

# Fortnightly Agri Update

4 July 2018



## A step lower

Dairy prices fell sharply in last night's GDT auction. While we had been expecting prices to soften in the coming months, the size of last night's fall in prices was a surprise, effectively taking prices to the lower bounds of where we were expecting to see prices trade over the season. While it's difficult to pin the reason for the fall in dairy prices on any one factor, increased nervousness about the impact of trade wars on global growth prospects may have played a role. We discuss these developments further in this week's Fortnightly Agri Update.

Dairy prices took a dive in last night's GlobalDairyTrade auction. The overall price index was down 5%, the biggest fall since March last year. Beneath the headline, weakness in prices was widespread across the products on offer. Whole milk powder prices fell 7.3%, a much bigger fall than the 1% or so decline futures markets had been expecting. Skim milk powder prices were also weaker, falling 4.6% while butter prices were down 4%. The GlobalDairyTrade price index has now fallen 7.4% over the last three auctions.

Importantly, the falls come at a time when volumes traded on the GDT auction are starting to lift. There was a 20% lift in the volume of WMP sold in last night's auction compared to the previous event and a 30% lift in SMP sold. This is broadly in line with the usual season pattern, which sees the volume of product sold peak around September/October. At high volumes, auction results have a large impact on the final milk price paid to farmers. That said, the proportion of product sold on the GDT platform has been drifting lower over the last year or so. There was 9% less WMP sold in last night's auction relative to a year earlier.

### GlobalDairyTrade Auction Results, 4 July 2018

	Change since last auction	Price index USD/Tonne
Anhydrous Milk Fat (AMF)	-1.7%	5,937
Butter	-4.0%	5,390
Butter Milk Power (BMP)	6.4%	2,480
Cheddar	-4.3%	3,713
Lactose	-	-
Rennet Casein	3.6%	5,089
Skim Milk Powder (SMP)	-4.6%	1,913
Whole Milk Powder (WMP)	-7.3%	2,905
GDT Price Index	-5.0%	986

### Farmgate milk price forecasts

	2017/18		2018/19	
	Westpac	Fonterra	Westpac	Fonterra
Milk Price	\$6.75	\$6.75	\$6.40	\$7.00

Dairy prices can be volatile in fortnightly auctions. So we're inclined to treat last night's dairy price outturn with a degree of caution. However, we have been warning of the prospect of weaker dairy prices on the back of slowing growth in China for some time. That's been the key reason our own milk price forecast of \$6.40 has been sitting below Fonterra's \$7 estimate for the 2018/19 season. While we acknowledge there was little direct evidence of this in

last night's auction (with no sign of reduced activity from Chinese buyers) we retain our view that commodity prices across the board are likely to come under pressure as the Chinese economy slows.

Indeed, on its own last night's move suggests downside risk to our \$6.40 forecast for the 2018/19 season (in one auction WMP prices have now fallen to the low we were envisioning for the season). However, this is partially offset by some tweaks we've made to our milk price modelling. What is clear however, is that last night's auction result puts Fonterra's \$7 milk price forecast under pressure.

As always, it's difficult to know for sure if there was a particular catalyst for last night's surprisingly weak result. In addition to softer growth in China, a number of other factors may have contributed.

Locally, the early indications for the outlook for milk production in the 2018/19 season looks favourable, and anecdotally early-season pasture conditions in many parts of the country have been good. Last season finished on a firm note. Fonterra is forecasting a 1.3% lift in milk collections next season. This seems like a reasonable starting point. However, much will depend on how the weather pans out over the spring. In addition, the impact of mycoplasma bovis, increasing environmental regulations and incentives being introduced to reduce the use of PKE feed supplements all suggest milk production could struggle to grow as quickly as in the past.

Fears around the impacts of global trade from escalating trade tensions may also have weighed on prices. The US has now placed tariffs on imports from some of its biggest trading partners. A number of affected countries have retaliated by introducing their own tariffs on US exports including some dairy exports. Measures to date have included Mexican tariffs on US cheese exports, which will soon reach 20-25%, Chinese tariffs of 25% on US dairy exports including powdered dairy products, and Canadian tariffs on yoghurt.

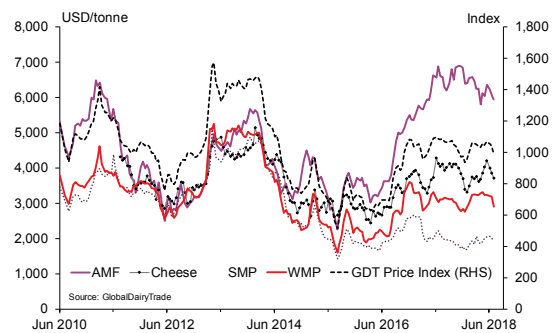
As last night's auction shows, the biggest threat for New Zealand is that we get caught in the downdraft of a slowdown in global trade which puts downward pressure on commodity prices across the board. It's certainly this fear that has been weighing on financial markets.

While there may be some opportunities for NZ dairy exporters to pick up the slack from any shift in Chinese demand away from US suppliers towards alternatives (one of the products China introduced 25% trade tariffs on is US dairy powders exports) US dairy exports will still be looking for a home on international markets. Total global supply of dairy products hasn't changed as a result of the tariffs.

Surprisingly there was no reaction to the fall in dairy prices in currency markets. The NZ dollar actually rose a little overnight. If we were to see further falls in dairy prices we would expect currency markets to sit up and take notice.

**Anne Boniface**  
Senior Economist

## Dairy prices

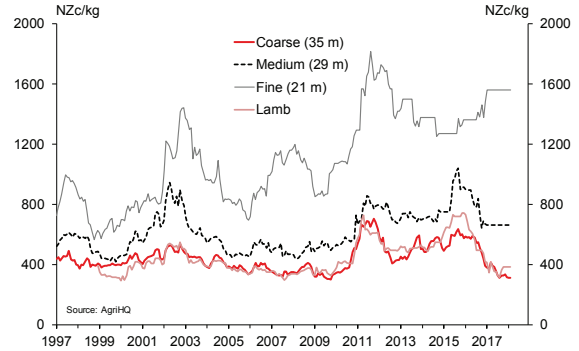


# Beyond the farm gate

## Wool

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

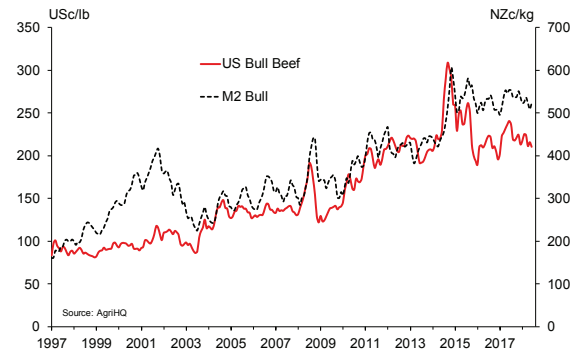
Fine wool remains the standout in wool markets. International demand for fine wool (including merino) has been firm in recent years, benefitting from solid growth in incomes in countries such as the US and Europe. This, in conjunction with tight global supplies, has helped push prices higher. Australia is the largest merino exporter, and there has been limited growth in supply there as farmers switch to crossbreeding sheep for meat and wool production. Tight supplies are likely to continue to underpin prices for fine wool products over the coming year.



## Beef

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

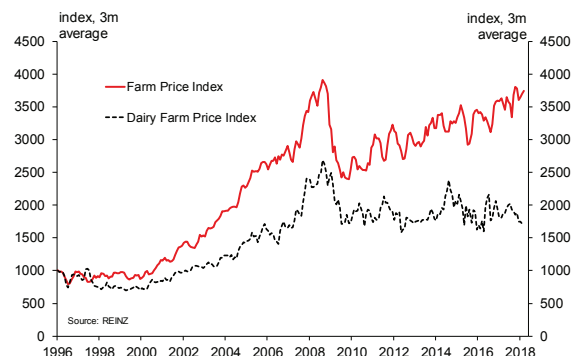
As expected, the outlook for beef prices is softening as US domestic supplies lift. In addition, there is some nervousness about the impact of retaliatory tariffs in the US beef sector. Canada has placed a 10% tariff on US beef exports which came into effect at the beginning of the month. Mexico has placed tariffs on US pork exports. Both moves could increase the domestic supply of protein for US consumers, potentially putting downward pressure on prices for imported product.



## Rural property prices

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

Dairy farm prices remained soft in May according to the REINZ's Dairy Farm Price Index. Prices rose 0.4% in the month, but were down 8.2% on a year earlier. In contrast, the overall farm price index ticked higher in the month, to be up 5.8% on a year ago. Sales volumes have been relatively soft over the last year. While dairy prices have remained at relatively favourable levels, sentiment in the dairy sector remains fragile. Dairy farm prices could come under further downward pressure as the impact of increased environmental regulations becomes clearer.



**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](mailto:economics@westpac.co.nz)

Past performance is not a reliable indicator of future performance. The forecasts given in this document are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The ultimate outcomes may differ substantially from these forecasts.

---

## Disclaimer

---

### Things you should know

Westpac Institutional Bank is a division of Westpac Banking Corporation ABN 33 007 457 141 ("Westpac").

### Disclaimer

This material contains general commentary, and market colour. The material does not constitute investment advice. Certain types of transactions, including those involving futures, options and high yield securities give rise to substantial risk and are not suitable for all investors. We recommend that you seek your own independent legal or financial advice before proceeding with any investment decision. This information has been prepared without taking account of your objectives, financial situation or needs. This material may contain material provided by third parties. While such material is published with the necessary permission none of Westpac or its related entities accepts any responsibility for the accuracy or completeness of any such material. Although we have made every effort to ensure the information is free from error, none of Westpac or its related entities warrants the accuracy, adequacy or completeness of the information, or otherwise endorses it in any way. Except where contrary to law, Westpac and its related entities intend by this notice to exclude liability for the information. The information is subject to change without notice and none of Westpac or its related entities is under any obligation to update the information or correct any inaccuracy which may become apparent at a later date. The information contained in this material does not constitute an offer, a solicitation of an offer, or an inducement to subscribe for, purchase or sell any financial instrument or to enter a legally binding contract. Past performance is not a reliable indicator of future performance. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The ultimate outcomes may differ substantially from these forecasts.

### Country disclosures

**Australia:** Westpac holds an Australian Financial Services Licence (No. 233714). This material is provided to you solely for your own use and in your capacity as a wholesale client of Westpac.

**New Zealand:** In New Zealand, Westpac Institutional Bank refers to the brand under which products and services are provided by either Westpac or Westpac New Zealand Limited ("WNZL"). Any

product or service made available by WNZL does not represent an offer from Westpac or any of its subsidiaries (other than WNZL). Neither Westpac nor its other subsidiaries guarantee or otherwise support the performance of WNZL in respect of any such product. The current disclosure statements for the New Zealand branch of Westpac and WNZL can be obtained at the internet address [www.westpac.co.nz](http://www.westpac.co.nz). For further information please refer to the Product Disclosure Statement (available from your Relationship Manager) for any product for which a Product Disclosure Statement is required, or applicable customer agreement. Download the Westpac NZ QFE Group Financial Advisers Act 2008 Disclosure Statement at [www.westpac.co.nz](http://www.westpac.co.nz).

**China, Hong Kong, Singapore and India:** This material has been prepared and issued for distribution in Singapore to institutional investors, accredited investors and expert investors (as defined in the applicable Singapore laws and regulations) only. Recipients in Singapore of this material should contact Westpac Singapore Branch in respect of any matters arising from, or in connection with, this material. Westpac Singapore Branch holds a wholesale banking licence and is subject to supervision by the Monetary Authority of Singapore. Westpac Hong Kong Branch holds a banking licence and is subject to supervision by the Hong Kong Monetary Authority. Westpac Hong Kong branch also holds a license issued by the Hong Kong Securities and Futures Commission (SFC) for Type 1 and Type 4 regulated activities. This material is intended only to "professional investors" as defined in the Securities and Futures Ordinance and any rules made under that Ordinance. Westpac Shanghai and Beijing Branches hold banking licenses and are subject to supervision by the China Banking Regulatory Commission (CBRC). Westpac Mumbai Branch holds a banking license from Reserve Bank of India (RBI) and subject to regulation and supervision by the RBI.

**UK:** The contents of this communication, which have been prepared by and are the sole responsibility of Westpac Banking Corporation London and Westpac Europe Limited. Westpac (a) has its principal place of business in the United Kingdom at Camomile Court, 23 Camomile Street, London EC3A 7LL, and is registered at Cardiff in the UK (as Branch No. BR00106), and (b) authorised and regulated by the Australian Prudential Regulation Authority in Australia. Westpac is authorised in the United Kingdom by the Prudential Regulation Authority. Westpac is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential



# Disclaimer continued

---

Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request. Westpac Europe Limited is a company registered in England (number 05660023) and is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.

This communication is being made only to and is directed at (a) persons who have professional experience in matters relating to investments who fall within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "Order") or (b) high net worth entities, and other persons to whom it may otherwise lawfully be communicated, falling within Article 49(2)(a) to (d) of the Order (all such persons together being referred to as "relevant persons"). Any person who is not a relevant person should not act or rely on this communication or any of its contents. The investments to which this communication relates are only available to and any invitation, offer or agreement to subscribe, purchase or otherwise acquire such investments will be engaged in only with, relevant persons. Any person who is not a relevant person should not act or rely upon this communication or any of its contents. In the same way, the information contained in this communication is intended for "eligible counterparties" and "professional clients" as defined by the rules of the Financial Conduct Authority and is not intended for "retail clients". With this in mind, Westpac expressly prohibits you from passing on the information in this communication to any third party. In particular this communication and, in each case, any copies thereof may not be taken, transmitted or distributed, directly or indirectly into any restricted jurisdiction. This communication is made in compliance with the Market Abuse Regulation (Regulation(EU) 596/2014).

## Investment Recommendations Disclosure

The material may contain investment recommendations, including information recommending an investment strategy. Reasonable steps have been taken to ensure that the material is presented in a clear, accurate and objective manner. Investment Recommendations for Financial Instruments covered by MAR are made in compliance with Article 20 MAR. Westpac does not apply MAR Investment Recommendation requirements to Spot Foreign Exchange which is out of scope for MAR.

Unless otherwise indicated, there are no planned updates to this Investment Recommendation at the time of publication. Westpac has no obligation to update, modify or amend this Investment Recommendation or to notify the recipients of this Investment Recommendation should any information, including opinion, forecast or estimate set out in this Investment Recommendation change or subsequently become inaccurate.

Westpac will from time to time dispose of and acquire financial instruments of companies covered in this Investment Recommendation as principal and act as a market maker or liquidity provider in such financial instruments.

Westpac does not have any proprietary positions in equity shares of issuers that are the subject of an investment recommendation.

Westpac may have provided investment banking services to the issuer in the course of the past 12 months.

Westpac does not permit any issuer to see or comment on any investment recommendation prior to its completion and distribution.

Individuals who produce investment recommendations are not permitted to undertake any transactions in any financial instruments or derivatives in relation to the issuers covered by the investment recommendations they produce.

Westpac has implemented policies and procedures, which are designed to ensure conflicts of interests are managed consistently and appropriately, and to treat clients fairly.

The following arrangements have been adopted for the avoidance and prevention of conflicts in interests associated with the provision of investment recommendations.

- (i) Chinese Wall/Cell arrangements;
- (ii) physical separation of various Business/Support Units;
- (iii) and well defined wall/cell crossing procedures;
- (iv) a "need to know" policy;
- (v) documented and well defined procedures for dealing with conflicts of interest;
- (vi) steps by Compliance to ensure that the Chinese Wall/Cell arrangements remain effective and that such arrangements are adequately monitored.

**U.S.:** Westpac operates in the United States of America as a federally licensed branch, regulated by the Office of the Comptroller of the Currency. Westpac is also registered with the US Commodity Futures Trading Commission ("CFTC") as a Swap Dealer, but is neither registered as, or affiliated with, a Futures Commission Merchant registered with the US CFTC. Westpac Capital Markets, LLC ("WCM"), a wholly-owned subsidiary of Westpac, is a broker-dealer registered under the U.S. Securities Exchange Act of 1934 ("the Exchange Act") and member of the Financial Industry Regulatory Authority ("FINRA"). This communication is provided for distribution to U.S. institutional investors in reliance on the exemption from registration provided by Rule 15a-6 under the Exchange Act and is not subject to all of the independence and disclosure standards applicable to debt research reports prepared for retail investors in the United States. WCM is the U.S. distributor of this communication and accepts responsibility for the contents of this communication. All disclaimers set out with respect to Westpac apply equally to WCM. If you would like to speak to someone regarding any security mentioned herein, please contact WCM on +1 212 389 1269. All disclaimers set out with respect to Westpac apply equally to WCM.

Investing in any non-U.S. securities or related financial instruments mentioned in this communication may present certain risks. The securities of non-U.S. issuers may not be registered with, or be subject to the regulations of, the SEC in the United States. Information on such non-U.S. securities or related financial instruments may be limited. Non-U.S. companies may not be subject to audit and reporting standards and regulatory requirements comparable to those in effect in the United States. The value of any investment or income from any securities or related derivative instruments denominated in a currency other than U.S. dollars is subject to exchange rate fluctuations that may have a positive or adverse effect on the value of or income from such securities or related derivative instruments.

The author of this communication is employed by Westpac and is not registered or qualified as a research analyst, representative, or associated person under the rules of FINRA, any other U.S. self-regulatory organisation, or the laws, rules or regulations of any State. Unless otherwise specifically stated, the views expressed herein are solely those of the author and may differ from the information, views or analysis expressed by Westpac and/or its affiliates.