

# Fortnightly Agri Update

7 June 2017



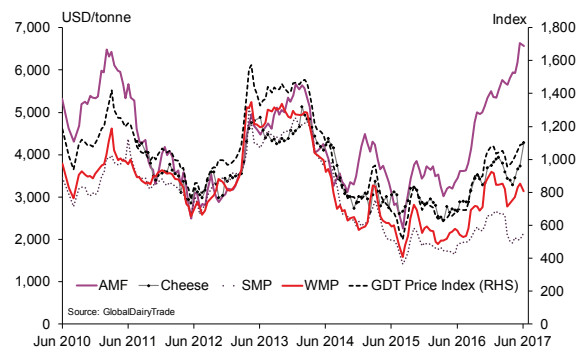
## Winter is here!

The GlobalDairyTrade (GDT) auction has continued to rally and lift the spirits of farmers from their troughs. Dairy prices are showing resilience and the dairy markets have been bullish over the past month. The past two seasons were very challenging for those in New Zealand's dairy sector, and left many farmers hoping for a miracle. It seems that a firm pricing outlook and Fonterra increasing their farmgate milk prices for the 2016/17 season to \$6.15/KgMs and \$6.50/KgMs for the 2017/18 season is the 'new hope' the dairy market has been holding out for. Winter is here and that means changes to domestic supply are unlikely this season, although a watchful eye remains on developments in the North. For the year ahead, supply pressures and financial conditions will continue to shape what will come of the dairy sector as it begins the new season.

The outlook for the dairy sector has improved considerably over the past year. Global dairy prices are around 50% higher than mid-2016. A contraction in milk production from key exporting regions, including Europe, Australia and New Zealand over the past year was a key catalyst for the rise in prices. That being said, when there are high prices, there tends to be a wave of supply hitting the market shortly after. Global production responses from major players like Europe is expected to limit the upside potential in prices for the 2017/18 season.

The demand backdrop remains firm especially across Asia. Chinese domestic production is lifting. However, the outlook for the Chinese economy is still positive, and continued demand for premium milk products that NZ exports is expected to provide a floor under prices for now.

### Dairy prices



Constraints on production along with firm demand are continuing to support prices. For instance, poor weather has been weighing on milk production in Europe, although this will be temporary. The massive stockpiles of skim milk powder built up by European milk producers before the removal of production quotas means that the improvement in global prices could lead to increased milk supply in the market. It's also worth keeping in mind that other exporting countries like Australia and the U.S. could also ramp up production, as we are observing a preference towards herd building relative to slaughtering for beef. Locally, we are expecting milk collection to increase as the new season begins. At present, there is little supply catering to the 2016/17 season, but there is a greater portion of dairy processors selling product on the futures markets for delivery into the new season. This is largely expected, as

the effects of poor weather mainly in the North Island have hampered milk supply.

### Sum of the parts

The market for natural foods remain firm, as the recent GDT results continue to capture the markets demand for fats and cheese. Consumers are shifting back toward consuming natural fats, reflecting current health-trends and better information around the benefits of consuming good fats. Anhydrous milk fat declined slightly, however cheese, butter and butter milk powder have continued to signal a solid market base. On the other-hand Skim Milk Powder (SMP) has shown quite a turnaround in the recent GDT. It is likely we will see a pick-up in SMP demand both on the spot and futures markets continuing for some time as prices remain low and supply remains high.

### Dairy Market and Financial Stability

The Reserve Bank of New Zealand recently released their half-yearly *Financial Stability Report (FSR)*, which included a look into the financial conditions and issues facing the NZ dairy sector. The RBNZ has highlighted the significant impact that low prices in previous years had on the sector. Many farmers were forced to take on additional debt to sustain day-to-day operations and general capital expenditure. This saw a notable increase in dairy sector indebtedness, even with lower costs of production.

Despite the current firmness in the dairy market, a lingering concern is how sensitive farmers' incomes (profits) are to swings in the global dairy price and changes in costs, including interest costs. Debt-to-income ratios in the dairy sector tend to be well above 3. Although, that doesn't mean that farmers are at risk of defaulting, it means that farmer operating costs could increase materially if interest rates rise. Around a quarter of dairy sector lending is to farms that are closely monitored by banks, with the most indebted 20% of farms holding around 50% of the debt.

Given that dairy prices are cyclical; the NZ dairy sector remains open to shocks to the global dairy price. Farms vulnerabilities to dairy market shocks remains high and, although banks have taken a medium-term view, the issue of sound financial management is an on-going concern. It is not surprising that the low payouts in the past two seasons have led to a greater share of vulnerable farms. Shocks to supply are the biggest risk to farmers' bottom line, and major exporting nations are ramping-up production across the board. A focus on balance sheet improvement will help to insulate farmers from the effects of the many potential supply or pricing shocks to the global dairy market in the seasons to come.

**Shyamal Maharaj**  
Economist

### GlobalDairyTrade Auction Results, 7 June 2017

	Change since last auction	Price index USD/Tonne
Anhydrous Milk Fat (AMF)	-1.2%	\$6,569
Butter	3.3%	\$5,631
Butter Milk Power (BMP)	5.8%	\$2,092
Cheddar	14.5%	\$4,285
Lactose	1.0%	\$971
Rennet Casein	4.8%	\$6,849
Skim Milk Powder (SMP)	7.9%	\$2,156
Whole Milk Powder (WMP)	-2.9%	\$3,143
GDT Price Index	0.61%	

### Payout Forecast Table

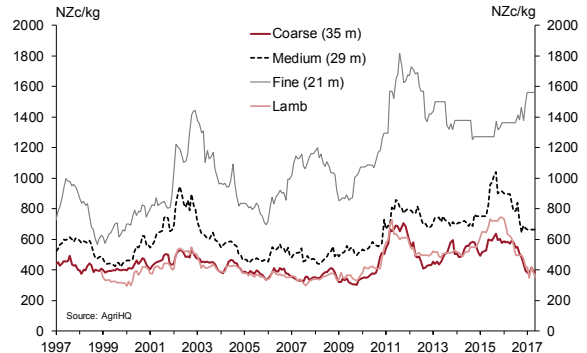
	2016/17	2017/18	
	Fonterra	Fonterra	Westpac
Milk Price	\$6.15	\$6.50	\$6.50

# Beyond the farm gate

## Wool

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

May has seen more of the same for the NZ wool market, with prices broadly stable. With China representing a large portion of demand, any potential up-tick rests on changes in the Chinese market for NZ wool. However, we don't expect big changes on this front in the near term. In the meantime, exporters have been forced to look elsewhere to generate demand, but this will be a challenge for wool farmers' profitability and create supply chain issues. Wool prices have remained stable, but targeted buying in May led to lifts across market indicators. Coarse wool has continued its decline, while finer wools, such as those used for pure wool suits or merino, are attracting interest. The outlook for the next half year remains flat. In the absence of any significant change in demand or change in composition of wool demand, we expect price and demand to remain around current levels for quite some time.

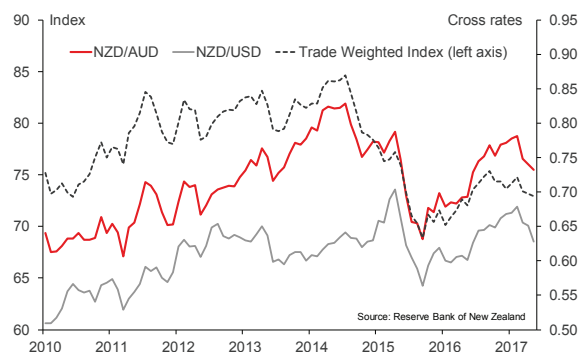


## NZ dollar

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

The five-month trend decline in the USD persists. Fed concerns around low inflation are growing, and if they continue they could ultimately lead to a reassessment of the Fed's policy path. On top of this, the outlook for US fiscal policy remains rocky. Trump's planned growth policies are facing obstacles, notably the challenge Republicans have finding a consensus that satisfies House conservatives and centrist Senators. "Russiagate" is adding to the challenges for the administration, both as an all consuming distraction and by reducing the president's political capital.

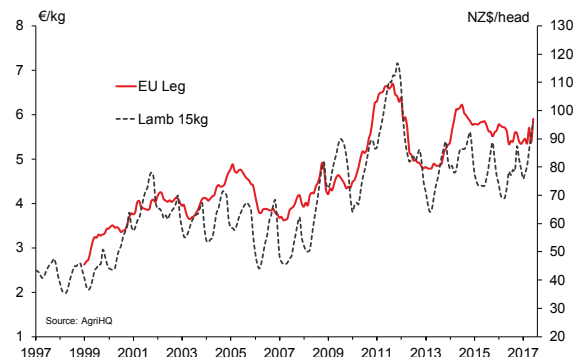
Our medium-term core view of a rising US dollar is based US growth, and therefore interest rates and the US dollar, resuming the trend rise witnessed in 2016.



## Lamb

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

Lamb prices have continued to firm, but there are signs that this surge has reached its peak. NZ lamb processing remained stable throughout May, but strong demand and relatively low slaughter numbers drove prices up. Weather issues have stalled processing and have led to stable supply levels. As weather conditions improve and farmers head back to the sheds, prices could edge back slightly. Lamb slaughter numbers were down 17% from the year to May. It is likely that higher prices will lead to increased slaughter in the coming months. That being said, further price gains might start having detrimental effects for long-term demand. On the global front, exports of frozen products to the UK fell by 34% over the past year, although the Middle East and US picked-up this slack, rising by 47% and 37% respectively. Meanwhile, China's demand for sheepmeat has kept stable, buying a similar amount to previous years' purchases in the month of April.



**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](mailto: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

---

### Things you should know

Westpac Institutional Bank is a division of Westpac Banking Corporation ABN 33 007 457 141 ("Westpac").

### Disclaimer

This material contains general commentary, and market colour. The material does not constitute investment advice. Certain types of transactions, including those involving futures, options and high yield securities give rise to substantial risk and are not suitable for all investors. We recommend that you seek your own independent legal or financial advice before proceeding with any investment decision. This information has been prepared without taking account of your objectives, financial situation or needs. This material may contain material provided by third parties. While such material is published with the necessary permission none of Westpac or its related entities accepts any responsibility for the accuracy or completeness of any such material. Although we have made every effort to ensure the information is free from error, none of Westpac or its related entities warrants the accuracy, adequacy or completeness of the information, or otherwise endorses it in any way. Except where contrary to law, Westpac and its related entities intend by this notice to exclude liability for the information. The information is subject to change without notice and none of Westpac or its related entities is under any obligation to update the information or correct any inaccuracy which may become apparent at a later date. The information contained in this material does not constitute an offer, a solicitation of an offer, or an inducement to subscribe for, purchase or sell any financial instrument or to enter a legally binding contract. Past performance is not a reliable indicator of future performance. 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.

### Country disclosures

**Australia:** Westpac holds an Australian Financial Services Licence (No. 233714). This material is provided to you solely for your own use and in your capacity as a wholesale client of Westpac.

**New Zealand:** In New Zealand, Westpac Institutional Bank refers to the brand under which products and services are provided by either Westpac or Westpac New Zealand Limited ("WNZL"). Any product or service made available by WNZL does not represent an offer from Westpac or any of its subsidiaries (other than WNZL). Neither Westpac nor its other subsidiaries guarantee or otherwise support the performance of WNZL in respect of any such product. The current disclosure statements for the New Zealand branch of Westpac and WNZL can be obtained at the internet address [www.westpac.co.nz](http://www.westpac.co.nz). For further information please refer to the Product Disclosure Statement (available from your Relationship Manager) for any product for which a Product Disclosure Statement is required, or applicable customer agreement. Download the Westpac NZ QFE Group Financial Advisers Act 2008 Disclosure Statement at [www.westpac.co.nz](http://www.westpac.co.nz).

**China, Hong Kong, Singapore and India:** This material has been prepared and issued for distribution in Singapore to institutional investors, accredited investors and expert investors (as defined in the applicable Singapore laws and regulations) only. Recipients in Singapore of this material should contact Westpac Singapore Branch in respect of any matters arising from, or in connection with, this material. Westpac Singapore Branch holds a wholesale banking licence and is subject to supervision by the Monetary Authority of Singapore. Westpac Hong Kong Branch holds a banking licence and is subject to supervision by the Hong Kong Monetary Authority. Westpac Hong Kong branch also holds a license issued by the Hong Kong Securities and Futures Commission (SFC) for Type 1 and Type 4 regulated activities. This material is intended only to "professional investors" as defined in the Securities and Futures Ordinance and any rules made under that Ordinance. Westpac Shanghai and Beijing Branches hold banking licenses and are subject to supervision by the China Banking Regulatory Commission (CBRC). Westpac Mumbai Branch holds a banking license from Reserve Bank of India (RBI) and subject to regulation and supervision by the RBI.

**UK:** The contents of this communication, which have been prepared by and are the sole responsibility of Westpac Banking Corporation London and Westpac Europe Limited. Westpac (a) has its principal place of business in the United Kingdom at Camomile Court, 23 Camomile Street, London EC3A 7LL, and is registered at Cardiff in

# 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 be 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.