Fortnightly Agri Update

20 September 2017

Lean and green

- There are downside risks for beef prices with global supply continuing to rise.
- Global competition is building as a waft of new trade deals enter the mix.
- Strong demand locally and abroad is keeping a floor on prices for now.

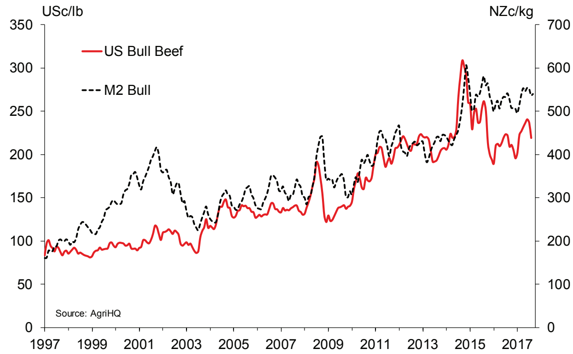
There is downward pressure on global beef prices with pressures from multiple angles. Of the risks facing the market, supply is the central issue. US production is trending higher even with the barbeque season having passed its peak. As such, there is a strong chance that prices continue to ebb lower.

Australian supply is also ramping up following a period of herd building, and export volumes are set to climb in the run up to the Christmas. With greater herd numbers, Australian beef exports are likely to surpass historical levels. This is likely to have a marked impact on the chilled trade through its peak in November.

Moreover, Australia has positioned itself well within key Asian markets, namely China and Japan following changes to trade agreements. The tariff advantage that Australia has in Japan over other major beef exporters has already led to the US redirecting supplies to other Asian consumers.

New Zealand is also facing high tariffs into Japan, which will be a serious challenge for exporters over the coming year. This is encouraging New Zealand beef farmers to hold back culling cattle in the near term as they face competition on prices and volumes. Despite these challenges, we expect our export volumes to rise going into November.

Global beef prices easing



Competitive pressures

Adding to the downward pressure on prices is the re-entry of US beef into China following the removal of trade restrictions. Increases in US exports are expected to be gradual as producers must meet newly imposed health and safety requirements, and these requirements will add to costs. Nevertheless, any cost increases are likely to be marginal compared to the gains from tapping into the world's second largest beef consumer, so won't deter an increase in US supply.

Reinforcing the downside pressure on New Zealand's export prices, at least for the short-run, is the recent EU-Japan Free Trade Agreement (FTA). The agreement reduces the tariffs on EU beef from 38.5% to 9% over 15 years. Furthermore, the deal permits the sale of a wide array of

EU agricultural foods into Japan with more than 90% of tariffs removed.

An indirect effect of the EU-Japan FTA is that products from other producers are being diverted into markets that New Zealand competes in, pressuring price downwards. For example, US beef exporters directed 10% more beef to South Korea in the year to July.

Prime demand

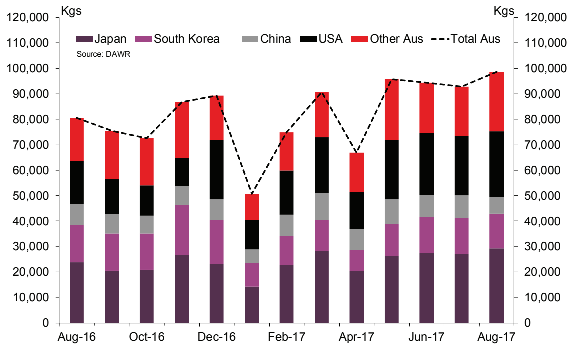
We are rapidly approaching the November peak in the chilled meat trade. Despite the rise in global supplies, the demand and price for New Zealand prime beef is faring well, supported by our reputation as a premium product. Domestically, tightness in supply and firm local demand is also helping to support the prices for prime cuts.

We expect that supply from New Zealand producers will increase over the coming months, with the November peak in the chilled meat trade approaching. The success of the six-month chilled beef trial into China is also likely to support a boost in production to meet the firm demand coming out of China for New Zealand prime cuts.

Putting all this together, we expect the global beef market to be tumultuous for the year ahead, mainly due to supply side factors. New Zealand beef processors and exporters are already feeling the pinch, which has influenced slaughter volumes and timelines. Even with the overall firmness in the demand environment, global beef prices look set to ease in the months to come.

Shyamal Maharaj
Economist

Australian Beef Exports trending higher



GlobalDairyTrade Auction Results, 20 September 2017

	Change since last auction	Price index USD/Tonne
Anhydrous Milk Fat (AMF)	5.3%	$6,794
Butter	1.2%	$6,026
Butter Milk Power (BMP)	n.a.	n.a.
Cheddar	-1.9%	$4,032
Lactose	-3.8%	$759
Rennet Casein	-2.4%	$6,036
Skim Milk Powder (SMP)	-1.2%	$1,920
Whole Milk Powder (WMP)	0.6%	$3,122
GDT Price Index	0.9%	

Payout Forecast Table

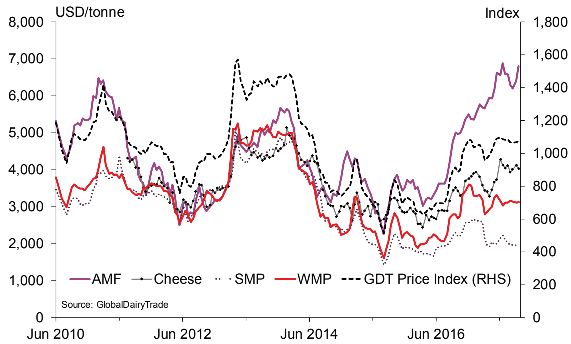
	2016/17	2017/18	
	Fonterra	Fonterra	Westpac
Milk Price	$6.15	$6.75	$6.50

Beyond the farm gate

Dairy

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

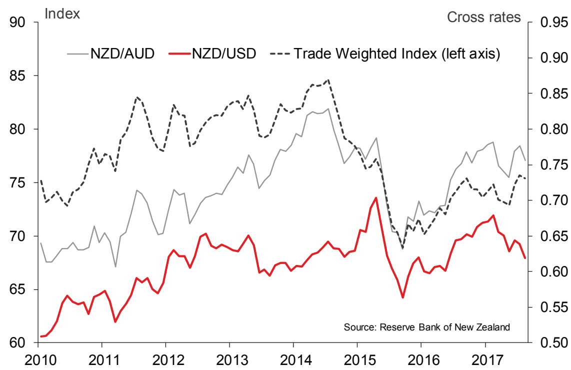
Last night's GlobalDairyTrade auction saw a 0.9% increase in the overall price index, with prices for milk fats and whole milk powder nudging upwards. The NZX dairy futures were in line with the recent auction, with forward contracts supporting our outlook for the year ahead. Milk production appears to be picking up across the globe, with New Zealand production set to ramp up in the coming months. Notably, Fonterra has increased the volume of whole milk powder (WMP) on offer in recent auctions. Seasonal increases in WMP volumes in the past have faced difficulties being absorbed at auction, and we could see some near-term easing in WMP prices. Our farmgate milk price forecast for this season remains at \$6.50/kgMS (vs Fonterra's forecast for \$6.75/kgMS).



NZ dollar

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

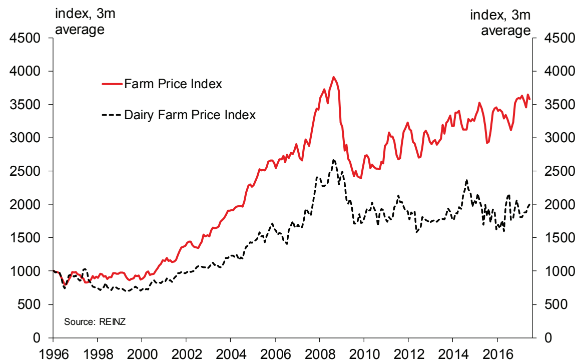
Against the US dollar, the New Zealand dollar has ranged between 0.7200 and 0.7350 during the past few weeks, capped by election uncertainty and supported by the downward trend in the US dollar. In the near term, the NZD/USD will likely be a reflection of the outcome of the FOMC meeting this week, which will give guidance around interest rate hikes and a timeline for balance sheet normalisation. We could also see some movement depending on the outcome of this weekend's NZ general election. As interest rate spreads narrow between NZ (fixed OCR) and the US (rising Fed funds rate), it is likely the US dollar will strengthen and pull the NZD/USD to the 0.70 area. Beyond this, the NZD/USD will be largely dependent on how US economic fundamentals pan out, as well as on going US political developments.



Land prices

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

The REINZ farm price index fell by 1.9% in the three months to August, leaving them up 8.9% on the same time last year. Although the dairy farm price index rose 2.1% in August, the median price for dairy farms has dropped by 6.5% over the last 12 months. Dairy farm sales remain soft. This is most likely a reflection of stronger milk prices and dairy farmers committing extra cash towards running down debt levels built up over the previous seasons. Overall, the number of farm sales continues to trend downwards, with the majority of sales being either finishing farms or grazing farms.



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

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