Fortnightly Agri Update

3 May 2017

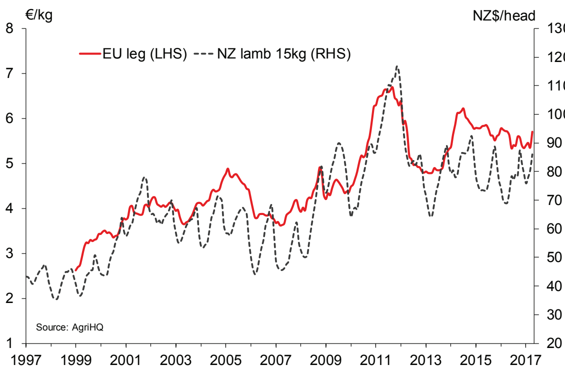
Lamb revival

With lamb processing in full swing across the country, we take a look at developments in lamb markets, and assess the outlook for prices over the coming months.

It's been positive news at the farm gate over the past couple of months, with lamb schedule prices bucking the usual seasonal downtrend. The average price in April rose above \$5.70/kg – that's up 25% from a year earlier. The weekly trend in prices has remained positive, and 2011 was the only time when schedules have been higher at this point of the season. The improvement in prices has come off the back of firming prices in key markets – continental Europe, the United Kingdom and China. But while demand has firmed, it's been lack of supply from New Zealand and Australia that has underpinned the price gains. A shortage of supply has also seen processors having to pay up to encourage farmers to bring stock forward, providing a further boost at the farm gate. Tight supply should keep a floor under international prices in coming months, although prices are expected to decline through the latter part of the year as supply begins to improve.

Beef and Lamb NZ recently released its mid-season update and are forecasting the volume of lamb exports to fall 3.2% this season (ending September 2017). That drop largely reflects a sharp fall in the spring lamb crop due to a declining sheep flock. Good summer and autumn weather has added to the tightness over the past couple of months, as favourable pasture conditions resulted in farmers holding onto lambs for longer to chase higher weights. Although lamb slaughter looks to have made up some ground through March and in early April, it's remained relatively low with processors cutting killing capacity as a result.

Lamb prices



And across the ditch, Meat and Livestock Australia are forecasting Australian lamb production to fall nearly 6% in 2017 as farmers rebuild their flocks. That's a slightly larger contraction than expected a few months ago. With production starting the year on a decent note, the tightness in supply will be most acute over the winter months. But before long, the recent flock rebuilding will begin to reap dividends with Australia's lamb exports expected to begin rising again in 2018.

At the same time, there have been positive signs on the demand side. The European Union is New Zealand's largest export destination, accounting for around half of New Zealand's export receipts (nearly half of which head to the UK). Prices in Continental Europe have firmed a bit, but the big improvement has come from the UK, where the benchmark leg price has risen 30% over the past year to the highest levels since 2014. The ability of the market to absorb the recent price rises is an important gauge for the underlying strength of demand, and whether these prices are sustainable over the longer term.

While the UK economy has fared better than expected in the wake of last June's Brexit vote (with household spending in particular holding up), the implications of Brexit remain relatively uncertain. The British PM, Teresa May, triggered Article 50 in March beginning the formal process of the UK leaving the European Union within two years. That paves the way for the UK to begin the complex process of renegotiating new trading arrangements. While it's likely that New Zealand can arrange relatively good trading conditions with the UK, there will be other moving parts that may not play into the hands of New Zealand's sheepfarmers. For instance, Australia could use Brexit as an opportunity to renegotiate better access for their lamb exports to the UK.

But those are issues for further down the track. More immediately, the sharp depreciation of the British pound in the wake of the Brexit vote remains a significant headwind for lamb exporters. Not only does it undermine NZ dollar export returns on UK sales, but it also makes New Zealand lamb less competiveness than British lamb in the Continental European market. While the NZD/GBP has pulled back from a sky-high 0.58 in February to around 0.535 currently, that's still 10% higher than a year ago (and higher than any levels seen pre-Brexit). Looking ahead over the coming year, we don't see much (if any) relief against the British pound. Likewise, we're expecting the New Zealand dollar to remain strong against the euro, at around the mid-0.60s.

Looking beyond Europe, China has become a much more important market for sheepmeat in recent years, although typically taking lower-value cuts, such as flaps and forequarters. Demand from China has remained firm in recent months, even though consumption is slower at this time of the year (post the Chinese New Year). This indicates some degree of stockpiling, and creates some risk if stronger consumption demand isn't forthcoming. Overall though, the Chinese market continues to present significant opportunity as the growing numbers of middle-to-upper income households continue to boost meat consumption. The trial of chilled lamb exports to China provides an opportunity to sell higher-value cuts into China which would raise the average price, although it's not clear whether the market will be willing to pay as much as its European competitors.

GlobalDairyTrade Auction Results, 3 May 2017

	Change since last auction	Price index USD/Tonne
Anhydrous Milk Fat (AMF)	4.7%	$6,185
Butter	1.1%	$4,911
Butter Milk Power (BMP)	21.8%	$1,859
Cheddar	4.6%	$3,666
Lactose	1.1%	$941
Rennet Casein	10.4%	$6,775
Skim Milk Powder (SMP)	-0.9%	$1,982
Whole Milk Powder (WMP)	5.2%	$3,233
GDT Price Index	3.6%	

Payout Forecast Table

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

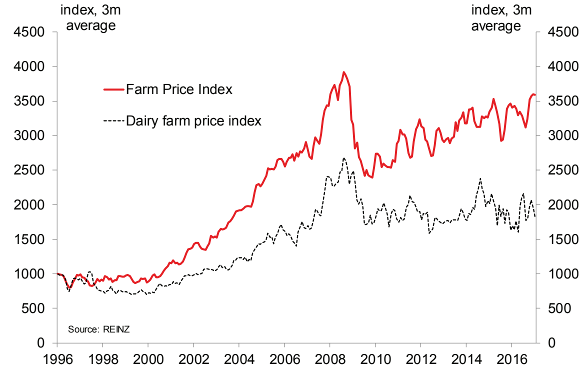
Sarah Drought
Economist

Beyond the farm gate

Land prices

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

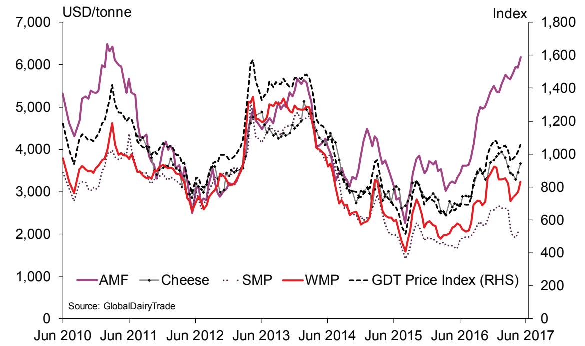
The REINZ farm price index rose 2% in the March quarter, with prices up nearly 6% from a year earlier. Within this, dairy farm prices fell 8% in the quarter, further unwinding the strong gains seen in the middle of 2016. Nonetheless, the dairy farm price index remains 6% higher than a year earlier, and turnover has improved. A slightly firmer dairy farm market isn't surprising given 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. Outside of dairy, demand for horticulture properties (and kiwifruit orchards in particular) remains high and prices have risen strongly, while demand and prices for other types of farms have been more mixed.



Dairy

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

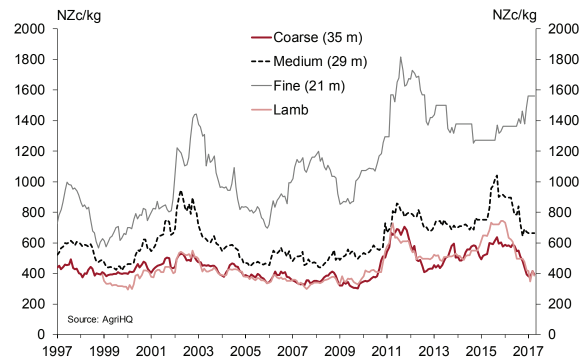
Dairy prices continued to track higher in last night's GlobalDairyTrade auction, with the aggregate price index rising 3.6%. Whole milk powder prices recovered the last of the early-March slump, rising 5.2% to $US3,233/Tonne. Milkfat prices continued to push higher, underpinned by very strong demand, while skimmilk powder remains an unwanted by-product, with prices edging down $0.9% to $1,982/tonne. While demand from China has remained solid and this is helping to put a floor under prices, dairy prices seem to be responding to concerns about New Zealand supply off the back of recent poor weather. We continue to expect prices to come under downward pressure later this year, as supply in New Zealand and aboard (especially in Europe) improves. Nonetheless, the stronger starting point for prices as we head into the new 2017/18 season creates upside risk to our milk price forecast of $6.10/kgMS.



Wool

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

Coarse wool prices continue to suffer from a lack of demand, especially from China (which has accounted for over half of New Zealand's wool exports in recent years). Prices are 30% below a year ago, and while they look to have found a base over the past couple of months, market dynamics remain soft. Indeed, the market couldn't absorb NZ's seasonal lift in wool, with a notable increase in the volumes passed in at auction. Low oil prices continue to make the price of synthetic fabrics relatively attractive, which subsequently dampens the demand for wool, while China is also reportedly running down its cotton stocks. At the same time, consumer demand for fine wool, such as merino, has remained robust with prices 14% higher than a year ago and 20% above the 10-year average.



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

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