

# Fortnightly Agri Update

5 September 2018

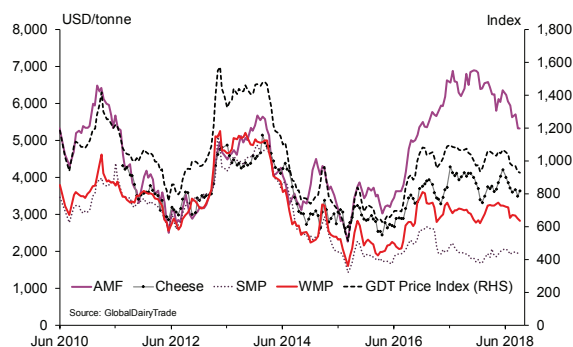


## Dairy download

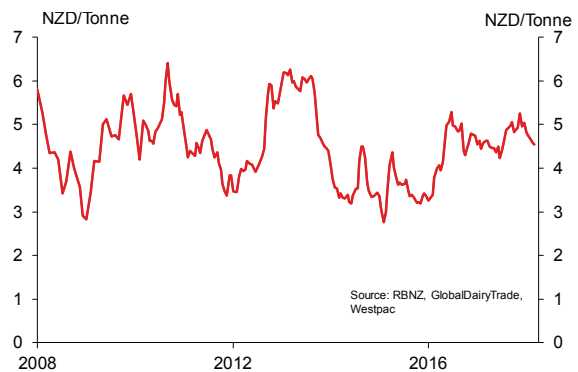
Dairy prices continued the theme of recent months, sliding further in last night's GlobalDairyTrade auction. The headline index was down a little, led by a 2.8% fall in butter prices and a 2.2% fall in whole milk powder prices. In contrast, there was a lift in cheese and skim milk powder prices.

The GDT price index now sits at its lowest level in almost 2 years. Whole milk powder prices, a key determinant of the farm gate milk price, have fallen 13% since the start of the current dairy season. The weaker NZ dollar has provided some offset, but even in NZ dollar terms dairy prices have fallen around 8%.

### Dairy prices



### Average GDT auction price, NZD/Tonne



For our part, an expectation of softer dairy prices over the second half of 2018 has been underpinning our \$6.50 milk price forecast for some time. In contrast, Fonterra started the season with a more optimistic view behind their \$7 milk price forecast. However, last week the falling dairy prices we've seen in recent months led to Fonterra downgrading their 2018/19 milk price forecast by 25 cents to \$6.75. We continue to view even this revised forecast as too optimistic. Even Fonterra appears wary of the prospect of further downgrades, advising farmers to budget with caution. Similarly the NZX milk price futures have also been falling and are now predicting a \$6.47 milk price for the 2018/19 season, down from \$6.90 at the start of the season.

Importantly, our own milk price forecast is based on WMP prices stabilising around current levels over the next few months before improving a little again in 2019. It allows for some further weakness in fats prices while the outlook

for SMP is a little more positive as European stockpiles are gradually run down, becoming less of a drag on SMP prices. That said, given the ongoing slide in WMP prices in recent weeks, we are wary of the downside risks to this outlook.

From an historical perspective prices remain at relatively robust levels. And at \$6.50 most farmers will be in positive cashflow territory. However, Fonterra's downgrade to its 2018/19 milk price, combined with its earlier decision to reduce the milk price and dividend paid to farmers for the 2017/18 season has been a hit to both revenues and sentiment in the sector.

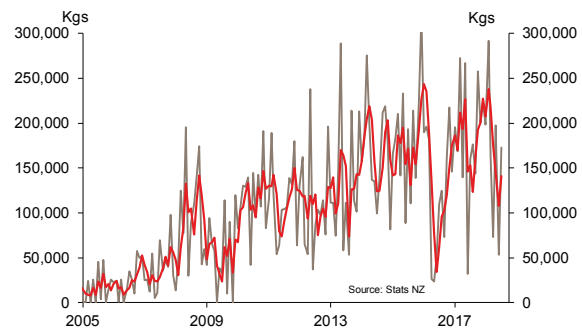
While commodity price fluctuations are part and parcel of the reality of being a dairy farmer, grumblings about Fonterra's corporate performance have been growing. No doubt there will be plenty of scrutiny from farmers when new Fonterra Chairman John Monaghan and recently appointed interim CEO Miles Hurrell front Fonterra's 2017/18 annual results presentation next week.

Locally, the arrival of spring means New Zealand milk production is beginning to ramp up. Around 12% of this season's milk production will probably occur in September, meaning that by the end of this month, almost 20% of this season's milk production will likely have been collected (New Zealand milk production typically peaks in October). Milk collections in June and July were running around 8% ahead of last season albeit on very light volumes. And anecdotally farmers in many regions are happy with current pasture conditions. That's in contrast to the soggy conditions many farmers were experiencing at the same time last year.

As always, much will depend on how the weather fares in the coming months. The latest NIWA forecasts suggest an El Niño event is increasingly likely as we progress through spring and into summer. An El Niño tends to see above average temperatures, less rainfall in the east, and more rain in the west. At this stage predictions are for a relatively mild event. But given the drought conditions that have been associated with El Niño conditions in the past, farmers will be keeping a watchful eye on how conditions progress.

One option that has been available to farmers in the past to help them cope with poor pasture growth is now less attractive. Fonterra farmers will now face financial penalties for changes to milk fat composition caused by feeding stock too much palm kernel extract (PKE). The new rules came into effect on September 1. This could lead to some farmers adapting their farming systems and/or reducing stocking rates as they look to reduce their use of PKE. In line with this, there have been signs of PKE imports trending lower in recent months.

## Volume of PKE Imports



Milk production also continues to grow in most key dairy exporters, albeit a little more slowly than was expected a few months ago. European milk supply is up 1.8% in the 6 months to June on the same period a year earlier with hot, dry conditions weighing on supply growth in some regions. US milk production is 1.1% higher. The US in particular recorded strong export growth over the first half of the year, helped by a weaker US dollar and increasing exports to South East Asia. Of the major dairy exporters, only in Australia is milk production shrinking. There, drought has hit farmers hard, with milk production 4.2% lower in July than a year earlier. Like in New Zealand, milk production volumes at this time of year are relatively low. However, poor pasture conditions combined with higher feed costs mean expectations for milk production for the forthcoming season are starting to be wound back.

## Anne Boniface

Senior Economist

## GlobalDairyTrade Auction Results, 5 September 2018

	Change since last auction	Price index USD/Tonne
Anhydrous Milk Fat (AMF)	0.2%	5,316
Butter	-2.8%	4,271
Butter Milk Power (BMP)	0.1%	2,474
Cheddar	4.2%	3,631
Lactose	-0.5%	917
Rennet Casein	3.7%	5,326
Skim Milk Powder (SMP)	2.2%	2,005
Whole Milk Powder (WMP)	-2.2%	2,821
GDT Price Index	-0.7%	928

## Farmgate milk price forecasts

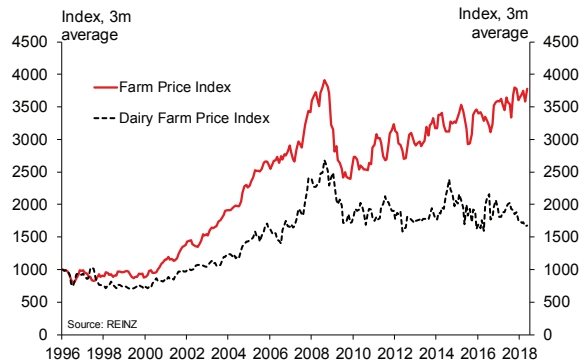
	2017/18		2018/19	
	Westpac	Fonterra	Westpac	Fonterra
Milk Price	\$6.70	\$6.70	\$6.50	\$6.75

# Beyond the farm gate

## Rural property prices

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

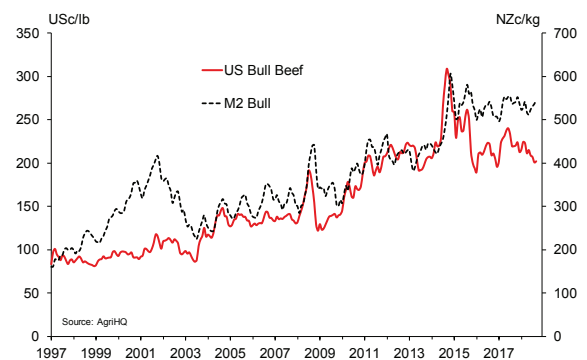
The divergence between dairy farm prices and other types of land prices has continued to widen in recent months. REINZ's dairy farm price index was almost 15% below its levels of a year ago in July while the broader farm price index is 4% higher. Dairy sales volumes have also been soft. In contrast arable land prices have been strengthening in recent months. This may reflect demand from dairy farmers for smaller support blocks as traditional off-farm grazing options are considered riskier given mycoplasma bovis concerns.



## Beef

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

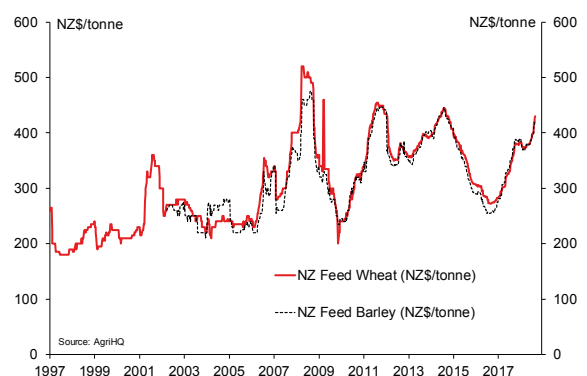
International beef prices have softened in recent months. The US is a key export market for New Zealand producers and US beef production has grown this year as the herd has increased and drought conditions in some key states has led pushed up slaughter rates. US beef producers are also concerned about the impact of US trade disputes. Of the top five US beef export markets (Japan, South Korea, Mexico, Canada and Hong Kong) only Hong Kong is unaffected by current trade negotiations. This is contributing to uncertainty amongst producers in the US, with fears access to these markets could be reduced. For New Zealand producers, this could mean a further lift in US domestic beef supply, reducing demand for NZ beef exports. However, there may be offsets in other markets.



## Grains

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

Grain prices have been improving in recent months. In part this is due to relatively tight supplies after challenging growing conditions for arable farmers in some regions. However, growers are also benefitting from Fonterra's new rules aimed at reducing the use of palm kernel. This is encouraging increased demand for domestically grown feed, contributing to upward pressure on prices.



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



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