

Fortnightly Agri Update

7 February 2019

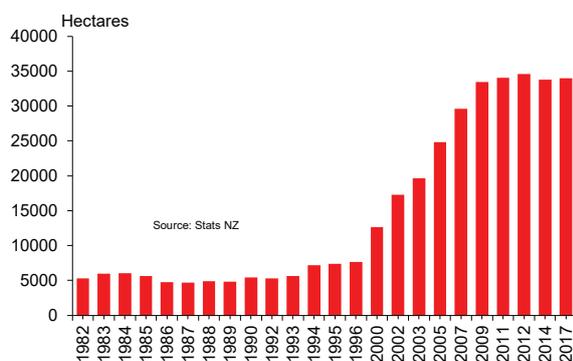


Full bodied but with hints of gooseberry

The Westpac Economics team recently published an in depth Industry Insight on New Zealand's winemaking industry.¹ In this week's Fortnightly Agri Update we briefly highlight some of the report's key findings. We predict that smaller wineries solely focussed on the domestic market will struggle, but larger wine producers that have cracked export markets have a huge opportunity in front of them.

The New Zealand wine making industry is a relatively small sector, with turnover of around \$2.5bn. It is comprised of activities such as viticulture, harvesting, processing, aging and bottling and the distribution of wine.

NZ grape growing area



GlobalDairyTrade Auction Results, 7 February 2019

	Change since last auction	Price index USD/Tonne
Anhydrous Milk Fat (AMF)	5.8%	\$5,579
Butter	4.2%	\$4,445
Butter Milk Power (BMP)	-	\$3,158
Cheddar	1.4%	\$3,565
Lactose	1.3%	\$1,035
Rennet Casein	10.9%	\$5,596
Skim Milk Powder (SMP)	3.9%	\$2,534
Whole Milk Powder (WMP)	8.4%	\$3,027
GDT Price Index	6.7%	1,005

Farmgate milk price forecasts

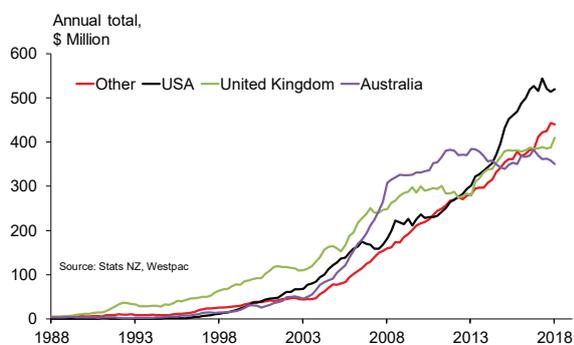
	2018/19		2019/20
	Westpac	Fonterra	Westpac
Milk Price	\$6.30	\$6-\$6.30	\$6.75

¹ <https://www.westpac.co.nz/assets/Business/Economic-Updates/2019/Bulletins-2019/Industry-Insights-Winemaking-Industry-Jan-22-2019-WEB.pdf>

The industry has grown substantially in recent decades. The volume of grapes produced in New Zealand grew by a whopping 423% between 2000 and 2018 as the area of land devoted to grape growing ballooned from 12,700 to almost 34,000 hectares. The industry is heavily concentrated in Marlborough which specialises in Sauvignon Blanc production. The region produces around three quarters of New Zealand's wine production (by value).

Like other New Zealand primary products, exports form the backbone of the wine industry. Wine exports have almost doubled in the last decade, and are valued at around \$1.7bn annually. While that pales in comparison to our \$16.6 billion of dairy exports, it still makes wine our 6th largest commodity export. New Zealand wine has grown in popularity as our "new world" lighter bodied wines have gained favour with consumers in the UK, Australia and the US. Exports to the US have grown particularly strongly in recent years. Importantly, it is this export market that is likely to underpin the fortunes of the industry going forward.

NZ wine exports



That said, the sector faces many of the same challenges other New Zealand producers face. As a relatively small player in a large market (New Zealand accounts for a little over 1% of global wine production) New Zealand grape growers and wine makers need to be able to differentiate their product on a crowded international stage. This is a challenge made even more difficult by New Zealand wines tending to be a little more expensive than some competitors.

One opportunity for doing this has been exposing tourists to New Zealand wine when they visit New Zealand. Just over 710,000 visitors to New Zealand in 2017 visited wineries, cellar doors (tasting rooms usually linked to the wineries), and/or stayed at vineyard accommodation. While that's still a relatively small proportion of approximately 3.7 million total visitors, numbers have grown substantially in recent years. Over 210 wineries in New Zealand now offer a wine tasting experience with many offering a range of activities, including tours and accommodation and food services. Looking further afield, this begs the question whether other primary industries may also have opportunities to leverage off New Zealand's tourism boom by whetting visitors' appetites for local produce when they're on our shores.

The industry as a whole has invested heavily in marketing, which is critical for attracting the attention of independent distributors that provide access to large retail networks. They are more likely to include a particular wine in their portfolios if it is well known. For larger firms that have their

own distributor network this is less of a problem, but for those without, especially small wine firms producing limited volumes in New Zealand, gaining access to distribution channels is a major challenge.

Despite stiff international competition, New Zealand wine exports have benefited from increased demand for wine globally. Some countries that have traditionally been beer consumers are now drinking more wine and spirits. An aging population in key markets has also provided a boost, as has the strong value proposition offered by New Zealand wine.

But like other agricultural commodities, wine producers face many challenges, not least of which is the weather. The availability of suitable land for producing a particular grape varietal and the ability to optimise existing land already under cultivation are also important factors for determining supply. As is having the local technical expertise to produce high quality wines.

Going forward, the divergence between limited opportunities in the domestic market and the potential for big gains in the export market look set to drive further evolution in the sector, threatening the survival of some, but presenting huge opportunities for others. On one hand, small winemakers producing premium products are likely to remain much as they are today. In contrast, large volume producers will compete by differentiating their products through various marketing and activities. In addition, expansion by some of these operators will allow them to reduce their costs of production. This could see a smaller number of boutique independent grape growers as well as fewer, larger, wineries.

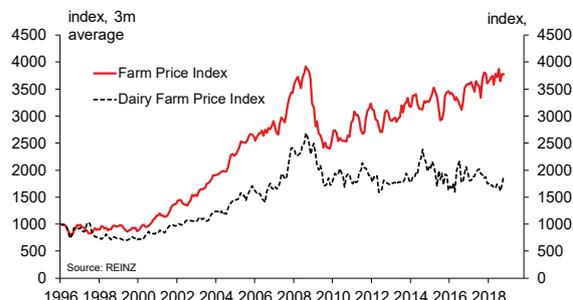
Anne Boniface
Senior Economist

Beyond the farm gate

Rural property prices

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

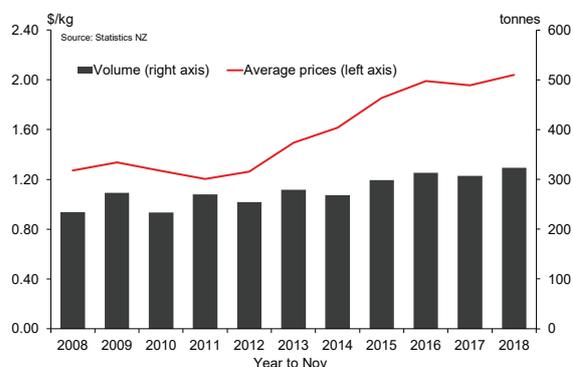
Overall farm prices have been broadly stable over the past three months, after rising steadily for the past few years. Dairy farm prices have also stabilised, but this is after a period of decline. However, the volume of dairy farm sales remains very soft, down 20% in 2018 compared to 2017. While good growing conditions in many parts of the country at the end of last year probably supported sentiment in the sector, we expect ongoing uncertainty about the regulatory environment to weigh on dairy farm prices for some time yet.



Apples

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

New Zealand Apples and Pears is expecting a record harvest of up to 604,500 tonnes of fruit this year. That would be a 2.5% increase in the gross crop for 2019 compared to 2018. And with growers benefitting from favourable weather conditions this season, they expect the quality of the fruit to be very high. However, growers are concerned that the tight labour market may limit their ability to harvest what is shaping up as a very good crop in the coming months. Growers in the Hawke's Bay have been lobbying the Government to get a seasonal worker shortage declared which would allow visitors on tourist visas to pick fruit. As yet no shortage has been declared, and harvesting is set to swing into gear within weeks.



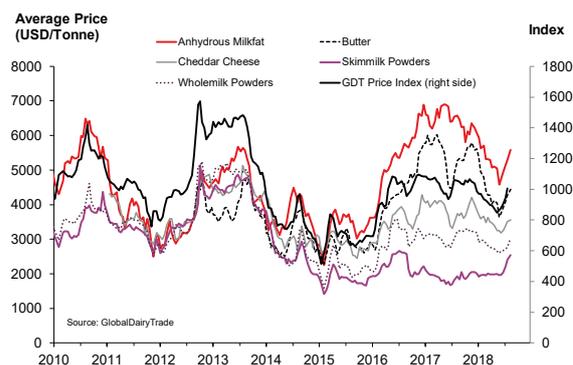
Dairy

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

Dairy prices jumped 6.7% in last night's GlobalDairyTrade auction. Whereas the strength in January auctions was dominated by higher prices for SMP as European stockpiles were unwound, higher WMP prices drove the lift in last night's auction. WMP prices rose 8.4% to \$US 3,027, their highest level since mid-2018. Interestingly, the strength of demand in last night's auction appears to be geographically broad-based, whereas earlier in the year Chinese buying was dominating.

Last night's lift in prices was probably due to the prospect of New Zealand supply being disrupted by the hot, dry weather in recent weeks. Pasture conditions were excellent late last year, but have started to deteriorate in the top of the South Island, Northland and parts of the East Coast of the North Island.

Our milk price forecast for the current season is \$6.30, but after the big jump in prices last night, this estimate is looking conservative and we see clear upside risk. What's more, if prices remain near current levels for the remainder of the current season, 2019/20 prospects are also shaping up better, with upside risk to our current \$6.75 forecast for the 2019/20 season.



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

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