

# Fortnightly Agri Update

16 March 2016

## Whispers in the wind

Dairy prices slid further in last night's GlobalDairyTrade auction. The headline index fell 2.9% although whole milk powder (WMP) prices held up a little better, down a more modest 0.8%.

The ongoing slide in dairy prices so far this year has prompted another downgrade by Fonterra of their milk price forecast for the current season. Last week, Fonterra reduced its farm gate milk price forecast by 25 cents to \$3.90 for 2015/16. Our own modelling continues to suggest a number a touch higher than this. However, the further we get through the season, with the bulk of the product sold, the more we defer to Fonterra's view (as they obviously have much more detail on total volumes sold). So while there is clearly a small downside risk to our \$4 pick, we'll wait and see if we glean any more information in Fonterra's 2016 financial year interim results next Wednesday before making any changes to this forecast.

Today's outturn is, however, very consistent with our view that WMP prices will bump along near current levels until late 2016. This in turn means we remain comfortable with our \$4.60 farm gate milk price for next season, implying cash flow pressures will remain intense for New Zealand dairy farmers for some time yet.

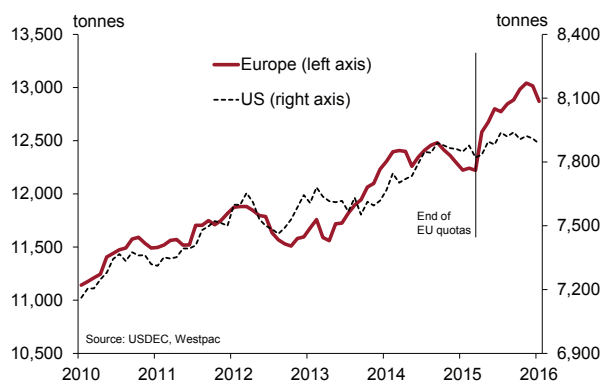
Clearly it's not just New Zealand dairy farmers who are feeling the pressure of an extended period of very low dairy prices. European farmers (who have been the key source of the lift in global supply over the last year) are also feeling the pain. There, there has been extensive lobbying by farmers for greater support in helping them deal with the sustained period of low prices. This week, the European Commission responded by announcing an additional range of support measures (an earlier support package was introduced in September last year) last week. Amongst other things, the package included the ability for individual producer organisations or cooperatives to temporarily establish voluntary agreements on their production and supply, and an increase in the intervention quantity ceilings for skimmed milk powder and butter to 218,000 and 100,000 tonnes respectively.

It remains to be seen what impacts these new measures will have. European milk processors may not want to reduce production after big investments to increase processing capacity. Furthermore, lifting the volume of SMP and butter stored in intervention schemes may support prices in the short term but simply kicks the oversupply can down the road. Nevertheless we don't expect they will be sufficient to entirely blunt the strong signal low prices are sending to many European farmers to reduce production.

Indeed, there are a few straws in the wind to suggest European milk production is already starting to respond to low prices. Looking at monthly, seasonally adjusted, European milk production data, there are signs that the pace of growth is slowing. But we'd be very cautious about reading too much into this data. The numbers are subject to revision (and often revised higher) and it's very early days yet. Nevertheless it provides perhaps a glimmer of hope that low prices are starting to lead to an adjustment in European milk supply.

Yet even if this proves to be the case, the sustained period of low dairy prices will probably have ensured that many customers have plenty of product on hand. In addition, there are European stockpiles that will need to be worked through. Consequently, even if we do see the pace of growth in global dairy supplies start to slow, any rebound in prices is unlikely to be particularly rapid.

## Northern Hemisphere milk production

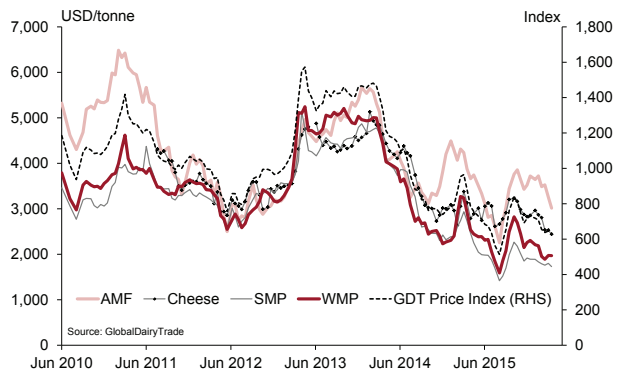


## Payout Forecast Table

	2015/16		2016/17
	Fonterra	Westpac	Westpac
<b>Milk Price</b>	\$3.90	\$4.00	\$4.60

**Anne Boniface**  
Senior Economist

## Dairy Prices



## GlobalDairyTrade Auction Results, 16 March 2016

	Change since last auction	Price index USD/Tonne
Anhydrous Milk Fat (AMF)	-6.5%	\$3,014
Butter Milk Power (BMP)	-6.4%	\$1,545
Butter	-2.8%	\$2,733
Skim Milk Powder (SMP)	-2.5%	\$1,731
Whole Milk Powder (WMP)	-0.8%	\$1,971
Cheddar	-5.6%	\$2,441
GDT Price Index	-2.9%	

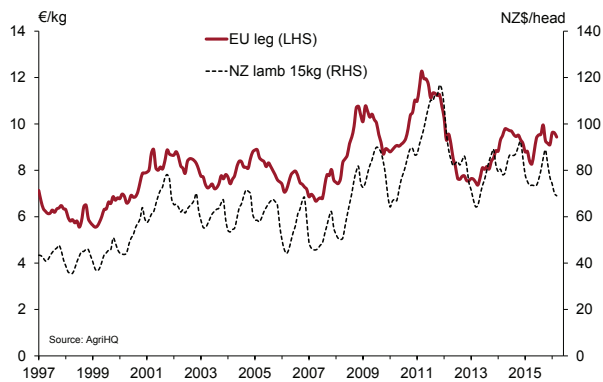
# Beyond the farm gate



## Lamb

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

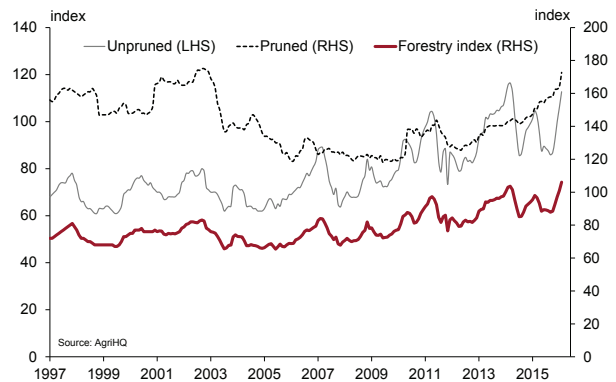
We continue to expect relatively tight supplies in NZ and Australia to underpin lamb prices this year. However, expectations of weaker growth in China and the Middle East (on the back of sharply lower oil prices) are likely to prove a headwind to any significant improvement in prices. Exports into the UK continue to compete with high volumes of domestic lamb.



## Forestry

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

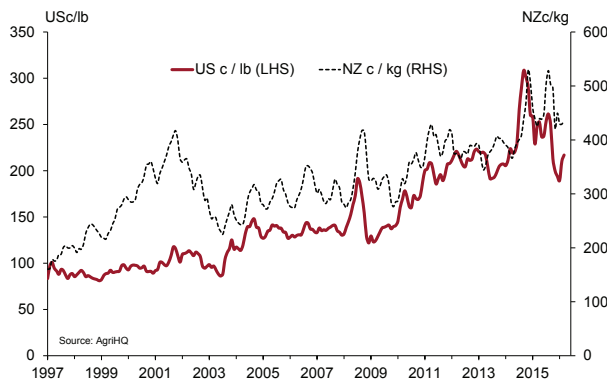
In contrast to our expectations, log prices rose further in February, however sentiment in export markets now seems to be becoming more negative. We remain sceptical that higher prices in China will be maintained in the face of anticipated softening in demand, but we acknowledge that tighter supplies locally seem to be supporting prices in the interim. And while China continues to take the lion's share of NZ's log exports, recent anecdotes point to improved demand from India. The domestic outlook remains favourable. We expect construction activity to pick up strongly over the first half of 2016, which should support domestic prices.



## Beef

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

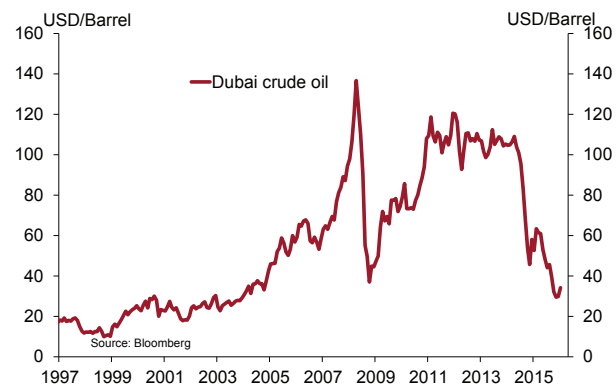
Over the medium term, international beef prices are likely to be underpinned by relatively tight global supply. However, locally increased culling of dairy cows in response to low prices could continue to temporarily add to domestic supply.



## Oil

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

Oil prices remain volatile. After moving higher this month, they have fallen again in recent days as Iran refuses to play ball on production caps and estimates of US stockpiles have increased. But while oil prices are above their lows from earlier in the year, over a longer horizon, we are sceptical over the extent of the degree of upside potential for oil prices. There is significant scope to increase supply if there is a sustained move higher in prices, which in turn should limit any increase in price.



NB: 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

**David Norman**, Industry Economist +64 9 336 5656

**Any questions email:** [economics@westpac.co.nz](mailto:economics@westpac.co.nz)

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