

Fortnightly Agri Update

19 December 2018



A look at lamb

Lamb producers have enjoyed strong prices of late. Looking ahead we expect to see international prices slip a little from current levels as growth in China slows and the Brexit debacle continues to weigh on the UK economy. However, tight lamb supplies in New Zealand and Australia and a weakening NZ dollar, should ensure any slippage at the farm gate is modest. We look at lamb markets in more detail in today's Fortnightly Agri Update.

While sheep may still feature in the quintessential image of New Zealand, sheep numbers have been in decline since they peaked at 70.3 million in 1982. Current estimates put the number of sheep in NZ at around 27.5 million. And while lamb numbers haven't fallen quite as dramatically, thanks to improving productivity and a lift in lambing rates, export volumes have broadly trended sideways in recent decades.

Locally, New Zealand lamb numbers are expected to be relatively stable in the 2018/2019 season. Beef and Lamb NZ estimates that the number of lambs in spring 2018 was 0.7% lower than a year earlier. Weather conditions during lambing were fairly favourable in most parts of the country. However, there was a decline in the number of breeding stock which Beef and Lamb NZ estimate was only partially offset by an increased lambing percentage (on average there were 1.29 lambs born for every ewe in spring 2018).

While weather conditions over summer will be an important determinant of the condition of stock and the timing of slaughter, anecdotally many farmers are happy with conditions on farm. It looks likely lamb export volumes will remain fairly stable in 2018/19 compared to last season.

We wish all our readers a merry Christmas and a happy new year!

This is the last Fortnightly Agri Update for 2018. We will resume on 16 January 2019.

GlobalDairyTrade Auction Results, 19 December 2018

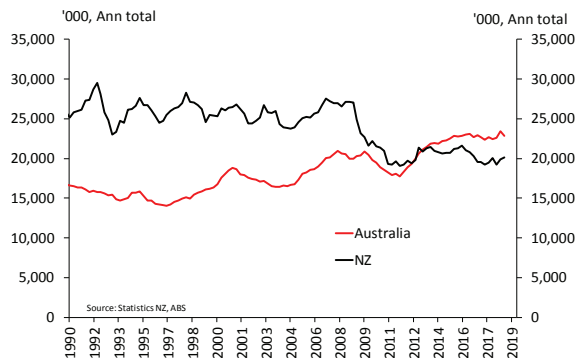
	Change since last auction	Price index USD/Tonne
Anhydrous Milk Fat (AMF)	4.0%	\$4,936
Butter	4.9%	\$3,928
Butter Milk Power (BMP)	n/a	n/a
Cheddar	2.2%	\$3,263
Lactose	1.6%	\$935
Rennet Casein	-2.1%	\$5,056
Skim Milk Powder (SMP)	3.4%	\$2,042
Whole Milk Powder (WMP)	0.3%	\$2,674
GDT Price Index	1.7%	879

Farmgate milk price forecasts

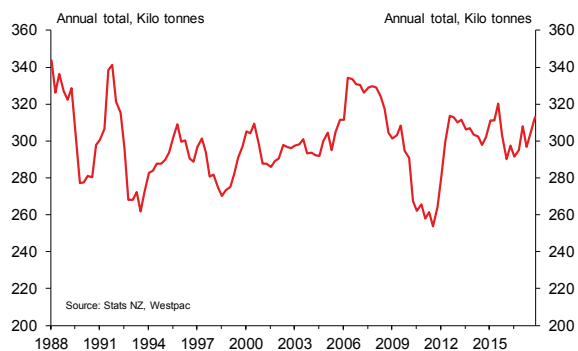
	2018/19		2019/20
	Westpac	Fonterra	Westpac
Milk Price	\$6.10	\$6-\$6.30	\$6.75

However, what's going on in New Zealand is only part of the story when it comes to thinking about trends in the global lamb supply. Also important is what's happening in Australia, the other big exporter of sheep meat globally.

Number of lambs slaughtered



NZ lamb exports



In contrast to New Zealand, Australia lamb exports have tended to rise in recent decades. Key export markets for the two countries are slightly different, with the US traditionally the key destination for Australian exports, while Europe (including the UK) plays a more significant role for New Zealand exporters. However, both New Zealand and Australia have seen a big lift in trade with China in recent years.

Most recently, Australian farmers have been badly affected by drought. And while this boosted export volumes in 2018, looking ahead ABARES expects poor weather conditions will reduce the number of lambs available in autumn 2019.

Consequently, relatively tight supplies in both New Zealand and Australia over the year ahead should help underpin global prices (even given the current elevated starting point).

Like in other commodities, China has become an increasingly important market for New Zealand lamb exporters in recent years. In the year to September 2018, around 38% of New Zealand lamb exports went to China up almost 50% on a year earlier. By value this market accounted for around 23% of exports. China is also a very important export market for mutton, with roughly two thirds of NZ mutton exports currently heading to China.

Consequently, what's going on in China plays an important role in the outlook for demand for NZ lamb. Importantly

growth in China has slowed sharply this year, from around 6.9% last year to an estimated 6.4% in 2018. To date, Chinese demand for lamb appears to have been little affected by this slowdown. However, with trade wars likely to remain a downside risk to the growth outlook, and a weaker Chinese yuan, we don't expect the pace of growth in Chinese demand for New Zealand lamb to be quite as strong over the year ahead.

Another very important market for NZ lamb exporters is Europe. Brexit negotiations are going down to the wire, as the possibility of a 'no deal' Brexit (where the UK leaves the EU without an agreement in place for what the relationship looks like post Brexit) looms on the horizon in the lead up to the March 29 deadline¹.

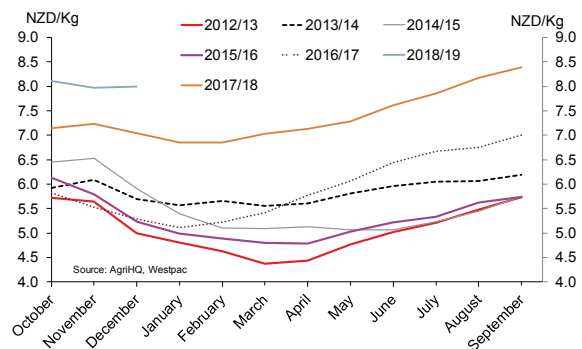
While we think a 'no deal' Brexit would be the messiest of all outcomes for New Zealand exporters, it would also involve massive disruptions to the UK economy. Consequently, there is likely to be little political will for this outcome, and we suspect politicians will ultimately come up with a solution which manages to leave the UK closely aligned with the EU. But exactly how and when such an outcome is achieved is a matter of considerable uncertainty.

The draft proposal to split New Zealand's export quota to Europe according to recent trade volumes would see New Zealand's sheep meat export quota split roughly fifty-fifty. However, industry groups have strongly opposed this proposal on the basis that it significantly reduces flexibility for exporters, limiting their ability to respond to changing market dynamics. However the situation eventually plays out from here, there appears to be relatively little upside for NZ lamb exporters, with economic growth in the UK set to remain subdued over the next few years, and risks tilted to the downside.

On balance we expect to see international lamb prices soften a little from their current levels as growth in key markets slows. However, back at the farm gate, this is likely to be largely offset by an anticipated fall in the New Zealand dollar. We expect the NZD/USD to fall from 68 cents currently to around 62 cents by the end of 2019, while the NZD/GBP is expected to fall from 54 to 0.49 pence by the end of next year.

This could see local prices remain near the impressive \$7.40/Kg season average that was achieved last year.

NZ lamb prices



Anne Boniface
Senior Economist

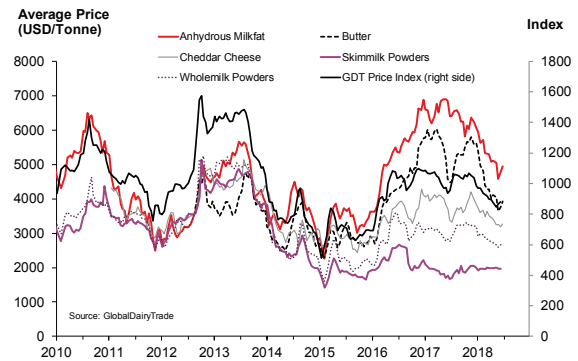
¹ Westpac Economics recently published an article on the outlook for Brexit and the implications for the New Zealand economy. You can find it here: <https://www.westpac.co.nz/assets/Business/Economic-Updates/2018/Bulletins-2018/Brexit-Commentary-December-12-2018.pdf>

Beyond the farm gate

Dairy

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

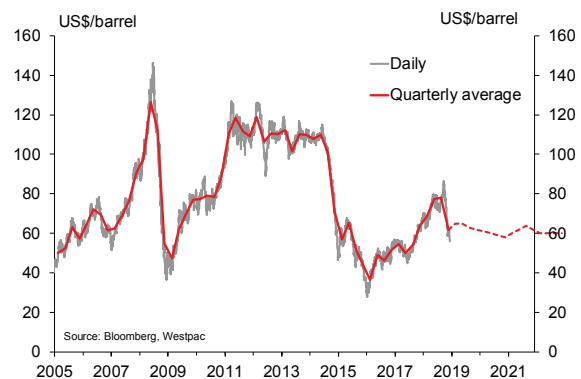
Dairy prices improved a little in last night's GlobalDairyTrade auction. In aggregate, prices rose 1.7%, boosted by a further rebound in fats prices (AMF was up 4% while butter was up 4.9%). Whole milk powder prices were broadly flat (up 0.3%). Last night's auction leaves us comfortable with our \$6.10 milk price forecast for the current season. Since our last *Update*, Fonterra has revised down its own forecast for the current season to a \$6-6.30 range, citing stronger supply weighing on prices. Like us, Fonterra noted that their forecast assumes dairy prices will firm across the remainder of the season. In other news, Fonterra also announced plans to once again offer farmers the opportunity to receive a fixed price for a portion of their milk production from June 2019. For now the programme is capped at just 5% of total production. We will discuss this in more detail in a forthcoming FAU.



Oil

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

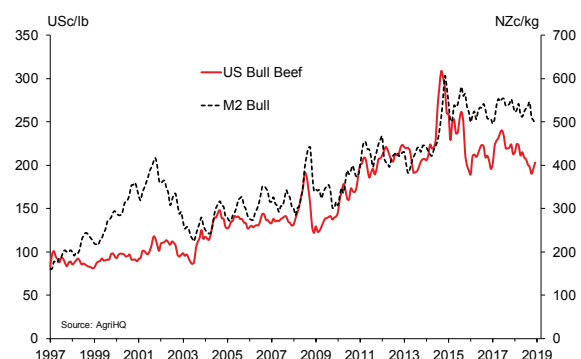
Oil prices peaked in early October with Brent crude rising above \$US 86/barrel. Since then prices have receded substantially on the back of increased supply and, most recently, concerns about the outlook for demand. Over the same period the NZ/USD has appreciated. While this fall in oil prices has happened more quickly than we were expecting, we have long been of the view that we would see a downward adjustment in oil prices. For New Zealand farmers, lower international oil prices and a higher New Zealand dollar should be reflected in lower fuel prices and transport costs.



Beef

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

Imported beef prices in the US have improved a little of late. However, we are sceptical about how long this will last. Markets have become increasingly nervous about the wider outlook for the US economy, questioning how much further the Fed will raise interest rates in 2019. While we remain positive about the prospects for the US economy from here, we do anticipate that the trend of growing domestic supply in the US has not yet fully run its course.



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

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