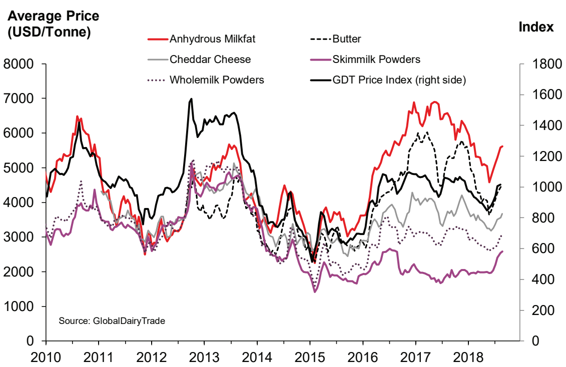
Fortnightly Agri Update

20 February 2019

When the price isn't right

Dairy prices edged a little higher in last night's GlobalDairyTrade auction, rising 0.9%. This was less than what was being signalled by futures markets but still means prices continued their upward trend of recent months. With concern about the impact of dry weather on NZ milk production supporting prices in recent weeks, news that NZ milk production was up 7.7% in January on the same month a year before (and 5.6% growth season to date) and forecasts of rain in some regions may have seen the lift in prices fall short of expectations.

Dairy prices



While dairy farmers will be hoping for some rain in the coming weeks, many farmers will be well prepared for a period of dry weather with plenty of feed on hand and stock in good condition after excellent pasture growth in the earlier part of the season.

GlobalDairyTrade Auction Results, 20 February 2019

	Change since last auction	Price index USD/Tonne
Anhydrous Milk Fat (AMF)	0.7%	$5,620
Butter	1.2%	$4,495
Butter Milk Power (BMP)	-	-
Cheddar	2.9%	$3,667
Lactose	-2.9%	$998
Rennet Casein	2.7%	$5,740
Skim Milk Powder (SMP)	2.8%	$2,580
Whole Milk Powder (WMP)	0.3%	$3,022
GDT Price Index	0.9%	1,014

Farmgate milk price forecasts

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

If dairy prices are maintained at current levels in the coming weeks, we think there's still a little bit of upside risk to our milk price forecast of $6.30 this season.

Despite reasonable prices and, until recently, excellent conditions on farm, sentiment in the rural sector remains downbeat. A recent Federated Farmers survey showed that when looking ahead to general economic conditions over the next year, confidence was at its lowest level in 9 years. Taken at face value, that's a more pessimistic outlook for the rural sector than when the milk price was below $4.

This begs the question, if it's not prices, just what is weighing so heavily on sentiment in the rural sector?

A growing concern for farmers in recent years has been uncertainty about the impact of ongoing environmental and regulatory reforms. Indeed, regulation and compliance costs have been among the top three concerns for farmers in the last three Federated Farmers Surveys (which are held twice a year). While this is not new news for the sector, ongoing uncertainty about the final form regulations will take and therefore uncertainty about the direct impact on individual operations is set to continue for some time yet.

Biosecurity incursions are also amongst the top concerns for farmers. While the news on Mycoplasma bovis has improved of late, with the Technical Advisory Group advising MPI now more confident than in mid-2018 that eradication is achievable, new biosecurity incursions are never far away. And these concerns are not just restricted to pastoral farmers. News of two separate fruit fly discoveries in Auckland in the last couple of weeks are a reminder of the importance of the advantages New Zealand's relative isolation provides. Yet with connections to the rest of the world continuing to grow, and millions of visitors arriving in New Zealand every year, small mistakes can have big consequences for New Zealand's agri-sector.

What's more, at least part of the costs of biosecurity incursions are borne by farmers and growers. For example, beekeepers are currently divided on a proposed levy of 10 cents on each kilo of honey produced, with the levy potentially used to fund, among other things, biosecurity measures. Elsewhere DairyNZ has announced a proposed a maximum levy of 3.9 cents per kilogram of milk solids on dairy farmers to pay its share of the costs, estimated to be $272 million for the 10-year eradication programme. While this will be reviewed annually, it could still mean an annual cost of around $6,100 for an average 430 cow farm.

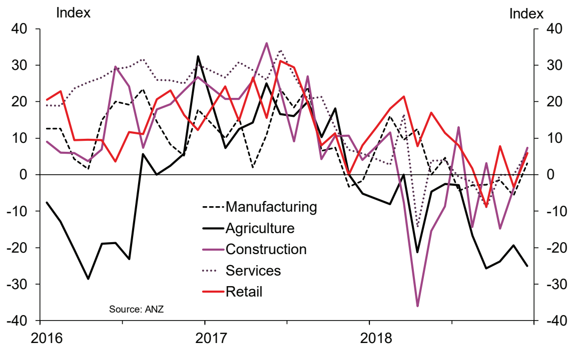
Another concern for farmers is increasing difficulty finding labour. This concern probably has both a structural and cyclical element. From a cyclical perspective farmers and growers are in the same boat as other business owners. The unemployment rate has been trending down since 2012 and at 4.3% is relatively low by historical standards. Consistent with this it has become more difficult to get workers in recent years. This has seen some industries lobby for short term solutions such as the declaration of seasonal labour shortages (which were officially declared in the Hawke's Bay last week allowing people on visitor visas to apply for variation of conditions permitting them to work on orchards and vineyards in the region).

But talk to those in the rural sector and many argue there is an important structural component to the current challenges finding quality skilled labour. They point the finger at a lack of education and training pathways and underselling the attractiveness to students of a career in agriculture. In this regard, it will be interesting to see how the Government's recently announced reform of the vocational education sector, which proposes combining existing government owned institutes of technology and polytechnics as one entity, will address these concerns. Inevitably, advances in technology, including automation, will also help change the nature of skills required by the agricultural sector over the longer horizon.

As exporters, New Zealand's rural sector is also heavily exposed to fluctuations in global growth. On this front news has become more negative of late as the synchronised upturn in the global economy has given way to more uneven terrain. But despite a modest slowdown in global growth expected this year, we think financial markets have overplayed the downside risks. Global growth will keep ticking over, albeit at a slower pace. The US economy remains fundamentally strong, and China's growth slowdown was foreseeable and has been a managed process. In addition, our central expectation is that worst case scenarios for Brexit and US-China relations will ultimately be avoided.

For the rural sector and regional New Zealand, the risk with weak confidence is that even if rural incomes hold up at reasonable levels, as we expect, farmers don't open their wallets as widely for on-farm spending and investment as they may have done in the past. Certainly investment intentions in the agricultural sector are lagging those in other parts of the economy. This could weigh on spending and land values.

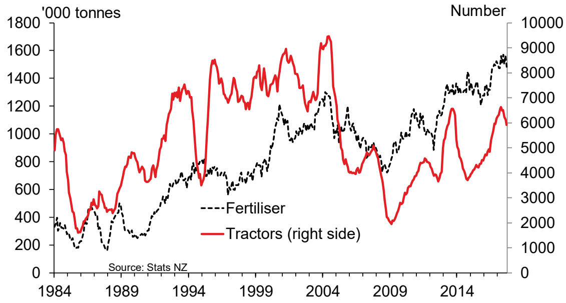
Investment intentions



That said, some of the things currently keeping farmers awake at night are doing so because of the cost they incur. For example, meeting tougher environmental regulations could requirement investment on-farm e.g. fencing waterways while securing labour in a relatively tight labour market may require higher wages. That's a negative if you're paying the bills, but a positive if you're supplying services or labour.

What's more, despite persistently weak confidence, there's been few signs of farmers actively closing their wallets to date, with indicators such as tractor and fertiliser imports continuing to show reasonable growth (although there has been a sharp drop in imports of milking machinery). On balance we think strength in farm incomes should continue to support regional economies over the year ahead, albeit with farmers continuing to pay down debt, and unlikely to go on a spending spree any time soon.

Imports of tractors and fertiliser (annual total)



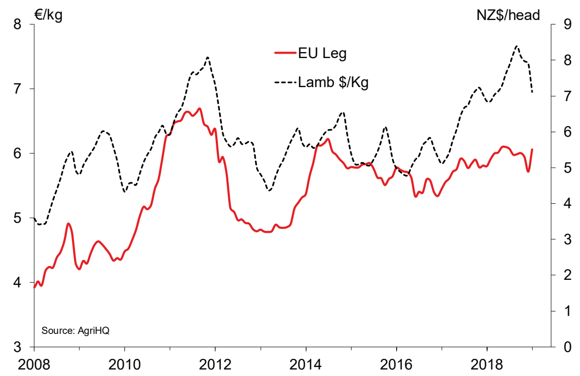
Anne Boniface
Senior Economist

Beyond the farm gate

Lamb

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

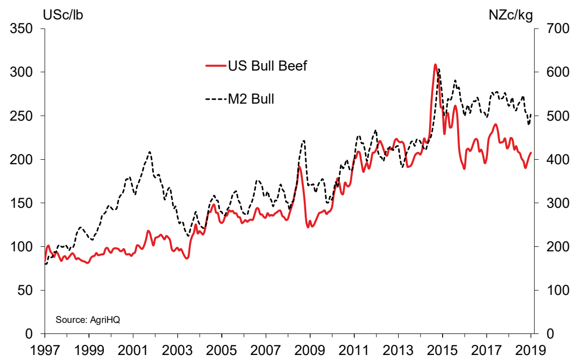
A feature of New Zealand lamb exports over 2018 was very strong growth in exports to China and this will be a key area to watch in 2019 as growth in China cools. Brexit uncertainties continue to weigh heavily on the outlook for lamb exports to the UK. There is still no clarity around what will path the UK will take following the current March 29 Brexit deadline.



Beef

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

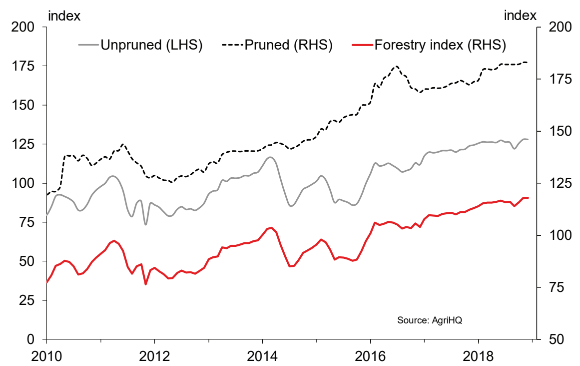
The volume of NZ beef exports to China grew by 36% in 2018. While that sounds impressive, it pales in comparison to other major exporters including Australia, which shipped 48% more beef to China in 2018 as it destocked on the back of widespread drought. Most recently efforts to stop the spread of African Swine Flu in China have led to widespread culling of pigs, reducing the amount of pork available to consumers. This has supported demand for imported protein (including chicken, pork and beef). This will be an important development to monitor in 2019.



Forestry

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

Strong log prices were a feature of 2018 with prices remaining well supported in January. Looking ahead we expect some moderation as Chinese demand slows. However, for now, some international supply disruptions are continuing to support prices for NZ logs.



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

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. 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.

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 license 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 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.