

Fortnightly Agri Update

3 October 2018

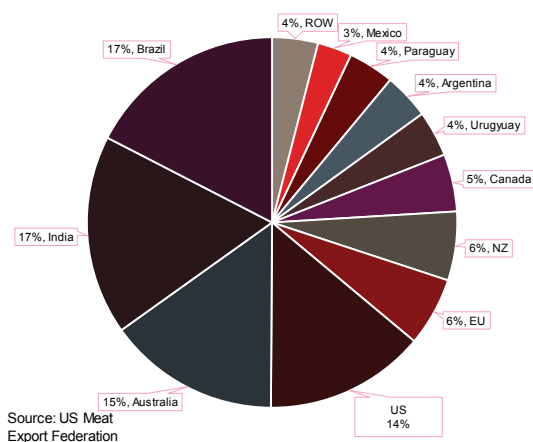


Where's the beef

International beef prices are coming under increased pressure on the back of a lift in supply. In this week's Fortnightly Agri update we take a look at developments in beef markets and consider what the prospects are from here.

In 2017, New Zealand was the 6th largest global beef exporter accounting for around 6% of global exports. That's just behind the heavyweights of Brazil, India (which largely exports buffalo meat), Australia and the US.

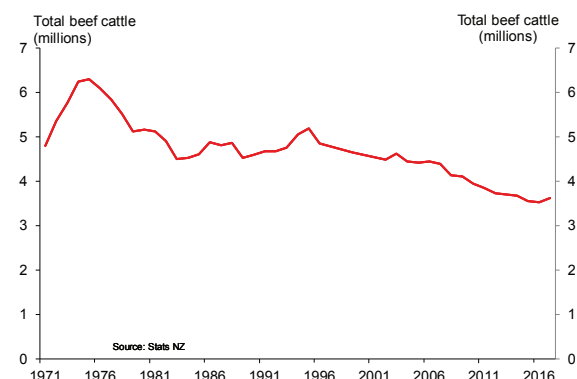
Global beef exports



Domestic beef cattle numbers have fallen steadily since the mid-1990s as profitability in the sector came under pressure and land was converted into dairying. However,

there was a 2.3% lift in the national beef cattle herd in 2017 as dairy conversions stalled and profitability in the sector improved on the back of higher meat (both beef and lamb) prices. Beef and Lamb NZ estimate numbers grew another 1.7% in the year to June 2018, led by a lift in South Island cattle numbers. Looking ahead, they're forecasting further growth, and another 1.9% lift in cattle numbers by June 2019. But as herds grow, Beef and Lamb NZ expect the number of cattle processed for export to shrink by 3% in 2018/19.

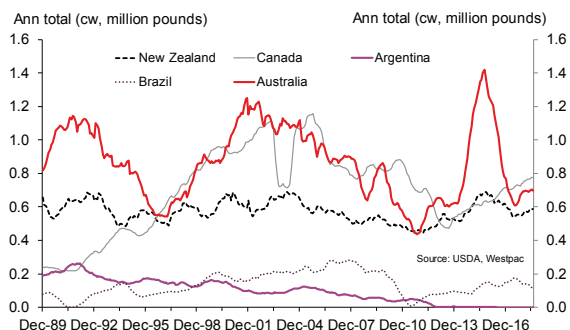
Beef cattle numbers



By value, New Zealand's largest export market is the US putting that country in the unique position of being both an important consumer of NZ beef and a key competitor – both internationally and domestically within the US. The bulk of NZ's exports to the US are lean manufacturing beef

which is used often used in burgers and mostly comes from bulls or dairy cows. New Zealand was the third largest supplier of beef to the US market in the year to July 2018 (behind Canada and Australia).

US beef imports



Somewhat helpfully Americans are big meat lovers, consuming around 25.8kg of beef per person annually last year. Although that's amongst the highest in the world according to the OECD, it still pales in comparison to Uruguayans whose average beef consumption is a whopping 43.2kg a year. And with American consumers in a healthy state thanks to a tight labour market and rising wages, demand for beef appears on firm footing. That said, consumers will continue to need to be convinced to choose beef over other alternative proteins – a task that can become more challenging as the relative price of beef has risen.

The US herd went through a rebuilding phase from roughly 2014 to 2016, with meat production lifting over the last couple of years as this rebuilding phase finished. However in recent times the US has been experiencing drought in major cattle regions which is further adding to supply. The USDA expects US beef production to lift from 27.1bn pounds in 2018 to 27.7bn pounds in 2019. In addition to increased supply, US beef exports have been growing strongly. Japan is the top destination for U.S. beef exports followed by South Korea & Mexico.

Like the US, Australia is another supplier of beef into New Zealand's key export markets including the US and China. The Australian herd has entered a destocking phase according to the Australian Bureau of Agricultural and Resource Economics and Sciences (ABARES) due to drought conditions in Queensland and New South Wales. Meat and Livestock Australia are forecasting a 10% lift in export volumes for calendar year 2018. Drought has also impacted the condition of stock with lower slaughter weights.

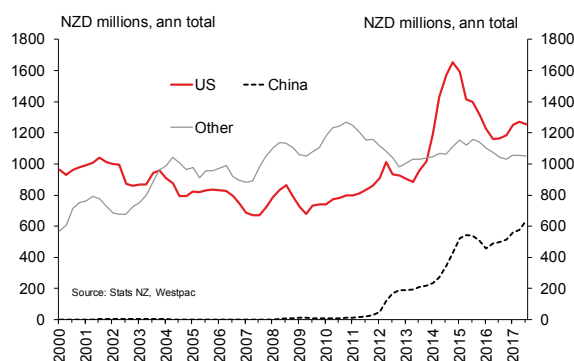
The upshot is that droughts in both the US and Australia are expected to add to global beef supply in the year ahead. Further down the track, assuming weather conditions improve, we would expect a period of restocking to lead to tighter supplies, helping to underpin prices.

Brazil (along with other countries in South America) is currently something of a sleeping giant in the beef industry. While it has long had a sizable herd, the sector has faced multiple challenges over the years. That said, in recent times there have been significant improvement in productivity on farm, increased access to international

markets and greater supply chain tractability which has helped improve its reputation on world markets. This has helped boost its presence on the global stage – a trend that is widely expected to continue in the coming years.

China is the second largest market for NZ beef exports, and demand has been growing strongly in recent years. The volume of beef exports in the year to June 2018 was up 25% on the same period a year earlier. The outlook for Chinese demand is mixed. On one hand there is a massive structural opportunity as households in China become richer and diets change. But this also must be overlaid with cyclical drivers. And on this front we are more circumspect. Growth in China is expected to slow from 6.9% in 2017 to 6.3% this year, and decelerate further in 2019. While this slowdown is not expected to be centred on the consumer, we doubt they will remain immune, so we could see softer demand.

NZ beef exports



On balance, we expect to see international beef prices continue to come under modest downward pressure over the coming year.

Risks and opportunities

Like other primary producers, the beef industry faces both risks and opportunities as it looks forward to the next decade.

Beef exporters have the potential to benefit from further improvements to trade agreements. The sector was one of the winners under the CPTTP agreement with improved access to Japanese market in particular. This will help NZ producers (amongst others) level the playing field with Australian exporters who are already benefitting from signing a free trade agreement with Japan in 2014. It also adds to pressure on US suppliers as the US is without a trade deal with Japan. Similarly, New Zealand's access to the Chinese market has improved in recent years with exporters dipping their toe into the water with chilled meat exports under a trial agreement. New Zealand trade negotiators will also be looking to improve access to European markets as trade deals are renegotiated in the wake of Brexit next year.

On the flip side, there are also implications for New Zealand producers from American President Donald Trump's "America First" policy and the associated and tit for tat trade war with China. Given international trade linkages and exposure to various markets, the implications of these developments are not straightforward. For example, the

US is only a very small exporter of beef to China, however its pork exports are more significant. A lift in the tariffs on Chinese imports from the US may lead to a lift in domestic pork supply, reducing the price in the US of a substitute to beef which could encourage some switching by consumers. In another channel, China has responded to US tariffs by allowing its currency to depreciate. While that may have succeeded in providing some offset to the higher cost of Chinese goods in the US following the imposition of tariffs, it also makes imports (including those from New Zealand) more expensive.

Disease and biosecurity incursions remain an important risk in the industry both locally and abroad. In the past countries have been very quick to shut doors following the discovery of diseases such as mad cow disease and foot and mouth disease and this has led to significant changes in global trade patterns. And while these major threats have never reached New Zealand, beef farmers have been reminded of the risks following the discovery of mycoplasma bovis. Beef farmers have been affected, with 22 of the current 37 infected properties beef farms. With the risk of future biosecurity incursions always on the horizon (and arguably growing as New Zealand becomes increasingly connected with the rest of the world) keeping NZ free from major cattle diseases will no doubt remain a priority for the sector.

Another other threat to New Zealand's beef industry (and meat industry more broadly) comes as synthetic meat moves from the laboratory to the supermarket aisle and local burger shop. We've already written about this previously (see our Fortnightly Agri Update from March <https://www.westpac.co.nz/assets/Business/Economic-Updates/2018/Fortnightly-Files-2018/NZ-Fortnightly-Agri-Update-21-March-2018.pdf>) so we won't dwell on the detail. Suffice to say, the sector will need to keep up to speed with these developments, and be front footed when it comes to tackling both the threats and opportunities they bring.

Anne Boniface
Senior Economist

GlobalDairyTrade Auction Results, 3 October 2018

	Change since last auction	Price index USD/Tonne
Anhydrous Milk Fat (AMF)	-4.4%	5,069
Butter	-5.9%	4,016
Butter Milk Power (BMP)	3.6%	2,522
Cheddar	-1.2%	3,468
Lactose	0.6%	913
Rennet Casein	3.0%	5,552
Skim Milk Powder (SMP)	-0.3%	1,982
Whole Milk Powder (WMP)	-1.2%	2,753
GDT Price Index	-1.9%	916

Farmgate milk price forecasts

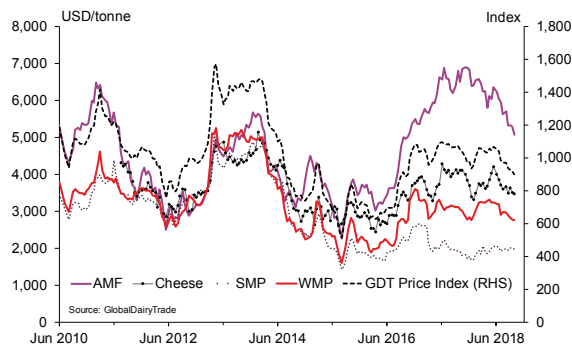
	2018/19	
	Westpac	Fonterra
Milk Price	\$6.25	\$6.75

Beyond the farm gate

Dairy

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

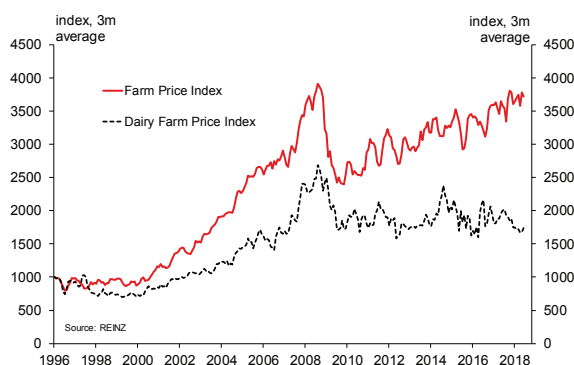
Dairy prices continued to drift lower in last night's GlobalDairyTrade auction. Headline prices fell 1.9%, led by a sharp fall in fats prices. AMF prices were down 4.4% and butter prices were down 5.9%. Whole milk powder prices fared a little better, but were still 1.2% lower. We suspect the strong start to the NZ dairy season is one factor now weighing on prices. NZ milk production grew 4.6% in August, with production for the season to date running over 5% ahead of last year. Anecdotes from around the regions suggest most farmers also had favourable conditions in September. For now, we retain our \$6.25 milk price forecast, but should prices continue to slip, the risks are to the downside.



Rural property prices

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

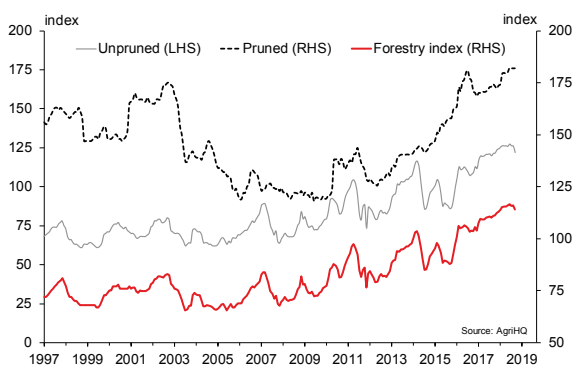
The latest rural property sales data shows ongoing pressure on dairy farm prices. REINZ dairy price index was up 3.6% in August, but is still down 13% on a year ago. That compares to a 1.7% fall in overall farm price index in the month, but a 4% lift over the last year. Anecdotally, buyers remain cautious. While there is still reportedly demand for "good quality" properties, those of lesser quality can be much harder to shift. Increasing environmental regulations, changes to foreign buyer rules, mycoplasma bovis and a softer dairy price outlook are all likely to be weighing on farm prices.



Forestry

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

After enjoying a surprisingly strong run for much of this year, international log prices are now weakening. Agri HQ's export log price index dropped almost 5% in September. Part of this weakness has been attributed to the increase in the NZD/CNY. This is a consequence of the US-China trade wars with Chinese authorities happy to allow the renminbi to depreciate against the USD to offset some of the impact of higher tariffs with NZ exporters caught in the crossfire. With growth in the Chinese economy now slowing, and the disagreements between China and the US showing no signs of abating, we're wary of further softness in prices in the coming months.



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

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