Fortnightly Agri Update

21 November 2018

The changing global backdrop

Many of the headlines looking at the global trade outlook in recent times have focused on the deteriorating relationship between China and the US. The risk of being caught in the crossfire of an escalating trade war between the US and China remains. But there has also been good news. New Zealand exporters will soon be reaping the benefits of the much-debated Comprehensive and Progressive Trans-Pacific Partnership agreement.

The deteriorating trade relationship between the US and China continues to be the key risk, but it is not the only development on the trade front. Brexit negotiations are coming to a head as the March deadline for the UK's exit from the European Union draws closer. While UK Prime Minister Theresa May is seeking approval for a draft exit agreement, she is facing significant political opposition. In addition, the UK and EU are yet to determine the nature of their future trading agreements. This leaves considerable uncertainty around the UK's growth outlook, with the risks skewed to the downside. Details about how New Zealand's trading relationship with the region will look post-Brexit remain scarce. Presently, New Zealand has an annual quota of sheepmeat exports to the EU of 228,000 tonnes. It has been proposed that this is simply split between the UK and Europe roughly 50/50. However, this would deny New Zealand the flexibility to respond to changes in the market, so the Government is protesting at the WTO.

While trade news from the US and Europe is discouraging, much of the rest of the world continues to pursue trade liberalisation. The ratification of the multiparty CPTPP by 6

In our last Fortnightly Agri Update we published our first 2019/20 milk price forecast. While there's plenty of water to flow under the bridge before this number is finalised in September 2020, our view of a modest improvement in dairy prices next year combined with earlier weakness in the NZ dollar leaves us picking a $6.75 milk price for the 2019/20 season.

GlobalDairyTrade Auction Results, 21 November 2018

	Change since last auction	Price index USD/Tonne
Anhydrous Milk Fat (AMF)	-9.4%	4,577
Butter	-9.6%	3,637
Butter Milk Power (BMP)	n.a.	n.a.
Cheddar	0.2%	3,252
Lactose	1.1%	920
Rennet Casein	-4.5%	5,067
Skim Milk Powder (SMP)	-1.6%	1,965
Whole Milk Powder (WMP)	-1.8%	2,599
GDT Price Index	-3.5%	846

Farmgate milk price forecasts

	2018/19		2019/20
	Westpac	Fonterra	Westpac
Milk Price	$6.25	$6.25-$6.50	$6.75

of the 11 signatories starts the clock ticking on the removal of trade barriers for New Zealand exporters. The deal will be New Zealand's first free trade agreement with Japan, Mexico, and Canada, and opens the door wider to trade with ten economies that account for around 13.5% of world GDP and are already the destination for almost 30% of New Zealand's goods exports. Importantly, the deal will eventually put New Zealand exports to Japan on a level playing field with key competitors such as Australia, Chile and the EU who have already negotiated bi-lateral free trade agreements. A wide variety of agricultural exporters will benefit including kiwifruit, onions, squash, wine, beef, lamb, fish and dairy exports.

It's estimated that when fully implemented, the CPTPP has the potential to deliver around $220 million savings on tariffs. But that's probably just the tip of the iceberg. The bigger benefits of the deal for New Zealand exporters stem from greater access to some of the world's biggest economies. It remains to be seen how New Zealand exporters will make the most of these opportunities, but the Ministry of Foreign Affairs and Trade estimates it could lift New Zealand GDP by somewhere between 0.3% and 1% ($1.2 billion to $4 billion).

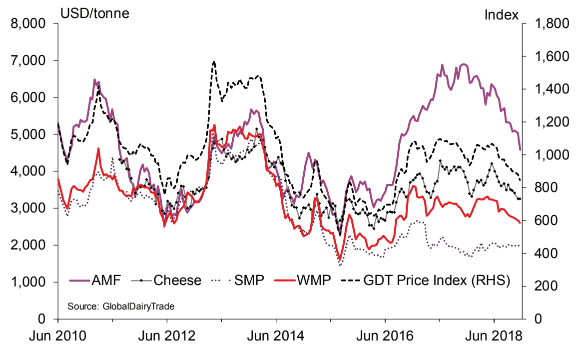
Anne Boniface
Senior Economist

Beyond the farm gate

Dairy

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

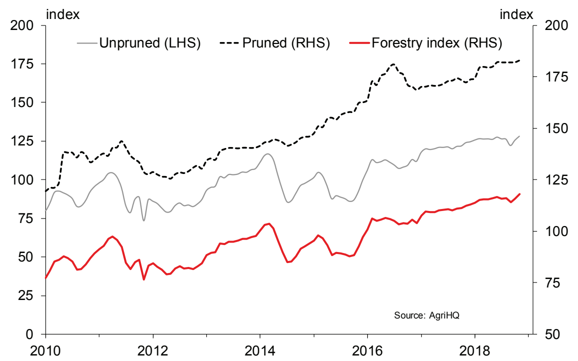
Dairy prices weakened further at last night's GlobalDairyTrade auction. The biggest falls were for fats prices with AMF and butter down 9.4% and 9.6% respectively. Whole milk powder prices were also lower, falling 1.8% to their lowest level since August 2016. This was in contrast to futures pricing which was pointing to a 2% lift in WMP prices. Strong growth in New Zealand milk production continues to weigh on prices. DCANZ data showed nationwide milk collections were up 6.5% in October compared to last year, with season to date milk production up 6%. While these comparisons are likely to become slightly less favourable over the coming months as the 2017/18 season improved after a relatively poor spring, nationwide milk production looks on track to be up at least 3% this year.



Forestry

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

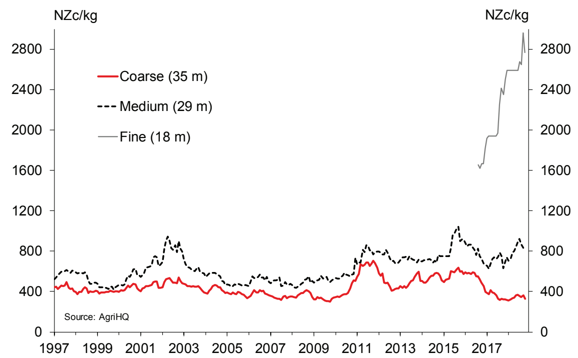
Log prices continue to defy our expectations, moving higher in October and more than reversing recent declines. Export prices led the way, with the AgriHQ log export price index jumping 4% in the month. There are reports that the recent lift has been due to low inventories in China, combined with less supply coming out of North America as the trade war between the US and China takes effect. Domestic log demand also looks to be remaining balanced, supported by ongoing strength in domestic construction activity.



Wool

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

Coarse wool prices have weakened in recent weeks, and continue to underperform relative to finer wool. Like in other sectors the weaker Chinese currency (as China looks to offset the impact of the US/China trade war on its exports) is weighing on demand. In addition, Chinese exports to the US (which use wool as an input) may also fall in response to higher tariffs. If tariffs remain in place, production could relocate to other countries, however that process would likely take some time.



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

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