across areas beyond trade. Examples of the failed multi-lateral coordination efforts include the U.S. pulling out of both the final stages of negotiations for TPP and its exit from the Paris Climate Accords.

Exports from major regions



Brexit has also added to the uncertainty of international trade relationships with the UK and other countries like New Zealand. The now weaker position of the UK to negotiate an exit from the EU poses challenges on how trade will fare, especially as the UK ventures down a path of pandering to populist sentiment much in the same sense that the U.S. does. However, in the case of the UK, the reality of Brexit may not produce conditions necessarily favourable to UK trade, and this has spillover effects for the UK's other trading partners. In this respect, it would seem that any tangible progress in terms of any trade deals between New Zealand and the UK will be on the back burner for some time as the conditions for Brexit restrict the UK from making deals until the formal exit is complete.

Despite popular opinion, protectionism is not a novel concept. Many of the world's major economies have some level of protection structurally embedded into their

trade relationships. Yet, what we are observing is that the appearance of change to the trading environment has made up more of the story than actual changes to agreements. Part of this has been the inability of governments to deliver on campaign promises, but also to the incredible complexity of satisfying all parties to a deal.

## State of Play

The current outlook for the global trade environment may not be as downbeat as originally thought. Notably, the rush to consolidate and build new trade relationships in the gambit to offset the risks from major changes to the trading environment coming out of the U.S. and UK has led to many countries going back to bi-lateral agreements to eliminate multi-party limitations. One of the biggest developments is the recent EU-Japan Economic Partnership Agreement (EPA). This is particularly relevant to New Zealand for two reasons.

Firstly, since the failed TPP negotiations, Japan and New Zealand have made a play to form TPP-11, which is an agreement mostly similar in substance to the original TPP agreement. The most important implication that TPP-11 is likely to have for New Zealand is that of potentially working past the vast protections geared at insulating the Japanese agricultural industry. For New Zealand tapping into the Japanese dairy market provides an incredible growth opportunity, not only to consolidate the Asian market, but an opportunity to smooth through uncertainties in the consumption trends in China for the long-term.

Secondly, the EU is a major producer and exporter of dairy and a powerful competitor. The removal of quotas and other restrictions will make it more cost effective for the EU to compete on a global scale by selling dairy products to Japan. These areas may pose challenges to the competitiveness of New Zealand's position not only as the TPP-11 unfolds, but also how effectively the EU competes in the ex-China Asian market.

Shifting tides in the trading environment have also seen the need for proactive responses by our government to ensure the future of trade. China has been our biggest market for goods exports since the NZ-China Free Trade Agreement

was signed in 2008. However, the agreement is well due for an upgrade. In particular, the Australia-China FTA that was completed in 2014 gives Australian exports a more advantageous treatment than those from New Zealand in many cases (such as dairy products). Our FTA with China allows for the terms to be renegotiated to at least match the terms offered in subsequent FTA's with other countries. The two countries agreed to upgrade the FTA in late 2016 and have since conducted two rounds of negotiations, with a third round expected later this year.

It would seem that despite the rhetoric and mass uncertainty regarding globalisation, the future of trade may not necessarily be circling the drain, but is most likely facing cloudy days ahead. One thing is for certain the New Zealand economy, especially our agricultural industry is better off in a world with trade and global coordination.

## Shyamal Maharaj

Economist

### GlobalDairyTrade Auction Results, 19 July 2017

	Change since last auction	Price index USD/Tonne
Anhydrous Milk Fat (AMF)	-0.2%	\$6,577
Butter	3.4%	\$6,004
Butter Milk Power (BMP)	n.a.	n.a.
Cheddar	1.6%	\$4,112
Lactose	-1.8%	\$825
Rennet Casein	2.4%	\$6,358
Skim Milk Powder (SMP)	-3.2%	\$2,024
Whole Milk Powder (WMP)	0.3%	\$3,114
GDT Price Index	0.2%	

### Payout Forecast Table

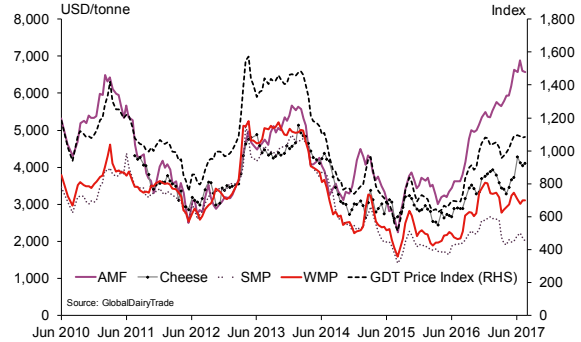
	2016/17	2017/18	
	Fonterra	Fonterra	Westpac
Milk Price	\$6.15	\$6.50	\$6.50

# Beyond the farm gate

## Dairy

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

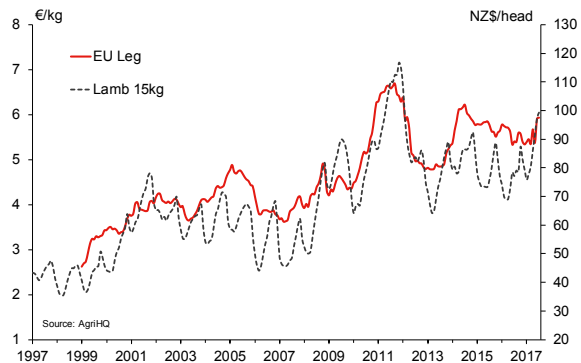
Dairy prices rose just 0.2% in last night's GlobalDairyTrade auction, leaving them effectively flat over the last two months. Whole milk powder prices rose by 0.3%, skim milk powder fell by 3.2%, and butter prices rose 3.4% to a new record high of just over \$6,000 per tonne. Global milk production rose strongly in the early part of this year, but has slowed again in the last two months, especially in Europe. That's helped to ease our concerns that a renewed supply glut could push down world prices over the course of this season. At the same time, though, the persistent strength of the New Zealand dollar is likely to undermine local currency returns. Our farmgate milk price forecast remains at \$6.50/kg for this season.



## Lamb

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

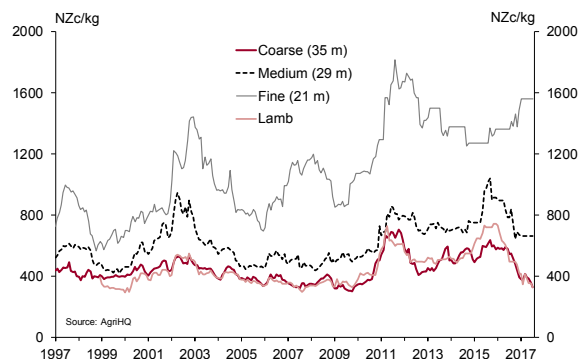
Market conditions for lamb remain strong, underpinned by tightness in supply from both in New Zealand and elsewhere. In New Zealand, poor weather conditions affected the quality and availability of feed, while in Australia low slaughter numbers have mainly been due to flock rebuilding. Demand should remain firm in the coming months, due to the increased demand for chilled lamb products that tends to peak around October for the Christmas trade.



## Wool

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

Coarse wool prices resumed their decline in June, while prices for finer wools held steady. With China representing a large portion of demand, any potential up-tick rests on changes in the Chinese market for New Zealand wool. However, we don't expect big changes on this front in the near term. Competition from cheaper synthetics – a delayed consequence of the sharp drop in world oil prices since late 2014 – is likely to remain a headwind for coarse wool prices.



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

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