



Fortnightly Agri Update

2 July 2015

NZD to the rescue

Dairy prices fell another 5.9% in last night's GlobalDairyTrade auction, taking the overall price index to a six-year low. A weak result was generally expected, given that the international backdrop for the auction is far from ideal right now. Uncertainty reigns over Greece's fate within the euro, which at the moment rests on a referendum to be held over the weekend. And an interest rate cut by the Chinese central bank has failed to stem a 21% plunge in the frothy Chinese sharemarket.

But in spite of these international concerns, we shouldn't lose sight of the fact that much of the dairy sector's woes have been specific to dairy. Prices for our other main commodity exports in recent weeks have ranged from strong (beef and wool) to steady (lamb) to soft but improving (wood). China is a major if not the dominant market for many of these products, so it's far from obvious that recent price trends can be pinned on a slowing Chinese economy.

We're still watching our four conditions for a turnaround in global dairy prices:

- **Global production:** Incomplete data for April shows a lift in European milk production since the quota system was removed, though not universally so: the two biggest producers, Germany and France, are still running behind year-ago levels. Current milk prices are likely to be below production cost for many of the higher-cost countries, so we don't expect strong growth over the course of the season.
- **Chinese growth:** There are tentative signs of the economy regaining some momentum. While the wild swings in the stockmarket have captured the most attention, this has not been a good gauge of the state of the underlying economy in recent years.
- **China's inventories:** Still no clear indications that excess stocks have cleared.
- **Russia's return to the market:** Russia's import ban has now officially been extended until at least January next year.

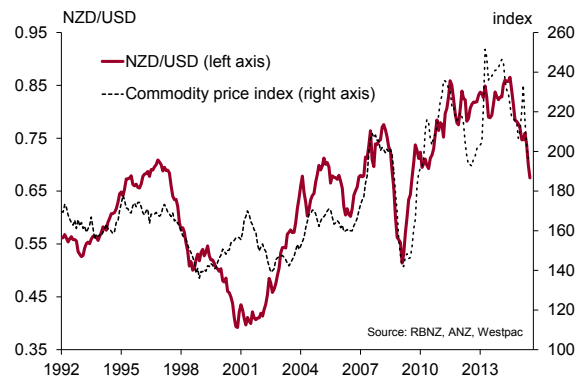
When it comes to domestic milk prices, there is one more factor to add to the mix: the steep fall in the New Zealand dollar in recent months. We expect a further fall over the rest of this year, with the Reserve Bank seemingly prepared to help it along by cutting interest rates further.

We've noted many times in the past that a floating exchange rate provides New Zealand with an important buffer against changing international conditions. While the exchange rate can't do anything about the relative performance of our exports (say, dairy vs beef

prices), it can respond to changes in the value of our overall basket of exports. And as it turns out, the fall in the NZ dollar to date has matched, and arguably outstripped, the fall in the overall commodity price index.

We think that the weaker NZ dollar has balanced out the recent falls in world dairy prices. So, notwithstanding the fact that there's still huge uncertainty around the near-term outlook for world prices, we see no reason to change our forecast of a \$5.40/kg milk price from Fonterra this season. As for other agricultural exporters, a weaker currency will prove to be a windfall for many of them.

NZD and commodity prices, adjusted for inflation



GlobalDairyTrade Auction Results, 1 July

| | Change since last auction | Price index USD/Tonne |
|--------------------------|---------------------------|-----------------------|
| Anhydrous Milk Fat (AMF) | 1.6% | \$2,855 |
| Butter Milk Power (BMP) | -8.1% | \$1,878 |
| Butter | -0.3% | \$2,694 |
| Skim Milk Powder (SMP) | -5.8% | \$1,875 |
| Whole Milk Powder (WMP) | -10.8% | \$2,054 |
| Cheddar | -4.9% | \$3,060 |
| GDT Price Index | -5.9% | |

Payout Forecast Table

| | 2014/15 | | 2015/16 | |
|------------|----------|---------|----------|---------|
| | Fonterra | Westpac | Fonterra | Westpac |
| Milk Price | \$4.40 | \$4.40 | \$5.25 | \$5.40 |

Michael Gordon
Senior Economist

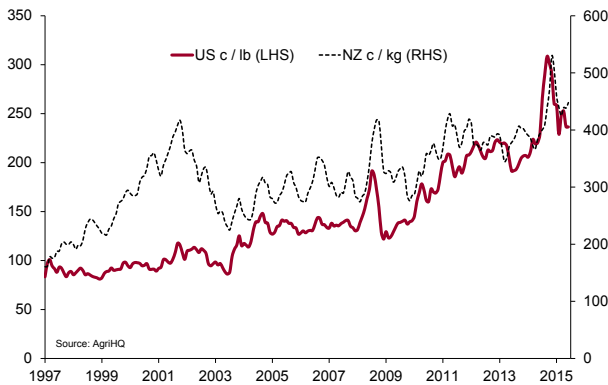
Beyond the farm gate



Beef

| | Current price level compared to 10 year average | Next 6 months |
|-------|---|---------------|
| Trend | Above Average | ↗ |

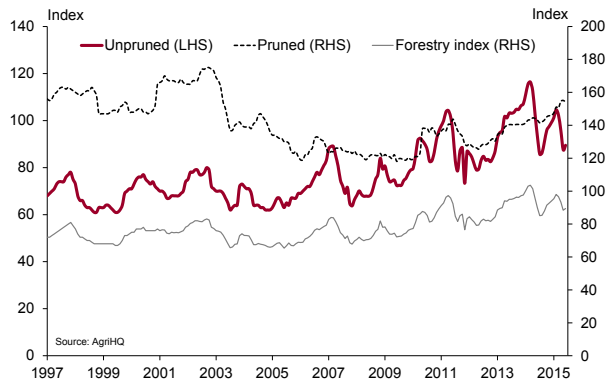
Imported beef prices in the US remain high, though on low volumes at the moment. US buyers are well placed to avoid a repeat of last summer's price spike, due to higher prices relative to other meats and ample stocks of imported product. A further decline in the New Zealand dollar this year is expected to boost returns.



Forestry

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

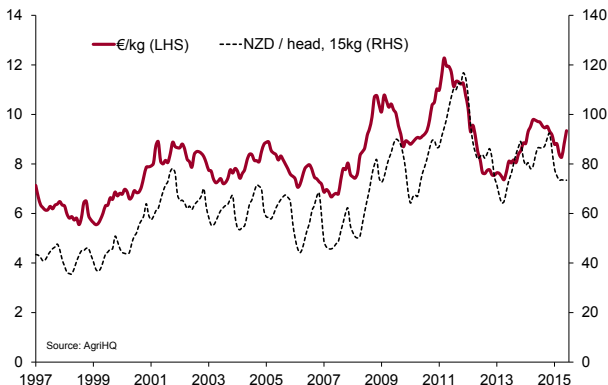
Unpruned log prices rose slightly in June after a sharp decline in the previous three months. The weaker NZD will go some way towards restoring the competitiveness of New Zealand's log exports. Demand for housing construction materials is holding steady nationwide, although the centre of growth is clearly shifting from Christchurch to Auckland.



Lamb

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

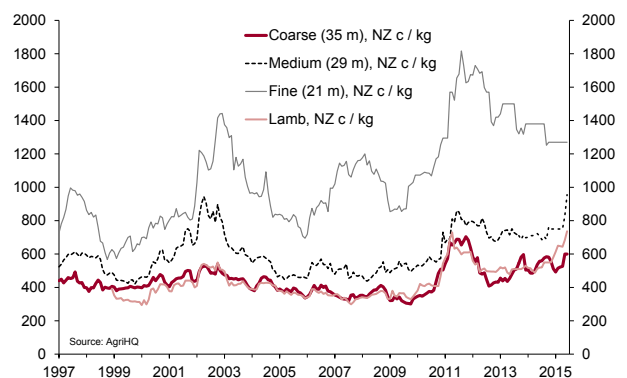
Lamb prices within Europe have picked up recently, though this will be of limited benefit to New Zealand farmers as local production winds down. The weaker New Zealand dollar will help to support returns.



Wool

| | Current price level compared to 10 year average | Next 6 months |
|-------|---|---------------|
| Trend | Above Average | ↗ |

Wool prices have remained resistant to competition from oil-derived synthetic materials to date. Lambs' wool has been the standout, with growing demand from China in the last year; this has been joined by significantly stronger prices for most other grades in recent weeks.



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

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