

Fortnightly Agri Update

21 June 2017



Market for Lamb - Strong

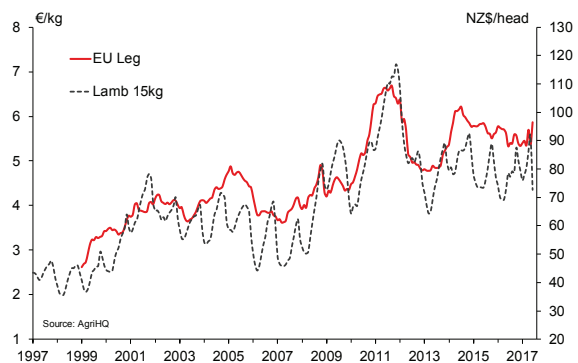
Currency factors and general conditions

We continue to see strength in the market for lamb. This has been underpinned by tightness in supply, both in New Zealand and globally. Prices are expected to continue their upward trend driven by a range of factors.

Slaughter numbers have been low in recent months, which has boosted prices globally. In Australia, low slaughter numbers have been mainly due to flock rebuilding. In New Zealand, poor weather conditions led to a slowdown in lamb processing, mainly due to the weaker grass growing conditions impacting the quality and availability of feed for sheep. In addition, sheep numbers have been somewhat low as well and this has made it harder for farmers to justify sending lambs to the slaughter. With slaughter numbers down significantly on previous seasons, the price for lamb across the various weights have risen. Although it would seem that the higher price would be attracting greater supply month on month, lamb supply has remained subdued.

Current market conditions for lamb are being shaped by the tightness in global supply but are also dependent on demand. On the demand side, the current pricing outlook is set to firm in the coming months. This is largely due to the increased demand for chilled lamb products that tend to peak around October for the Christmas trade. With sheep numbers tighter this year, prices moving towards the end of this year are likely to be north of peak prices observed in previous seasons. Although supply is likely to pick up in reaction to higher slaughter prices, as the new season begins, the general outlook for the lamb market is looking to stay firm for now.

Lamb prices



Brexit and the outlook for lamb

One of the key areas of concern regarding the outlook for lamb exports are demand conditions in the UK. Last year's unexpected referendum result has seen increased uncertainty around the demand environment in the UK, and has also seen the pound fall sharply over the past year. The recent snap election, which saw the Conservatives losing their majority, has reinforced the uncertainty around the outlook, especially as it may erode the UK's negotiating position in the coming Brexit negotiations.

The immediate concern for New Zealand exporters is that the lower pound is making our lamb exports less competitive and eroding NZD returns. We don't see much relief on this front for some time. Although the BOE's recent statement was a bit more hawkish than expected, the

lingering downside risks for activity means that the policy rates in the UK will remain at relatively low levels for an extended period of time. This signals continued weakness in the pound.

Longer term, the key concern is what happens to trade agreements and market access. Over the coming years, the UK will need to renegotiate a large number of trading agreements, and it's hoped that New Zealand can negotiate a favourable deal. While that would be great news for New Zealand farmers, we don't want to get our hopes up just yet. Trade agreements will take some time to negotiate, and work on them may not even begin until Brexit negotiations are completed (which will still take about 18-24 months). Even then, a key reason for the Brexit decision was an increase in protectionist sentiment, and that may affect the favourability of any future trade agreements with the UK. At the same time, Australia will also be looking to improve its market access, which could affect the competitive environment.

Turning to the European markets, the euro relative to the NZD has also weakened. There is risk about how responsive retailers and the end-consumers will be to rising global prices. However, firm prices in the past have not seen any major pull back in demand. We will be keeping an eye on demand conditions in Europe as we approach the peak demand period in October.

Shyamal Maharaj
Economist

GlobalDairyTrade Auction Results, 21 June 2017

	Change since last auction	Price index USD/Tonne
Anhydrous Milk Fat (AMF)	4.4%	\$6,885
Butter	2.9%	\$5,768
Butter Milk Power (BMP)	n.a.	n.a.
Cheddar	-3.8%	\$4,121
Lactose	-11.1%	\$869
Rennet Casein	-8.0%	\$6,104
Skim Milk Powder (SMP)	1.4%	\$2,218
Whole Milk Powder (WMP)	-3.3%	\$3,022
GDT Price Index	-0.8%	

Payout Forecast Table

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

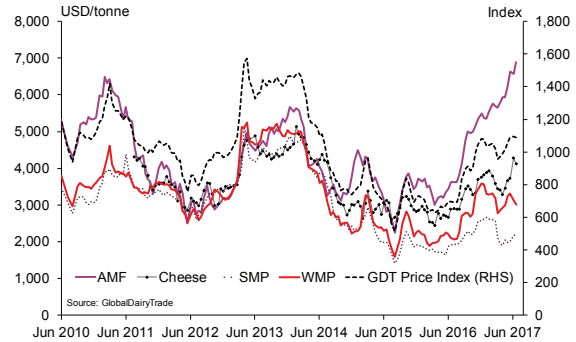
Beyond the farm gate

Dairy

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

Dairy prices fell 0.8% in last night's GlobalDairyTrade auction, the first fall since early March.

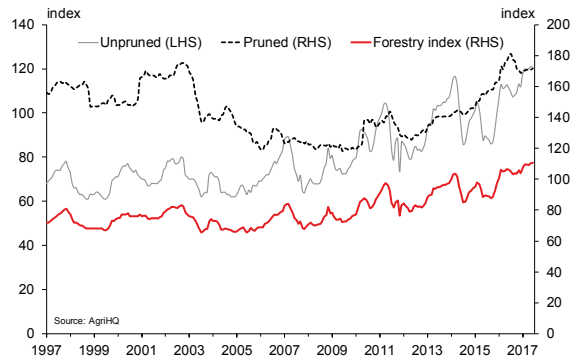
The fall was driven by a 3.3% drop in whole milk powder prices. However, skim milk powder (SMP) prices rose 1.4%, and fat products continued to reach new highs. Our forecast of a \$6.50/kgMS milk price for this season allows for some pullback in whole milk powder prices over the rest of this year. Milk production among the major exporting nations has turned higher again this year, as prices have risen back above break-even levels. However, demand for milkfat products remains high, which should continue to underpin milk prices overall.



Forestry

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

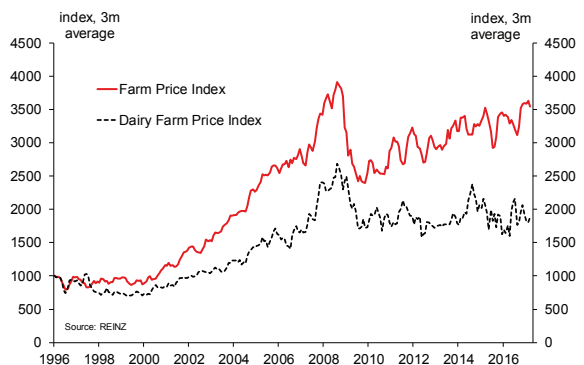
Log prices have continued to firm this year. AgriHQ's log price index in June was higher than a year earlier, and continues to perform above the 10-year average. The outlook for construction in New Zealand continues to underpin high prices in the domestic market and we expect this to continue, with plans around greater residential building going forward. That being said, the global outlook especially in China remains the focus. 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 has its uncertainties, and combined with rising global supply (encouraged by high log prices), export prices could come under some downward pressure heading into next year.



Land prices

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

The REINZ farm price index fell slightly over the three months to May, though this move appears to be largely seasonal; prices were up nearly 5% on the same time last year. Dairy farm prices have improved compared to a year ago, when they were at their lowest in a decade. A firmer dairy farm market is in keeping with the improved sentiment in the sector over the past year, as the rise in farmgate milk prices has put cashflows for most dairy farmers back in the black. Elsewhere, sales of horticulture properties have slowed in recent months, and demand and prices for other types of farmland have been more mixed.



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

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