

Fortnightly Agri Update

3 April 2019



Dairy diary

This week we bid farewell to our Fortnightly Agri Update. Going forward it will be replaced by two new publications. A new “Dairy Update” will be published following fortnightly GlobalDairyTrade auctions, while “Over the fence” will be a monthly research note covering a broad range of developments in the agriculture sector. It will be published in the first week of the month. If you’re receiving this publication directly in your inbox, you’ll automatically receive both new publications.

The headline GlobalDairyTrade index edged 0.8% higher in last night’s auction. The increase was led by strong increases in fats prices, with butter prices up 5.8% and AMF rising 3.7%. While prices for AMF have been volatile lately, prices for both remain elevated compared to long run averages.

In contrast, whole milk powder (WMP) prices had a much softer tone, falling for the first time since November. We had been wary of at least some retrace in WMP prices as local weather conditions normalised and concerns about the negative impact of recent dry weather on milk production eased. With DCANZ data showing New Zealand milk production in February was broadly flat on a year earlier (much weaker growth than we saw through the first half of the season, but perhaps not as low as some were anticipating), and decent rainfall in parts of the north island in recent weeks, those supply concerns may have ameliorated somewhat. While milk collections for the remainder of the season are likely to be well down on the same time last year, we still expect nationwide milk production to end up around 2% higher. That’s stronger growth than the 0.3% lift Fonterra is currently forecasting for its own collections.

GlobalDairyTrade Auction Results, 3 April 2019

| | Change since last auction | Price index USD/Tonne |
|--------------------------|---------------------------|-----------------------|
| Anhydrous Milk Fat (AMF) | 3.7% | \$5,867 |
| Butter | 5.8% | \$5,374 |
| Butter Milk Power (BMP) | - | \$3,548 |
| Cheddar | 3.2% | \$4,248 |
| Lactose | -5.2% | \$948 |
| Rennet Casein | 7.5% | \$6,703 |
| Skim Milk Powder (SMP) | 1.8% | \$2,468 |
| Whole Milk Powder (WMP) | -1.3% | \$3,287 |
| GDT Price Index | 0.8% | 1,076 |

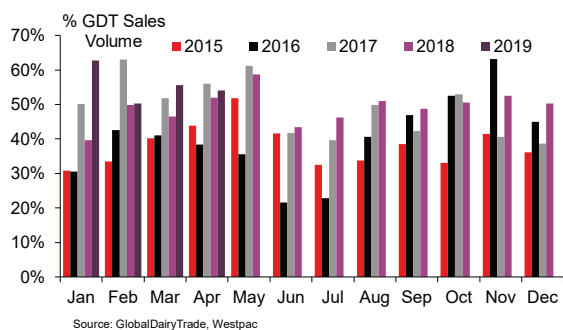
Farmgate milk price forecasts

| | 2018/19 | | 2019/20 |
|------------|---------|---------------|---------|
| | Westpac | Fonterra | Westpac |
| Milk Price | \$6.40 | \$6.30-\$6.60 | \$7.00 |

While last night's pull back in WMP prices was broadly in line with our expectations, the higher fat prices of late mean we see upside risks to our \$6.40 milk price this season.

However, supply concerns aren't the only factor supporting the lift in dairy prices in recent months. The strength of Chinese demand has also been notable. Chinese dairy imports were up 14% over January and February combined. In last night's auction, buyers from the north Asian region (dominated by China) snapped up over 50% of product on offer, a touch ahead of the same time a year ago. This demand for dairy stands in stark contrast to concerns about the downside risk to growth in China. Our own view is that while GDP growth in China is set to slow noticeably this year, this slowdown won't be centred in the household sector. This should be a silver lining for New Zealand agricultural exporters who are heavily reliant on Chinese consumers.

GDT sales to north Asia



In other parts of the globe, the outlook for milk production is mixed. Australian milk production was down 11% in January 2019 compared to a year earlier, with national production 5.8% lower for the season to date. Australian farmers have struggled with a combination of high costs, shrinking herds and reduced supplementary feeding. That said, export volumes haven't been as weak with total Australian dairy export volumes down 0.7% for the season

to date (led by a 40% fall in WMP export volumes). While production this season will clearly be well down, looking ahead to the 2019/20 season, improving prices and weather conditions means Australian milk production is unlikely to continue to contract at the same pace that we've seen this year.

In the US, exports have also held up better than milk production, at least until recently. US milk production was up an estimated 0.6% in February on a year earlier. Like in New Zealand, the national dairy herd has been shrinking, with the growth in milk collections driven by productivity improvements. The US is also exporting a greater proportion of its production. In 2018, almost 16% of US dairy production was exported up from almost 15% in 2017. That said, the impact of trade war between US and China has become apparent in recent months, with US exports to China falling sharply in December and January.

European milk collections were down 1.5% in January, however this degree of weakness is not expected to persist, with most forecasters expecting EU milk production to be up a little over 1% this year (following 0.9% growth last year). European dairy exports were mixed in 2018, with growth in skim milk powder, cheese and whey export volumes offset by weaker WMP and butter exports.

On balance, while milk production in key dairy exporting regions is likely to slow modestly in 2019, the impact of this on global markets may be at least partially offset by weaker domestic demand and growing export volumes. In addition, if the recent lift in dairy prices is maintained, this is likely see improved margins and could support a lift in milk production. And with dairy markets starting from a broadly balanced position, we're not expecting prices to improve significantly from current levels over the year ahead. Indeed, a slight softening in dairy prices from current levels underpins our \$7 milk price forecast for next season.

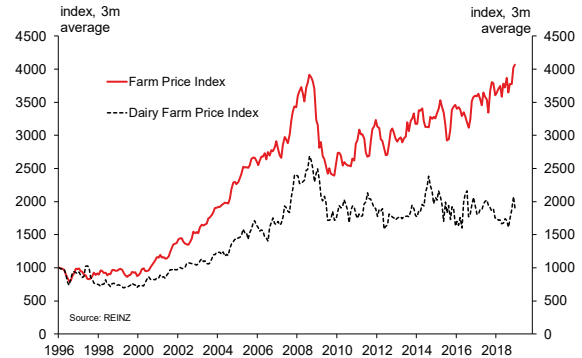
Anne Boniface
Senior Economist

Beyond the farm gate

Rural Property Prices

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

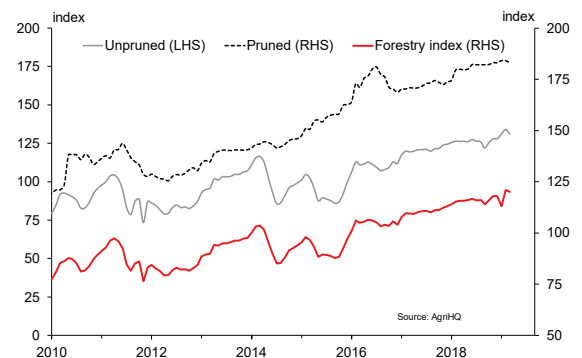
The REINZ all farm price index (which attempts to adjust for differences in the characteristics of farms being sold) was up 13% on the same period a year earlier, boosted by a lift in dairy farm prices. However, while dairy farm prices appear to have stabilised lately, sales volumes remain very weak. There were 55 dairy farms sold in 3 months to February, down almost 40% from the same period a year earlier and 30% below the 5 year average number of farm sales for this time of the year. Ongoing concern about the cost of increased environmental regulation remains a key issue for both buyers and sellers.



Forestry

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

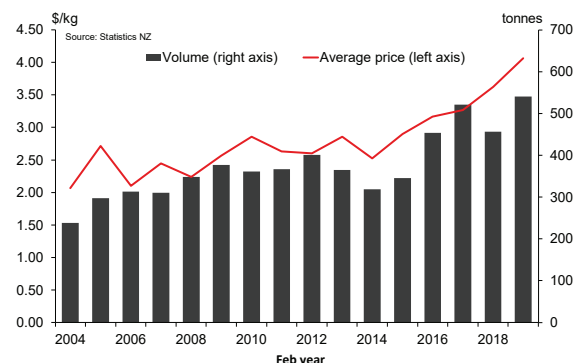
As we outlined in our last Fortnightly Agri Update, log prices were stronger than we had expected over much of 2018, but we continue to expect softer prices over the year ahead. The small fall in log prices in March is consistent with this view. However anecdotes continue to report firm demand in China, meaning that prices may not fall much further in the near term.



Kiwifruit

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

With the kiwifruit harvest now underway across the country, Zespri has announced that it expects to export more gold kiwifruit than green for the first time this season. Gold export volumes are predicted to climb 15% while the volume of traditional green kiwifruit is expected to shrink slightly. The higher volumes on offer are expected to put some downward pressure on the price of gold kiwifruit, however they will still be sold at a substantial premium to their green counterparts.



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

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