

Fortnightly Agri Update

19 September 2018



The new kids in town

Conditions for the undisputed heavy hitter of New Zealand's primary sector, the dairy industry, are becoming more challenging. Consequently, conversation is turning to the benefits of diversification within the agricultural sector. But while this can certainly offer benefits, experience shows that not all of the products touted as the next big thing will enjoy unbridled success.

Diversification is a hot topic in the agriculture sector right now. Partly this is a result of increased pressure on the dairy industry. While the dairy industry is still the undisputed heavy weight in the New Zealand agricultural sector, accounting for about 25% of New Zealand's merchandise exports and with export revenues of over \$14bn in the year to June 2018, the sector has been losing some of its gloss of late.

Last week it was the performance of Fonterra, New Zealand's largest dairy company, in the spotlight. Fonterra processes around 85% of all milk collected in New Zealand and the release of their 2017/18 annual results saw the company post its first ever financial loss of \$196m. And this in turn has reignited debate about the sustainability of Fonterra's current structure. One where high milk prices benefit its farmer shareholders, but which also reduce profit margins for the value-add side of the business.

Further weighing on confidence in the dairy sector this year has been mycoplasma bovis outbreak, and uncertainty whether the current phased eradication programme will be successful. So far, 71 properties throughout New Zealand have been confirmed as infected (a combination of dairy

After yet another soft GlobalDairyTrade auction last night, we've downgraded our milk price forecast for the current season to \$6.25. We discuss this change further in our dairy section on the back page.

GlobalDairyTrade Auction Results, 19 September 2018

	Change since last auction	Price index USD/Tonne
Anhydrous Milk Fat (AMF)	-0.6%	5,294
Butter	-0.1%	4,270
Butter Milk Power (BMP)	n.a.	n.a.
Cheddar	-3.5%	3,503
Lactose	-0.3%	910
Rennet Casein	1.7%	5,421
Skim Milk Powder (SMP)	-1.1%	1,980
Whole Milk Powder (WMP)	-1.8%	2,768
GDT Price Index	-1.3%	916

Farmgate milk price forecasts

	2017/18	2018/19	
	Final	Westpac	Fonterra
Milk Price	\$6.69	\$6.25	\$6.75

and dry stock farms and smaller lifestyle blocks). 37 of these remain contaminated, and the remainder have already been depopulated. Of the 345 compensation claims received by MPI, 126 have been completed in either full or part, with \$22.2m in claims paid. While any eradication was never going to happen overnight, it is clear that *Mycoplasma bovis* is set to be a cloud over the outlook for dairy and beef farmers for some time yet.

What's more, new more stringent rules on overseas purchases of foreign land have weighed on farm prices, most notably in the dairy sector. In contrast to other sectors where land prices have risen in line with growing revenues and increased profitability, the REINZ dairy farm price index has fallen 15% over the last year, with anecdotes attributing some of this softness to the higher hurdle for foreign ownership.

Yet perhaps the biggest change facing both the dairy sector and the agricultural sector more broadly is the increased focus and regulation on the environmental impact of farming operations. Not only will addressing methane emissions inevitably play an important part of New Zealand's international commitments to reducing climate change, but an increased focus on water quality and preventing nitrate leaching may also add to farmers' costs and lead to some reevaluation of farming practises.

And while commodity price fluctuations are par for the course, biosecurity incursions are an unfortunate (and possibly more frequent) consequence of our deepening connections with the rest of the world. Restrictions on who and who can't buy New Zealand land could easily fluctuate with an electoral cycle. Furthermore, the increasing focus on the environmental consequences of different land uses will have a long lasting impact on the operating landscape of the agricultural sector.

Consequently, the ramp up in dairy cow numbers and the shift in land use toward dairying we've observed over the last couple of decades won't be a theme that continues from here. Already the value of New Zealand's dairy exports, as a proportion of total exports, has plateaued at around 25% (up from 13% in the mid-1980s). So if we're at peak cow, and nearing peak dairy exports, where to from here?

Dairy exports as a percentage of total exports



There's seemingly no shortage of primary products vying to be 'next big thing'. For example, excitement has been building amongst those in the hemp industry, on the back of pending law changes which will allow hemp seed products to be sold for human consumption. Proponents argue it is a high value and 'low input' crop able to be grown in most conditions and with the added benefit removing contaminants from waterways. On a somewhat bigger scale the likes of avocados, Manuka honey and kiwifruit production have all received more attention in recent times on the back of strong international demand, high prices and productivity improvements.

It remains to be seen which industries will live up to the hype and which will retain their niche status. Success will require a combination of hitting the right mark with increasingly demanding international consumers, the ability to differentiate (and hopefully command a premium) for New Zealand product and doing things smarter than our competitors. All much easier said than done. And with the scars of past boom bust periods still etched into the memories of farmers and growers across New Zealand, many will tread cautiously. That said, while New Zealand is likely to remain a food exporter, in the future dairy won't be quite as dominant as it has been in recent years.

Anne Boniface

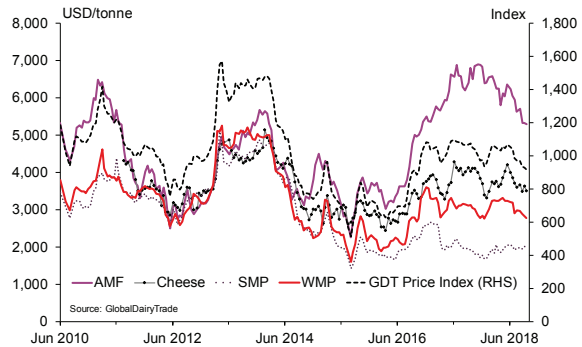
Senior Economist

Beyond the farm gate

Dairy

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

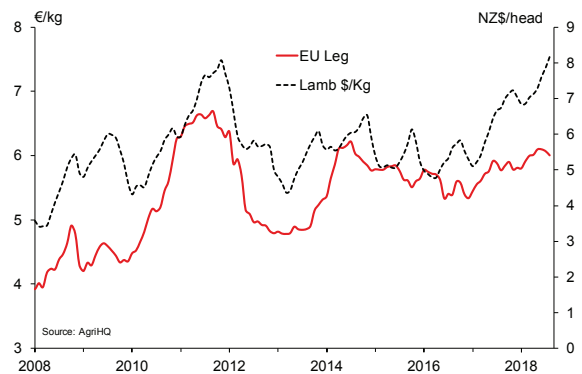
It was another soft GlobalDairyTrade auction last night. The headline price index fell 1.3% with prices slipping for most products on offer, including a 1.9% fall in whole milk powder prices. While we have long been factoring softer dairy prices into our outlook, prices have slid further than we had been expecting in recent weeks. And with farmers pleased with pasture conditions in many parts of the country, at this stage prospects for NZ milk supply appear favourable. This may be one factor behind Fonterra's 3% lift in the forecast volume of product it expects to offer on the GlobalDairyTrade platform over the next 12 months (driven by a lift in forecast whole milk powder supply). Consequently, we have lowered our milk price forecast to \$6.25 (previously \$6.50). As we noted last week, we continue to view Fonterra's \$6.75 forecast as too optimistic.



Lamb

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

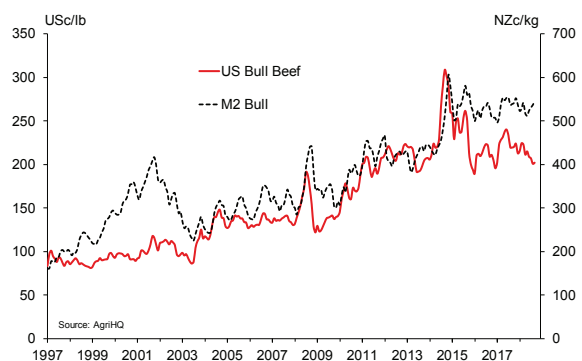
This week Beef and Lamb NZ released its new season outlook. It expects lamb export volumes will fall slightly (-1.7%) on the back of a forecast 3.8% fall in New Zealand's lamb crop this season. As always, weather will play an important role. It was a very poor start to spring for some farmers with recent snow storms reportedly leading to significant lamb losses in the eastern and central North Island. This could see nationwide lamb numbers shrink even further than forecast.



Beef

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

The theme of softer demand for NZ beef in US markets remains prominent. In addition to weakening prices, anecdotes of softer demand continue to filter through as drought conditions in parts of the US contribute to a lift in domestic supply. Drought conditions in Australia are also behind increased slaughter there. The latest ABARES forecasts indicate that total Australian beef production could rise by 3% over the next year on the back of drought conditions in Queensland and New South Wales.



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

Contact the Westpac economics team

Dominick Stephens, Chief Economist +64 9 336 5671

Michael Gordon, Senior Economist +64 9 336 5670

Satish Ranchhod, Senior Economist +64 9 336 5668

Anne Boniface, Senior Economist +64 9 336 5669

Paul Clark, Industry Economist +64 9 336 5656

Any questions email: economics@westpac.co.nz

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