

Fortnightly Agri Update

8 March 2017



Speed wobbles

Dairy prices fell 6.3% in last night's dairy auction, following a 3.2% decline a fortnight ago. Within this, powder prices have been under the most pressure, with whole milk powder prices falling 16% over the past fortnight, including a sharp 12.4% fall last night. At \$US 2,782/MT, whole milk powder prices are now back at levels from October last year, although are still some 35% higher than the middle of last year

As a result of the recent price declines and a softer near-term outlook, we've revised down our forecast for this season's farmgate milk price from \$6.20/kgMS to \$5.90/kgMS, slightly below Fonterra's of \$6.00/kgMS. While we're still looking at an improved outlook for farmgate milk prices next season (2017/18), we've pared back our forecast from \$6.50/kgMS to \$6.10/kgMS, although this far out the uncertainty bands are wide.

A key catalyst for the decline in prices over the past fortnight has been better milk volumes out of New Zealand. Last month, Fonterra upgraded its forecast for this season's milk collections to a 5% decline (from 7% previously), and this was reinforced last week by a 4% upward revision to Fonterra's expected offerings on the GDT platform over the next 12 months. With plentiful summer rainfall resulting in extremely favourable production conditions, we see a bit more upside to Fonterra's milk collections through the final months of the season.

A few months back, buyers were looking ahead to the New Zealand autumn expecting a much tighter backdrop for supply, and therefore had been willing to pay a premium to secure product. But now, this has well and truly faded, with prices firmly moving in the other direction. Indeed, last night's auction result for whole milk powder was even weaker than the headline suggests, with prices for some product delivered in May and June hitting the lower price limit, meaning there might be some residual downside for prices to come through next auction.

GlobalDairyTrade Auction Results, 8 March 2017

	Change since last auction	Price index USD/Tonne
Anhydrous Milk Fat (AMF)	-0.8%	\$5,653
Butter	1.2%	\$4,653
Butter Milk Power (BMP)	8.4%	\$1,846
Cheddar	-4.2%	\$3,435
Lactose	-4.3%	\$924
Rennet Casein	-6.6%	\$5,678
Skim Milk Powder (SMP)	-15.5%	\$2,118
Whole Milk Powder (WMP)	-12.4%	\$2,782
GDT Price Index	-6.3%	

Payout Forecast Table

	2016/17		2017/18
	Fonterra	Westpac	Westpac
Milk Price	\$6.00	\$5.90	\$6.10

At the same time, European production levels are looking firmer. While the latest production data for December showed production was still back 3% on a year earlier (after a 3.6% decline in November), seasonally adjusted data highlights that the level of production stabilised in October, and had begun to move higher by December.

Speed wobbles continued

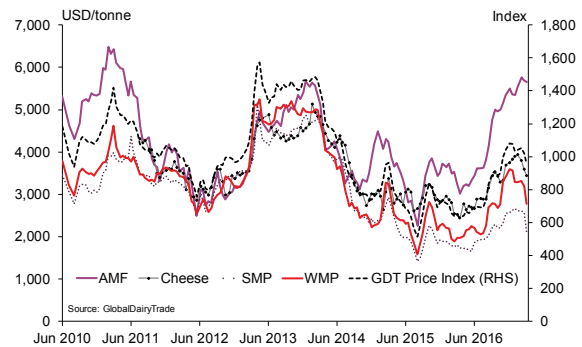
Farm gate prices rose strongly through the latter part of the year, topping €33/100kg in January. With many of the more efficient producers in North-West Europe reportedly able to expand output with farm gate prices above €30/100kg, production should improve further as we head towards the new season in April. However, we expect the improvement in European production to gradual, with some countries still struggling with low profitability, which will be made worse by the recent downturn in global prices. A fall in Dutch milk production as farmers reduce cow numbers by around 10% to meet new environment regulations (around phosphate emissions) will also weigh on the region's production.

On the demand side, the picture hasn't changed much in recent months. China's imports in January were down 10% on a year earlier, but still remain much above 2015's troughs. With China's domestic milk producers under financial strain, import demand should remain solid. More broadly, China's economy has gained momentum in recent months, which should help bolster demand for dairy (and other commodities) this year.

Overall, fundamentals in dairy markets still look much better than they did a year ago. Global supply remains well shy of last year's peak, and demand has remained steady. So while the near-term outlook has softened, prices should remain well off 2016's lows, and we expect some improvement in prices as we move through this year.

Sarah Drought
Economist

Global dairy prices

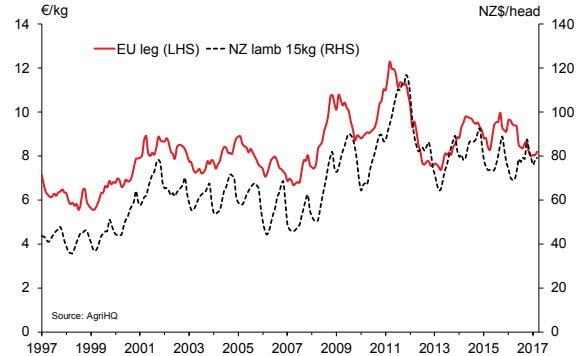


Beyond the farm gate

Lamb

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

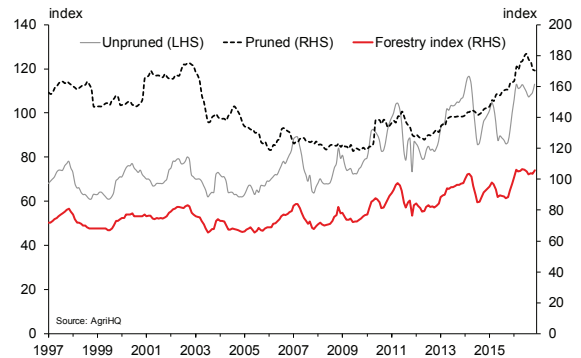
Tight supply of lamb from New Zealand is helping to underpin global prices. Cool and damp spring conditions slowed lamb growth early in the season, with plentiful summer rainfall removing the need for farmers to reduce stocking rates. In early February, slaughter for the season was running over 13% behind year ago levels, and suppliers reportedly only just managed to meet orders for the lucrative UK chilled Easter trade. But while in-market prices for lamb leg are over 30% higher than a year earlier, the high NZD/GBP continues to erode NZ dollar returns. The weaker pound is also making conditions more difficult in the continental European market, as more competitively-priced UK lamb legs puts some downward pressure on prices there. Meanwhile, Chinese demand for sheepmeat has remained strong, boosting prices for cheaper cuts of meat like lamb flaps, which are now up 45% from a year earlier.



Forestry

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

Log prices have continued to push higher this year. AgriHQ's log price index in February was 3% higher than a year earlier, and over 25% above the 10-year average. Strength in New Zealand construction continues to underpin high prices in the domestic market, with China boosting the global demand for logs. Although log inventories at Chinese ports have reportedly increased this year, some increase will be related to the shut-down in activity over the Chinese New Year period. The Chinese government will want to present a strong economy ahead of November's National Congress. This means we're likely to see public investment continuing to grow strongly this year, in turn helping to support construction and log demand. However, Chinese demand may falter next year, and combined with rising global supply (encouraged by high log prices), export prices are likely to come under some downward pressure heading into next year.

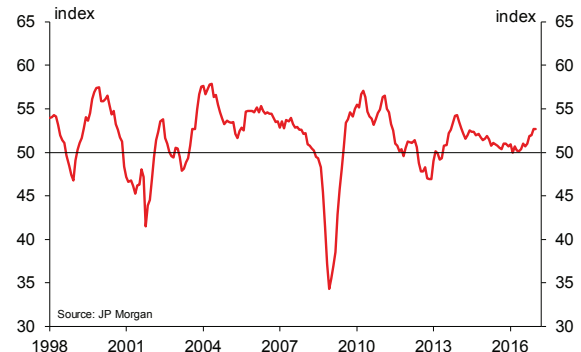


Global Growth

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

After a stretch of subdued growth, the world economy started to gather momentum from around the middle of 2016, which has carried through into the early part of 2017. We're forecasting world growth of 3.5% for each of the next two years, a slightly stronger pace than in the last few years. The risks to our forecast are increasingly to the upside for this year, but at the expense of downside risk for next year. In the US, businesses and markets have been encouraged by President Trump's plans for tax cuts and infrastructure spending, but sentiment could turn down again if he fails to deliver over the next year. China has turned towards easy credit to re-stimulate the economy ahead of the National Congress this November, but afterwards the government's focus is likely to return to economic reform, which would dampen the overall pace of growth.

Global manufacturing index



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

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