Fortnightly Agri Update

21 June 2017

Market for Lamb - Strong

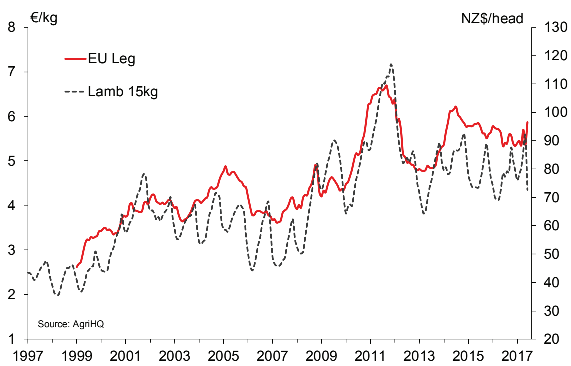
Currency factors and general conditions

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 expecting 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 excepted, 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

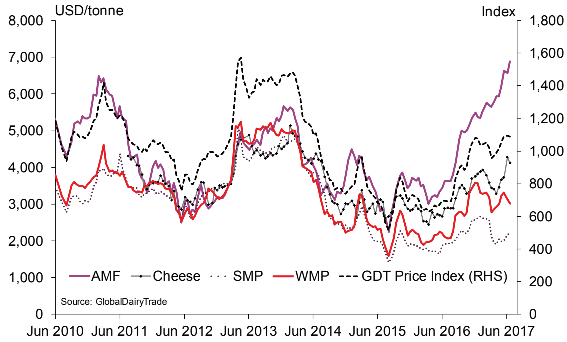
Beyond the farm gate

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.

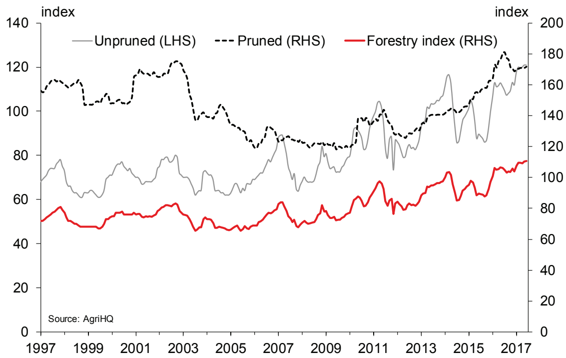
The fall was driven by a 3.3% drop in whole milk powder prices. However, skim milk powder (SMP) prices rose 1.4%, and fat products continued to reach new highs. Our forecast of a $6.50/kgMS milk price for this season allows for some pullback in whole milk powder prices over the rest of this year. Milk 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	↗

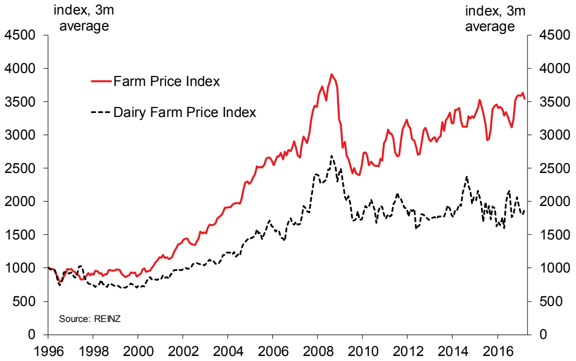
Log prices have continued to firm this year. AgriHQ's log price index in June was higher than a year earlier, and continues to perform above the 10-year average. The outlook for construction in New Zealand continues to underpin high prices in the domestic market and we expect this to continue, with plans 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.

Contact the Westpac economics team

Michael Gordon, Acting Chief Economist +64 9 336 5670

Satish Ranchhod, Senior Economist +64 9 336 5668

Shyamal Maharaj, Economist +64 9 336 5669

Any questions email: economics@westpac.co.nz

Past performance is not a reliable indicator of future performance. The forecasts given in this document are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The ultimate outcomes may differ substantially from these forecasts.

Disclaimer

Disclaimer continued

the UK (as Branch No. BR00106), and (b) authorised and regulated by the Australian Prudential Regulation Authority in Australia. Westpac is authorised in the United Kingdom by the Prudential Regulation Authority. Westpac is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request. Westpac Europe Limited is a company registered in England (number 05660023) and is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.

This communication is being made only to and is directed at (a) persons who have professional experience in matters relating to investments who fall within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "Order") or (b) high net worth entities, and other persons to whom it may otherwise lawfully be communicated, falling within Article 49(2)(a) to (d) of the Order (all such persons together being referred to as "relevant persons"). Any person who is not a relevant person should not act or rely on this communication or any of its contents. The investments to which this communication relates are only available to and any invitation, offer or agreement to subscribe, purchase or otherwise acquire such investments will be engaged in only with, relevant persons. Any person who is not a relevant person should not act or rely upon this communication or any of its contents. In the same way, the information contained in this communication is intended for "eligible counterparties" and "professional clients" as defined by the rules of the Financial Conduct Authority and is not intended for "retail clients". With this in mind, Westpac expressly prohibits you from passing on the information in this communication to any third party. In particular this communication and, in each case, any copies thereof may not be taken, transmitted or distributed, directly or indirectly into any restricted jurisdiction. This communication is made in compliance with the Market Abuse Regulation (Regulation(EU) 596/2014).

Investment Recommendations Disclosure

The material may contain investment recommendations, including information recommending an investment strategy. Reasonable steps have been taken to ensure that the material is presented in a clear, accurate and objective manner. Investment Recommendations for Financial Instruments covered by MAR are made in compliance with Article 20 MAR. Westpac does not apply MAR Investment Recommendation requirements to Spot Foreign Exchange which is out of scope for MAR.

Unless otherwise indicated, there are no planned updates to this Investment Recommendation at the time of publication. Westpac has no obligation to update, modify or amend this Investment Recommendation or to notify the recipients of this Investment Recommendation should any information, including opinion, forecast or estimate set out in this Investment Recommendation change or subsequently become inaccurate.

Westpac will from time to time dispose of and acquire financial instruments of companies covered in this Investment Recommendation as principal and act as a market maker or liquidity provider in such financial instruments.

Westpac does not have any proprietary positions in equity shares of issuers that are the subject of an investment recommendation.

Westpac may have provided investment banking services to the issuer in the course of the past 12 months.

Westpac does not permit any issuer to see or comment on any investment recommendation prior to its completion and distribution.

Individuals who produce investment recommendations are not permitted to undertake any transactions in any financial instruments or derivatives in relation to the issuers covered by the investment recommendations they produce.

Westpac has implemented policies and procedures, which are designed to ensure conflicts of interests are managed consistently and appropriately, and to treat clients fairly.

The following arrangements have been adopted for the avoidance and prevention of conflicts in interests associated with the provision of investment recommendations.

(i) Chinese Wall/Cell arrangements;

(ii) physical separation of various Business/Support Units;

(iii) and well defined wall/cell crossing procedures;

(iv) a "need to know" policy;

(v) documented and well defined procedures for dealing with conflicts of interest;

(vi) steps by Compliance to ensure that the Chinese Wall/Cell arrangements remain effective and that such arrangements are adequately monitored.

U.S.: Westpac operates in the United States of America as a federally licensed branch, regulated by the Office of the Comptroller of the Currency. Westpac is also registered with the US Commodity Futures Trading Commission ("CFTC") as a Swap Dealer, but is neither registered as, or affiliated with, a Futures Commission Merchant registered with the US CFTC. Westpac Capital Markets, LLC ('WCM'), a wholly-owned subsidiary of Westpac, is a broker-dealer registered under the U.S. Securities Exchange Act of 1934 ('the Exchange Act') and member of the Financial Industry Regulatory Authority ('FINRA'). This communication is provided for distribution to U.S. institutional investors in reliance on the exemption from registration provided by Rule 15a-6 under the Exchange Act and is not subject to all of the independence and disclosure standards applicable to debt research reports prepared for retail investors in the United States. WCM is the U.S. distributor of this communication and accepts responsibility for the contents of this communication. All disclaimers set out with respect to Westpac apply equally to WCM. If you would like to speak to someone regarding any security mentioned herein, please contact WCM on +1 212 389 1269. All disclaimers set out with respect to Westpac apply equally to WCM.

Investing in any non-U.S. securities or related financial instruments mentioned in this communication may present certain risks. The securities of non-U.S. issuers may not be registered with, or be subject to the regulations of, the SEC in the United States. Information on such non-U.S. securities or related financial instruments may be limited. Non-U.S. companies may not subject to audit and reporting standards and regulatory requirements comparable to those in effect in the United States. The value of any investment or income from any securities or related derivative instruments denominated in a currency other than U.S. dollars is subject to exchange rate fluctuations that may have a positive or adverse effect on the value of or income from such securities or related derivative instruments.

The author of this communication is employed by Westpac and is not registered or qualified as a research analyst, representative, or associated person under the rules of FINRA, any other U.S. self-regulatory organisation, or the laws, rules or regulations of any State. Unless otherwise specifically stated, the views expressed herein are solely those of the author and may differ from the information, views or analysis expressed by Westpac and/or its affiliates.