

Fortnightly Agri Update

8 August 2018



A woolly outlook

While prices for most of the agricultural products New Zealand produces have enjoyed a strong run over the last couple of years, strong wool prices have bucked the trend. In today's Agri Update, we take a closer look at recent goings on in wool markets.

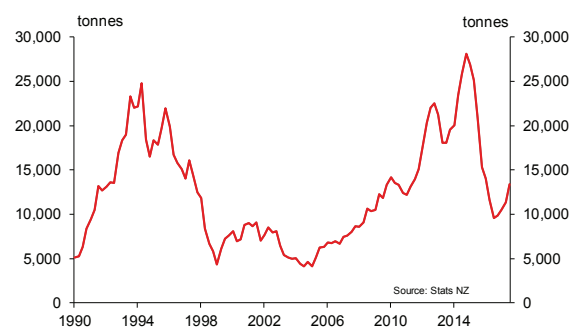
Surely there are few other countries where a town proclaims to be "sheep shearing capital of the world" (complete with 7 metre high statue and annual running of the sheep).

Yet while images of sheep grazing in paddocks might still be a core part of the typical image of rural NZ, the number of sheep farmed in New Zealand has been declining for more than 3 decades. From a peak of over 70 million in 1982 there are now around 27.5 million sheep roaming New Zealand paddocks (that's around 6 sheep for each New Zealander). Unsurprisingly, the amount of land dedicated to sheep grazing has also shrunk. Between 2002 and 2016, the sheep and beef farming area shrunk by almost 20%, from 10.7million ha to 8.5 million.

The decline in sheep numbers has gone hand in hand with falling wool export volumes. And at the same time, weak wool prices have seen wool revenues make up a shrinking proportion of sheep farmers' total revenues. In 1960, around 70% of the value of sheep meat and wool exports was coming from wool, by 2017 that had shrunk to around 15%. This increasing reliance on meat as a source of revenue for farmers has encouraged the breeding of stock for meat rather than wool.

Before discussing the demand and supply drivers for wool, it's important to note that not all wool is created equal. The bulk of the New Zealand clip is coarse crossbred wool. In contrast, wool exports from the other big global wool exporter, Australia, are dominated by fine merino wool. Uses for the two wools can be quite different. While coarse wool tends to be used in products such as carpet, upholstery or felt, merino wool is a niche product that is used for high end fashion garments such as suits (or recently even shoes).

NZ wool exports to China (annual total, tonnes)



Most recently the prices for coarse and fine wool have diverged. While coarse wool prices have been languishing near lows, prices for finer merino wool have been performed much better.

Demand from China has played a critical role in the slide in coarse wool prices. Traditionally a key market for NZ wool exporters, the value of wool exports to China slumped

almost 30% in the year to June. That said, there have been some signs of improvement of late with wool exports to China improving over the last six months and average export prices also improving a little.

Some of the other factors weighing on coarse wool prices have also unwound a touch. The NZ dollar has fallen and is expected to fall further in the coming year. There are anecdotal reports of local stock piles starting to unwind. And oil prices have risen from around \$30/a barrel in 2016 to above \$70/barrel now, increasing the production costs of synthetic alternatives. Cotton prices have also risen significantly over the course of 2018 (despite concerns about the impact of trade tensions between the US and China). Global growth remains firm, however the mix is changing. Growth in China is slowing, while the US economy continues to strengthen.

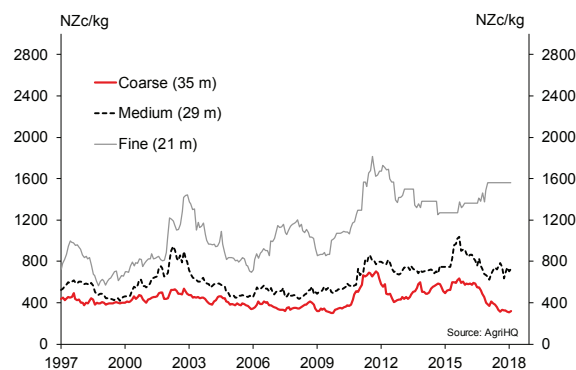
Looking ahead, some of these factors are expected to reverse. Most notably, oil prices are forecast to fall in 2019 as higher prices encourage a lift in fracking production and growth in China is forecast to slow. This could limit the extent of any improvement in price. Rising labour costs (and a recent focus by the industry on improving compliance with labour laws) could also mean shearing costs come under some upward pressure.

Locally, the search is on to find alternative uses for cross breed wool. Most recently a wool industry summit organised by Government was focused on finding “innovative solutions” for some of the challenges the sector is facing. In other developments, a new wool trading platform was launched in May with fortnightly auctions aiming to streamline the buying process and reach a wider range of buyers. Around six thousand bales have been sold on this platform to date.

On the face of it wool is an attractive proposition. A natural, biodegradable and sustainable fibre, it has good insulation properties and is fire resistant. What’s more it’s ‘free range’. Such characteristics seem to have worked in merino’s favour, allowing a premium to be charged for the fabric compared to the alternatives. While consumer preferences can be fickle, coarse wool marketers need to find a way to convince consumers that their offering is also worth paying a premium for.

Anne Boniface
Senior Economist

Wool Prices



Global Dairy Trade Auction Results, 8 August 2018

	Change since last auction	Price index USD/Tonne
Anhydrous Milk Fat (AMF)	1.2%	5,709
Butter	-3.2%	4,802
Butter Milk Power (BMP)	-5.9%	2,441
Cheddar	1.3%	3,663
Lactose	-	n.a.
Rennet Casein	8.0%	4,971
Skim Milk Powder (SMP)	-0.3%	1,972
Whole Milk Powder (WMP)	0.1%	2,958
GDT Price Index	0%	970

Farmgate milk price forecasts

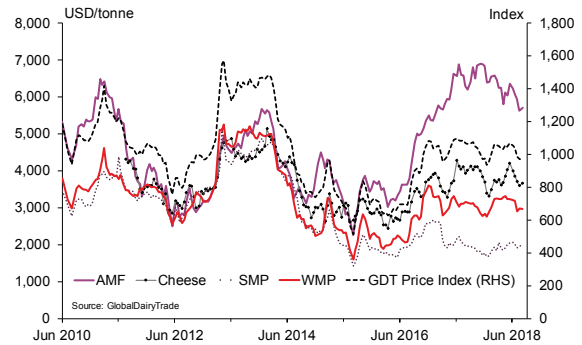
	2017/18		2018/19	
	Westpac	Fonterra	Westpac	Fonterra
Milk Price	\$6.75	\$6.75	\$6.40	\$7.00

Beyond the farm gate

Dairy

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

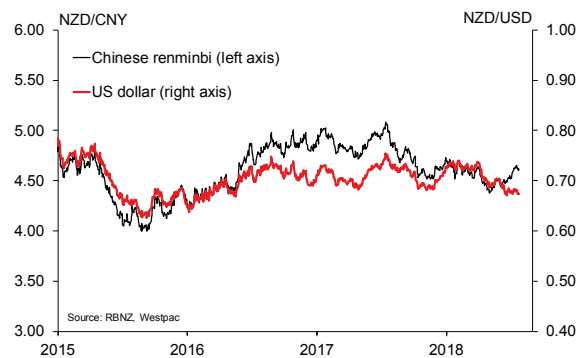
Dairy prices were stable in last night's GlobalDairyTrade auction. The headline index was unchanged, while there were mixed results for the individual products on offer. On the face of it, this was a relatively firm result given the seasonal lift in volumes now coming through the GlobalDairyTrade platform. In our milk price modelling, we had been allowing for a little further softening in prices to come through in August, so on its own last night's auction suggests a touch of upside risk to our \$6.40 milk price forecast.



NZD/Yuan

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

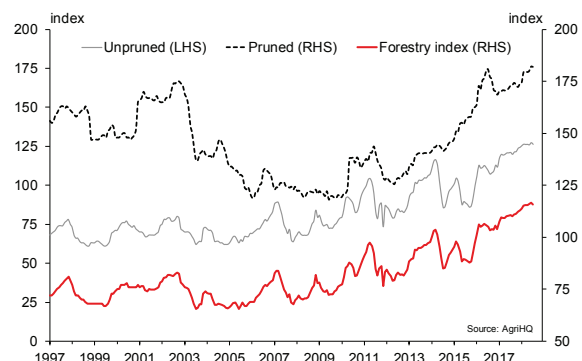
The NZD has depreciated notably against most of our key trading partners in recent months, implying NZ exports are less expensive in local currency terms. However, an important exception has been the Yuan. The NZD/CNY has actually strengthened by 5% since mid-May, which could weigh on demand for NZ commodity exports to China. The weaker Yuan has largely been attributed as China's response to growing trade tensions and the imposition of tariffs against Chinese exports in the US. However, this trend is unlikely to go too much further. A very weak yuan relative to the US dollar in particular could be a trigger for increased outflows of capital from China, which could bring with it heightened risks to the financial system.



Forestry

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

We have been surprised by the ongoing strength in log prices to date given the recent slowing of growth in China. However, in recent weeks anecdotes of a softening in Chinese demand are starting to appear. Locally there have been reports of stocks building at mills. Given these developments, and our ongoing view that Chinese growth will prove disappointing for many in the coming months, we continue to expect some softening in prices ahead.



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

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