

Fortnightly Agri Update

7 February 2018



A positive start to 2018

Export commodity prices have started 2018 on a firm footing thanks in part to the buoyant global trade backdrop. The weaker NZ dollar over the course of 2017 has also boosted farm gate returns. Recent dairy auction outturns have led us to revise up our payout forecast to \$6.50. Yet despite the solid start to the year, we remain wary of the impact slower Chinese growth may have on demand for NZ's commodity exports over the course of 2018.

Most of New Zealand's key commodity export prices have started 2018 in a buoyant mood. The horticulture sector is benefitting from strong global demand for specialist varieties of kiwifruit and apples, international beef prices have eased from their recent highs but remain at historically favourable levels on the back of robust consumer demand, and lamb prices are also firm as solid demand coincides with tight supplies in key exporting countries. Looking across the NZ commodity export spectrum, only wool prices stand out as bucking the trend, and remain weak.

In addition to firm international prices, the weaker NZ dollar over the course of 2017 has added the icing on the cake. On a trade-weighted basis, the NZ dollar fell around 4% over the course of 2017. This has provided some support to farm gate returns of all persuasions. However, since the start of 2018, this trend has reversed. The NZ dollar has pushed higher, mainly thanks to a weakening US dollar. We don't expect this to persist as the year progresses. Instead, we continue to expect that the NZ dollar resumes its downward trend this year, as the US Federal Reserve hikes interest rates, while the RBNZ remains firmly on hold.

GlobalDairyTrade Auction Results, 7 February 2018

	Change since last auction	Price index USD/Tonne
Anhydrous Milk Fat (AMF)	0.5%	6,581
Butter	7.9%	5,277
Butter Milk Power (BMP)	8.4%	2,039
Cheddar	7.2%	3,739
Lactose	n.a.	n.a.
Rennet Casein	5.0%	4,943
Skim Milk Powder (SMP)	7.2%	1,932
Whole Milk Powder (WMP)	7.6%	3,226
GDT Price Index	5.9%	1,061

Farmgate milk price forecasts

	2017/18		2018/19
	Westpac	Fonterra	Westpac
Milk Price	\$6.50	\$6.40	\$6.50

Locally, weather remains challenging for farmers up and down the country. Nationwide milk collections were down 3% on a year ago in December as the dry weather started to bite, and January collections are set to show a similar trend. Recent widespread rain has provided some relief to farmers, although official declarations of drought remain in place, with Rural Assistance Payments available to farmers in 6 regions (Taranaki, Manawatu-Wanganui, Wellington, West Coast, Southland, Otago). On balance, we expect milk collections this season to be broadly on par with 2016/17 season (although greater use of supplementary feed and

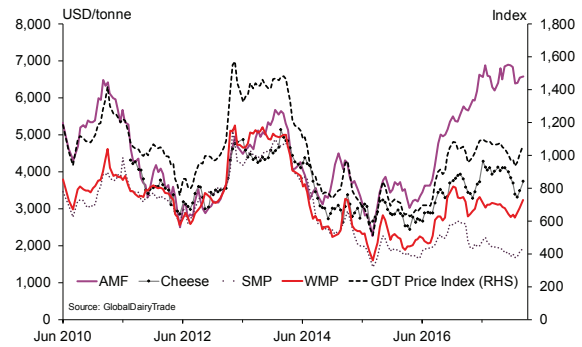
poor pasture in some areas may have a bigger impact on fat content).

Fears of tighter international supplies, particularly for whole milk powder, helped dairy prices squeeze higher in the first few GlobalDairyTrade auctions of 2018. Overall prices rose 5.9% in last night's auction, including a 7.6% gain for whole milk powder. Higher auction prices have led us to upgrade this season's milk price forecast to \$6.50/kg, slightly ahead of Fonterra's estimate.

We continue to caution however, against extrapolating recent trends too far into 2018. Our view remains that growth amongst New Zealand's key trading partners is likely to slow this year – led by China. Chinese policymakers are poised to follow through with moves to rebalance their economy, reduce the risks generated by rapid credit expansion, and put the economy on a more sustainable growth path. And while the consumer sector isn't the focus for Chinese policymakers, they are unlikely to escape a period of slower growth completely unscathed. With China such an important market for almost all New Zealand commodity exporters, this could see New Zealand's prices soften as 2018 progresses.

Anne Boniface
Senior Economist

Dairy product prices

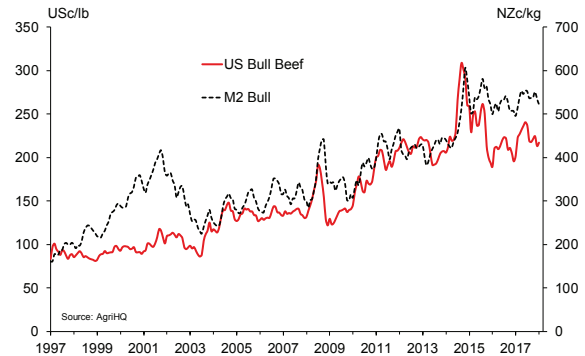


Beyond the farm gate

Beef

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

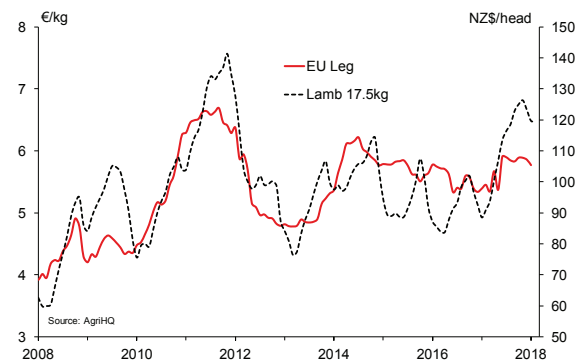
Beef prices have eased but remain at elevated levels. This has been perhaps surprising given very strong growth in US herds over the last year. For now US consumer demand has held up, however with predictions of further growth in US herds in 2018, prices could come under downward pressure in this market over the coming year. Production is also climbing in the likes of Brazil, Argentina and Australia, so we are wary of the potential for New Zealand farm gate prices to soften further from these levels.



Sheepmeat

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

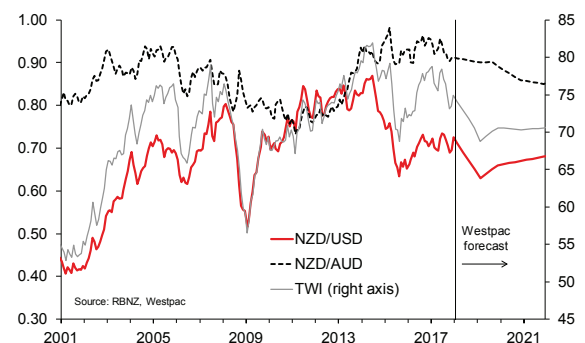
Global lamb supplies remain tight. Locally, lamb production looks set to remain around current levels over the next couple of years. In Australia (the other key global lamb and mutton exporter) farmers continue to rebuild flocks following drought. Demand from China has been particularly solid (especially for mutton and lower value cuts) however, we are conscious of the potential for this market to slow as the economy there cools in 2018.



NZ dollar

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

The NZ dollar has ground higher in early 2018 as the US dollar has weakened and some of the nervousness that we saw following last year's election has faded. We still expect the NZ dollar will depreciate over the coming year as the Fed hikes rates and the RBNZ remains on hold. However, with the NZ dollar starting from a higher than expected point, our revised target for NZD/USD by the end of 2018 is now USD 0.65 cents.



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

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