Fortnightly Agri Update

16 January 2019

A positive start to the New Year

Dairy prices jumped 4.2% in last night's GlobalDairyTrade auction. Add this to the rise in the early-January auction and dairy prices have now risen 7% over the last month and are up 11% from their November lows. This has led us to upgrade our milk price forecast for the current season to $6.30.

Last night's increase was led by a 10.3% jump in skim milk powder (SMP) prices, while whole milk powder (WMP) prices were also up a solid 3%. The recent lift in SMP prices is particularly notable given the 14.5% increase in the volume of SMP sold in the most recent auction (in contrast to usual seasonal trends which tend to see the volume of SMP sold gradually falling at this time of year). And while the lift in SMP prices in the early January auction was driven by a sharp increase in prices paid for earlier deliveries, last night's increase was broad-based right across the various contracts on offer.

The rise in WMP prices has also come at a time where the outlook for milk production growth in New Zealand remains favourable. While nationwide milk production was up by 2.3% in November 2018 compared to the same month a year earlier, this was well down from the 6.5% growth recorded in October on the same basis. Although this slowdown may appear sharp, these comparisons were always going to get less favourable as we moved through the season. That's because milk production through August, September and October in 2017 was pretty soft on the back of widespread heavy rain which slowed pasture growth and depressed milk production. In contrast, milk collections through September and October 2018 were very strong.

GlobalDairyTrade Auction Results, 16 January 2019

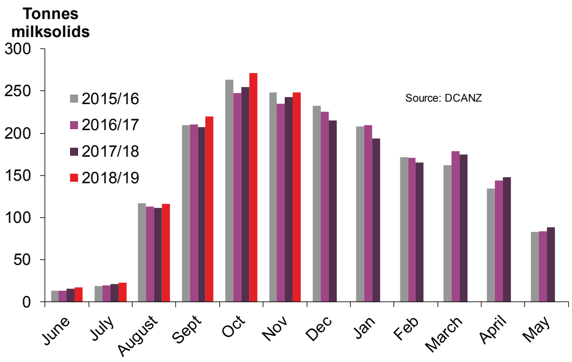
	Change since last auction	Price index USD/Tonne
Anhydrous Milk Fat (AMF)	3.2%	$5,294
Butter	4.6%	$4,262
Butter Milk Power (BMP)	-	-
Cheddar	4.2%	$3,504
Lactose	7.9%	$1,032
Rennet Casein	-1.4%	$5,047
Skim Milk Powder (SMP)	10.3%	$2,405
Whole Milk Powder (WMP)	3.0%	$2,777
GDT Price Index	4.2%	942

Farmgate milk price forecasts

	2018/19		2019/20
	Westpac	Fonterra	Westpac
Milk Price	$6.30	$6-$6.30	$6.75

Currently, while there are a few dry spots around the country, for the most part soil moisture deficit levels are near average for this time of the year. NZX's pasture growth index also remains well above average levels. We expect milk production growth to be around 3.5% over the full season. That said, as always much will depend on pasture conditions over the remainder of the summer.

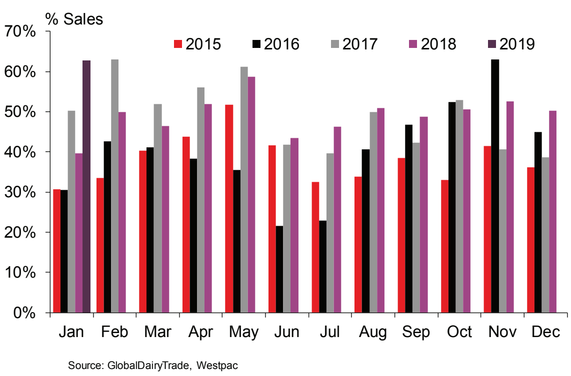
NZ Milk production



There was also evidence in the January auctions of a lift in demand from China with buyers from North Asia (dominated by China) gobbling up more than 60% of product on offer in the month. That's well above average levels for that time of year. This is a trend we will be watching closely as Chinese demand remains key for New Zealand dairy exporters.

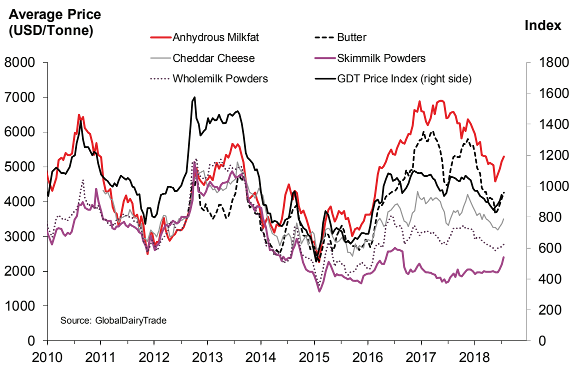
The apparent lift in Chinese demand may be in part due to poor domestic milk production growth in China with reports of hot dry weather hampering domestic milk production. However, it's worth noting the apparent lift in demand from China also comes at a time when other data points to growth in China slowing sharply. Most recently weaker data have included the first annual fall in vehicle sales in China since 1990, Apple's warning of weaker revenue forecasts on the back of weak Chinese sales and a sharp drop in China's exports in January. More broadly, we're forecasting growth in China to slow from an estimated 6.4% in 2018 to 6.1% in 2019. At face value the strong lift in the proportion of GlobalDairyTrade sales headed to the North Asian region (dominated by China) in January seems at odds with this.

Proportion of GDT sales to North Asia



While we have long been anticipating the decline in dairy prices over the second half of 2018 to reverse as we headed into the New Year and growth in milk production slowed (particularly in Europe and the US), both the speed and extent of the improvement over the past month has exceeded our expectations. Consequently we've upgraded our milk price forecast for the current season to $6.30. This conservatively assumes auction prices linger near current levels over the next few months. Given the recent upward momentum in dairy prices there's clearly the potential for prices to continue to improve further from here if the recent lift in demand is maintained. However, we remain cautious about the potential for the pace of growth in Chinese demand for dairy products to slow as growth in China more broadly cools, and the potential for New Zealand milk production to continue to grow strongly. The New Zealand dollar has also been stronger than expected in recent months. Our forecast of $6.30 is the upper end of Fonterra's current $6-6.30 forecast range for this season.

Dairy prices



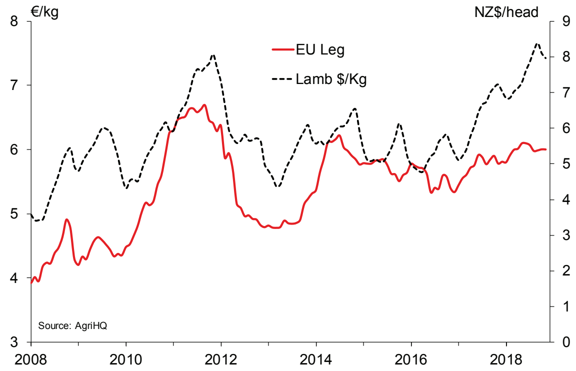
Anne Boniface
Senior Economist

Beyond the farm gate

Lamb

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

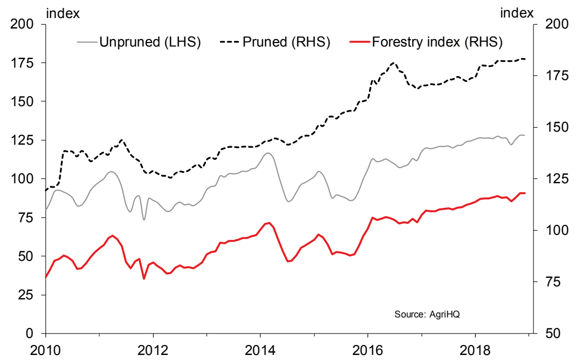
Uncertainty about the impact of Brexit on New Zealand exporters has only increased in recent weeks. British Prime Minister Theresa May has failed so far to get political agreement for her proposed exit plan. This has left the outlook for the UK mired in uncertainty with a range of outcomes still possible. Despite this, tight lamb supplies in both NZ and Australia as well as reasonable demand from other export markets should help underpin lamb prices at favourable levels this year.



Forestry

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

Log prices were stronger than we expected over 2018. While there was some volatility in the second half of the year on the back of tensions between the US and China, the AgriHQ unpruned log price index finished the year at a record high. Strong Chinese demand has been key to supporting log prices but we remain sceptical that prices will be maintained at record levels in 2019 as the Chinese economy slows. Locally, we expect construction activity to grow at a slower pace this year which could impact local lumber sales.



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

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