Fortnightly Agri Update

2 May 2018

The big picture

It's easy to get bogged down in the minutiae of changes in commodity prices, especially as this can have a big impact on day to day operations and decision making. However, it's also important to sometimes take a step back and look at the bigger picture.

Do this, and it becomes clear (from a revenue perspective at least) New Zealand's agricultural sector is in a bit of sweet spot right now. With the odd exception, commodity prices are at very healthy levels in many sectors and have generally been stronger than we expected in recent months. Even dairy prices, while a long way from their highs, are still at levels which should leave most dairy farmers comfortably in positive cash flow territory this year and next. Of course, there's always an exception to every rule. In this case it's coarse wool prices, which remain low due to ample supplies and soft demand.

Strong commodity prices helped push New Zealand's terms of trade to a record high in the last quarter of 2017. The high terms of trade is welcome news for the NZ economy. It will provide a supportive backdrop for growth at a time when other drivers of the economy, such as the housing market, business investment and construction activity, are expected to slow.

The global growth backdrop remains positive with the US economy particularly buoyant. The tight US labour market (the unemployment rate is at its lowest level in 17 years) is putting pressure on wages and price pressures are picking up more widely. Combined with an increase in fiscal stimulus, this is supporting consumer spending.

However, it is not all smooth sailing on the global growth front. We're still a long way off checkmate in the trade spat between the US and China, and uncertainties about US-related trade tensions more generally are also keeping markets on edge. But it's not only threats on the trade front, there are also opportunities – particularly from a New Zealand perspective. The CPTPP will provide additional access to for New Zealand's agricultural exports to the likes of Japan (particularly beneficial for New Zealand beef exporters). And new trade agreements in the wake of next year's Brexit were also front and centre during the Prime Minister's discussions with European leaders in recent weeks. Of course, achieving New Zealand's ambitious goals of access for our agricultural exports to EU and the UK, won't be easy. There is likely to be stiff lobbying from domestic agricultural producers, keen to protect their local industries, and it remains to be seen what can be achieved.

The biggest headwind from global growth is likely to come from slowing growth in China. Recent monthly data suggests momentum is fading and employment growth (already soft through 2016/17) has eased further. Along with authorities' tight rein on credit and investment, this is likely to see GDP growth slow materially to 6.3% in 2018 from 6.8% in 2017. While not concentrated in the consumer sector, we don't think households will emerge completely unscathed from the slowdown. This will likely lead to slower growth in demand for New Zealand commodity exports such as dairy, beef and lamb.

However, partially offsetting softer international prices is an expected depreciation in the NZ dollar. US interest rates have risen substantially on the back of stronger growth and emerging inflation pressures. The Federal Reserve has been lifting its key policy rate and is expected to lift it further. What's more, it is also unwinding the Quantitative Easing measures put in place following the Global Financial Crisis. In contrast, inflation pressures in New Zealand remain subdued. We expect the Reserve Bank of New Zealand to leave its policy rate on hold for the rest of this year and most of next. While we have been forecasting a weaker NZD/USD for some time, it's only been in the last couple of weeks that markets have reached the same conclusion and the currency has fallen sharply. The NZD/USD has fallen from almost 74 cents in mid-April to around 70 cents currently. We think his move has further to go yet. We're forecasting the NZD/USD to get down to 64 cents by the middle of next year.

Anne Boniface
Senior Economist

GlobalDairyTrade Auction Results, 2 May 2018

	Change since last auction	Price index USD/Tonne
Anhydrous Milk Fat (AMF)	-1.9%	6,032
Butter	0.0%	5,647
Butter Milk Power (BMP)	0.5%	1,990
Cheddar	3.1%	4,024
Lactose	0.6%	616
Rennet Casein	-10.5%	5,177
Skim Milk Powder (SMP)	3.6%	1,999
Whole Milk Powder (WMP)	-1.5%	3,231
GDT Price Index	-1.1%	1,046

Farmgate milk price forecasts

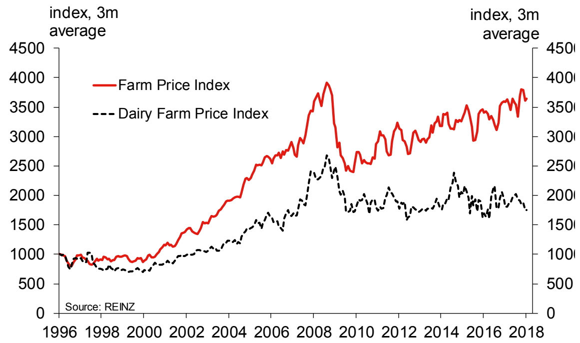
	2017/18		2018/19
	Westpac	Fonterra	Westpac
Milk Price	$6.55	$6.55	$6.50

Beyond the farm gate

Rural property prices

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

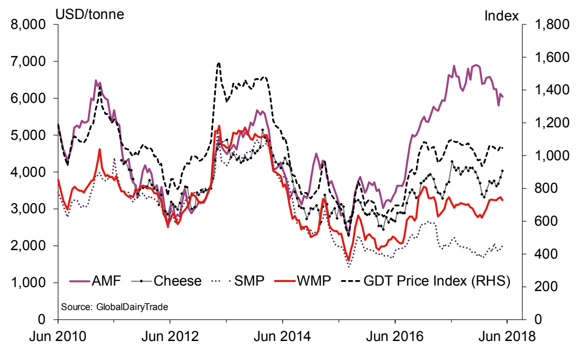
The rural property market remains subdued. REINZ farm price index (which attempts to adjust for the composition of sales) is up 1.6% in the three months to March compared to the same period a year ago. There has been particular softness in dairy farm prices, with the dairy farm prices index down 4% over the same period. Sentiment in the rural property market has been weighed down by uncertainty over the impact of environmental regulations while the changes to rules around offshore purchases of rural land is also having an impact.



Dairy

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

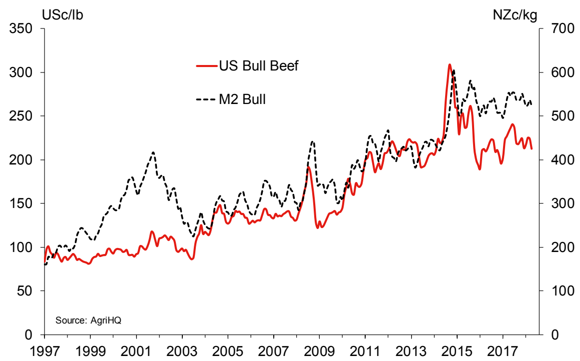
Prices eased in last night's GlobalDairyTrade auction, falling 1.1%. This is broadly a continuation of the period of relative stability in prices we've seen this year. Beneath the headline, butter held onto recent gains, unchanged from the previous auction, while whole milk powder prices eased 1.5% to an average price of $3,231. Going forward we maintain our view that dairy prices are likely to gradually ease later this year as global milk supply increases and demand growth from China slows. However, the recent sharp depreciation in the NZD/USD also gives us confidence that next year's farm gate milk price will be supported by a lower NZ dollar.



Beef

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

With the dairy season winding up, dairy cattle are being culled, adding to local supply of ground beef and putting some downward pressure on prices in the near term. Offshore, the US beef market is reportedly softer with a lift in local slaughter adding to the seasonal increase in supply from both Australia and New Zealand. The USDA continues to expect growth in US beef production from here, and we expect this to weigh on NZ export prices in the coming months.



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

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