ANZ RESEARCH

AGRI FOCUS

AUGUST 2019

RISING TIDE

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INSIDE

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Returns at the farm and orchard gate are strong for our food-producing sectors. Global risks remain heightened but short supply in the dairy and meat producing sectors is supportive of prices at present. Rising costs of production are, however, biting into returns and limiting confidence, particularly in the dairy sector.

Ongoing improvement in environmental standards is at the forefront of the minds of our dairy producers. Relatively slow development of rules and policies by some regional councils is impacting farmers' confidence to invest in on-farm solutions. Thus far sheep and beef producers have not faced the regional council or media scrutiny that their dairy compatriots have, but this is beginning to change.

There is upward pressure in farm operating costs and incomes will be subjected to additional levies in the near future. A biosecurity levy will apply to the dairy and beef industries from September, to cover the costs of the Mycoplasma bovis response, and a greenhouse gas emission levy on meat and milk is also expected to be introduced as a stopgap measure until individual farm monitoring is introduced in 2025.

The cost of transporting New Zealand's produce to the rest of the world is also forecast to increase due to stricter environmental regulations on the shipping industry. From the beginning of 2020 ships will be required to reduce their sulphur emissions, which can be achieved by using cleaner-burning, more expensive fuel or fitting exhaust devices to capture the sulphur before it is emitted. The additional shipping cost will hit low-value bulky goods such as logs to a greater degree than higher-value products.

Prices at farm/orchard level relative to 10yr average		
Dairy	Dairy prices are expected to stabilise near current levels in the short term before firming later in the year on the back of slower growth in global milk supply.	
Sheep	Mutton prices are at record levels and lamb returns are also very strong. A no-deal Brexit could disrupt the early season chilled market.	
Beef	China is providing a strong alternative market to the US, which is supporting returns. Farmgate prices eased slightly during the peak processing period but underlying markets remain strong.	
Forestry	Log prices took a tumble last month due to Chinese markets being oversupplied during their quieter summer season. Felling activity has slowed as small woodlot owners opt to delay their harvest.	

DAIRY

POSITIVE MARKET SIGNALS

Dairy markets are currently strong enough to deliver a milk price above $7/kg milksolid this season, despite the softer prices on offer in the global markets in recent months. Slow growth in global milk supply will be supportive of prices this season, offsetting any reduction in demand caused by slower global economic growth.

Dairy commodity prices turned a corner at the second GlobalDairyTrade (GDT) event held in July. The 2.7% lift in the GDT Price Index marked the first positive movement in the index in over two months. Whole milk powder (WMP) prices pushed back over the USD3,000/t level and prices are expected to remain near this level in the near term, with further price gains expected later in the season.

The lift in price has come at a critical time for New Zealand milk producers. The seasonal volume of product on offer starts to lift from now on as the new season milk supply is sold forward. The higher volumes will test the depth of the buying bench and we may see prices bounce around a bit in the short term.

It is becoming clear that global milk supply growth is subdued and therefore higher prices will be needed to balance supply and demand. Milk supply is virtually stagnant in the main dairy-exporting countries, meaning there is a high chance that demand will outstrip available supply.

SLOWER GLOBAL GROWTH A RISK

A reduction in demand on the back of slowing global growth remains a risk, but traditionally end-user demand for dairy commodities does not swing wildly. However, a build-up of stock can severely limit the appetite of importers, and the lack of transparency within the supply chain means inadvertent stockpiling is an ongoing risk. Stocks within China are thought to have increased a little due to the large volumes imported earlier this year, but their own milk supply remains subdued, so stocks are unlikely to have built significantly.

Publicly visible stocks of dairy commodities are minimal, so conditions are ripe for higher prices to prevail as we progress through the year.

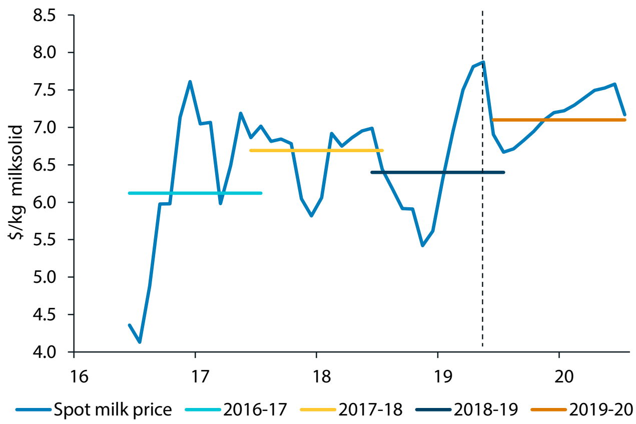
Futures prices show a slower recovery in prices than the fundamentals predict. WMP futures dated prior to Feb 2020 are all priced in the USD3,000-3,100/t range.

MILK PRICE MOVEMENTS

Milk price futures for the 2019-20 season have lifted to $6.87/kg MS as at the end of July. Futures are trading below our revised 2019-20 season milk price forecast of $7.10/kg MS. The forecast has been revised down 20c/kg MS due to some softening in dairy commodity prices in recent months and the NZD holding at higher rates for longer than expected.

Our forecast assumes the NZD will ease as the year progresses. The projected path of the NZD will be determined by events both on and offshore, particularly the outlook for global growth and the direction of US monetary policy. Further RBNZ policy easing will also weigh on the NZD. Meanwhile, as global uncertainties persist, investors will remain wary of 'risk' currencies such as the NZD.

FARMGATE MILK PRICE



Source: ANZ Research, GDT

DAIRY

Future movements in the exchange rate don't have a linear impact on the farmgate milk price. Dairy company hedging policies mean the impact of changes in the NZD have a delayed impact.

At this early point in the milk production season there remains a considerable degree of risk in any milk price forecast. Supply-side fundamentals show potential for dairy commodity prices to lift more than currently forecast, but this is offset by global uncertainty, which has the potential to disrupt consumption demand as the season progresses.

The milk price risk can be mitigated through locking in a portion of milk production through the fixed milk prices offered by some dairy companies, or by trading milk price futures. The proportion of milk producers using these tools remains small but is steadily growing. The value of these tools to individual businesses depends on risk appetite, and how well positioned a business is to manage income fluctuations.

GLOBAL MILK GROWTH SLOWS

Minimal growth in milk production is anticipated in all three main dairy-exporting regions for the rest of this year. Production growth is subdued in Europe, the US and New Zealand. Milk supply is forecast to slow in some of the smaller dairy-exporting nations, including Argentina and Australia. The US Department of Agriculture (USDA) now forecasts that 2019 milk intakes in the five largest dairy exporting countries will grow by just 0.4%.

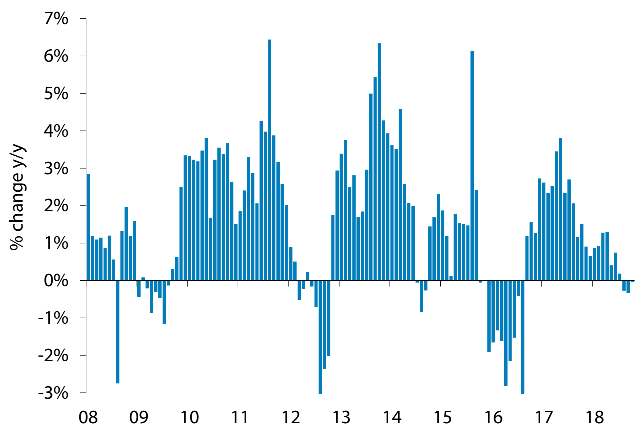
Europe has contributed the majority of the additional milk in recent years. However, while output is still growing in some parts of Europe, this is being balanced by a contraction in milk supply in other regions. Ireland and the UK are the standout growth regions within Europe. Ireland tends to have a more favourable climate for dairying than most other parts of Europe and therefore has lower costs of production. Dairy farmers in Ireland have continually expanded their operations with national milk production expanding by 37% in the four years since EU milk quotas were abolished.

EUROPEAN OUTPUT SUBDUED

Milk output is more subdued in Europe's two largest producers. Production in Germany and France was down 1.5% and 1.6% respectively for the month of May. Milk output in the Netherlands is constrained by environmental rules that limit the quantity of nitrogen and phosphate that can be applied to pasture. These rules have effectively limited Netherlands milk supply in much the same way as the milk quotas previously did.

For the season to date EU milk production expanded by 0.5%. Output in May lifted just 0.1%, which is significant given this is the peak production month. Official forecasts put growth at 1% for both the 2019 and 2020 calendar years. The 2019 forecast now looks aspirational, with 0.5% growth more likely.

GLOBAL MILK PRODUCTION



Source: DCANZ, Dairy Australia, CLAL, Datum, USDA

Milk production in the US during May and June was lower than at the same time last year. Farm profits are falling and driving a contraction in both the number of farms operating and dairy cows. The number of cows in milk is back by about 90,000 head or nearly 1%, but this has been partially offset by a lift in yield. Feed costs are relatively cheap at present but the corn crop is expected to be poor this season, which will push up feed costs through the Northern Hemisphere winter months. The USDA is forecasting growth of just 0.3% in 2019, but higher growth of 1.6% is forecast for 2020.

AUSTRALIA AND ARGENTINA UNDERPERFORM

Australia and Argentina are both expected to underperform in 2019. Drought continues to plague Australia's dairy industry, with exceptionally high milk prices forecast this season as dairy companies compete hard for the dwindling milk supply. Fonterra Australia has a milk price forecast of AUD6.80/kgMS, equivalent to NZD7.08/kgMS. Some other Australian dairy companies are offering suppliers more than AUD7/kgMS. The higher milk prices will increase the Australian business's costs, reducing potential profits.

DAIRY

FONTERRA DEBT CHALLENGES

Fonterra continues to progress its debt restructuring. Some of the assets sold to date have generated substantial returns and will contribute to the goal of reducing debt by $800 million. Other assets have been sold at a significant discount to book value, but their dispersal will help stem future losses. While Fonterra announced in late 2018 their plan to exit their investment in Beingmate, details of what this entails are yet to be revealed. There has also been no announcement on whether Fonterra will divest the loss-making farming hubs it has in China. Further details of the asset sales are expected to be revealed when Fonterra releases its 2019 financial results.

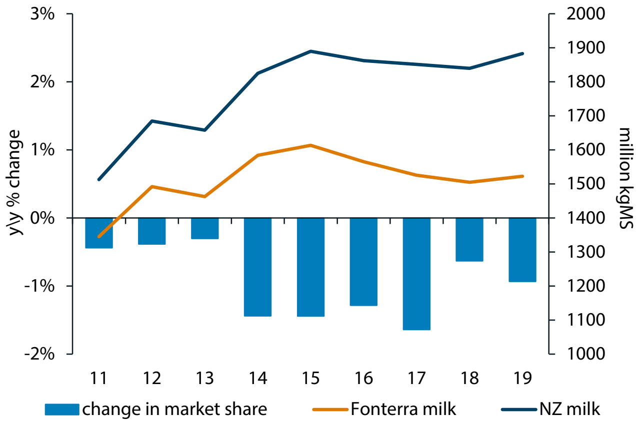
FONTERRA SHARE PRICE

Source: Reuters

The uncertainty associated with Fonterra's restructure has not assisted its share price. Nor has stagnant milk supply and movement of suppliers to alternative processing companies.

Fonterra's milk intakes peaked in the 2014-15 season and have trended down since. Total milk intakes also peaked in the 2014-15 season, but Fonterra's intakes have fallen more rapidly as its market share has been eroded by competing dairy companies.

FONTERRA MILK SUPPLY AND CHANGE IN MARKET SHARE



Source: DCANZ, Fonterra, DairyNZ

Fonterra has forecast a small increase in its milk supply in the 2019-20 season, but this seems unlikely given ongoing growth in competitors. The expansion by Synlait into the North Island will come largely at the expense of Fonterra's market share.

Suppliers divesting Fonterra shares put downward pressure on its share price. The share price does have some seasonality to it with shares trading at lower levels during the winter months.

LOW LAMB NUMBERS PUSH PRICES UP

Lamb returns continue to lift on the back of reduced winter supply. Schedule prices are now north of $8/kg carcase weight (CW) and are expected to rise further. The strength of the returns at the processor level are underpinning store lamb prices as well. Lambs near killable weights have been making exceptional returns when traded through the sale yards. Ewe prices are also strong, although with lambing already underway the number of in-lamb ewes moving through the yards is starting to dwindle.

Store markets for lambs are being underpinned by the strong winter contracts which some growers hold. Growers short of contracted numbers are paying very strong prices for any lambs that become available through paddock or yard sales. Prices achieved at sales in the lower North Island recently have been exceptional, and at a level that would be difficult to justify based on current schedule prices.

MUTTON AT RECORD LEVEL

Schedule prices keep pushing up as processors fight hard to secure the limited number of lambs coming through. In the North Island schedule prices are currently stronger than they were this time last year for both lambs and ewes. In the South Island prices are more closely aligned with year-ago levels. Mutton prices are at record levels with $5.50/kg CW the going rate in the North Island and South Island prices only fractionally below this. This means cull ewes are worth about $150/head, which is underpinning store prices as well, for both ewes and ewe hoggets.

Lamb processing this season to date (Oct-mid July) is behind by 1 million lambs or 6%. Beef+Lamb NZ have estimated 19 million will be processed in the year to 30 September 2019. However, this forecast looks aspirational, requiring more than 2.5 million lambs to be processed in the final three months of the season. This is well in excess of the number of lambs processed during this time period in the past couple of seasons. Therefore it is more likely lamb processing numbers for the 2018/19 season will be in the vicinity of 18.5 million lambs, 7% below last year.

The reduction in the number of lambs processed will be partially offset by higher slaughter weights. Lambs processed this season have on average been 0.5kg heavier than last season. Lamb weights were up significantly in the early part of the season due to good pasture production either side of Christmas. Lambs processed in June were also heavier than usual on reduced numbers. There were 21% fewer lambs processed in May and June this year than the corresponding period a year earlier.

Markets have been strong for lamb throughout this season. China continues to underpin the markets for the cheaper lamb cuts and mutton. The reduction in the number of lambs being processed in both New Zealand and Australia is also supporting prices.

NUMBERS DOWN IN AUSTRALIA

Lamb processing in Australia is down 6% for the calendar year so far. Meat & Livestock Australia is projecting a 7% decline in the number of lambs processed in 2019 relative to 2018. Sheep numbers are down across Australia due to persistent drought. Just 21.2 million lambs are expected to be processed this year. Australia's national sheep numbers are expected to have fallen to about 65.8 million as at June.

While lower numbers will support prices, looking forward we could still see some disruption in the markets at the beginning of the new production season due to the timing of the revised Brexit negotiations.

LAMB & WOOL

BREXIT LOOKING MORE LIKELY

The new UK Prime Minister Boris Johnson is adamant the UK will go ahead with Brexit on October 31, with or without a deal from the European Parliament. A 'no-deal' Brexit would create some temporary disorder in the markets. It is possible that the current subsidies that UK sheep farmers are entitled to will disappear overnight, reducing the profitability of farming sheep in the UK. If this happens then there could be a glut of lamb and mutton hitting UK shelves, which could reduce UK demand for our early season lamb. While the lucrative Christmas market may be disrupted, some order should have returned to the market in time for the larger Easter trade market.

Currently the UK and EU plan to split the existing WTO tariff rate quotas evenly, which would reduce the flexibility NZ exports currently enjoy to move product between these two markets. Beef+Lamb NZ and the Meat Industry Association oppose the current proposals and are campaigning to get a more favourable outcome.

New Zealand is also keen to get a free trade agreement signed with the UK as soon as possible but the UK may have other priorities.

COARSE WOOL KEEPS SLIPPING

Wool prices have continued to bounce around at low levels as the year has progressed. The new season for wool commenced at the beginning of July with prices about 10% weaker than the same time a year ago. Throughout the 2018-19 season prices have bounced along but the market still lacks any solid signs of recovery.

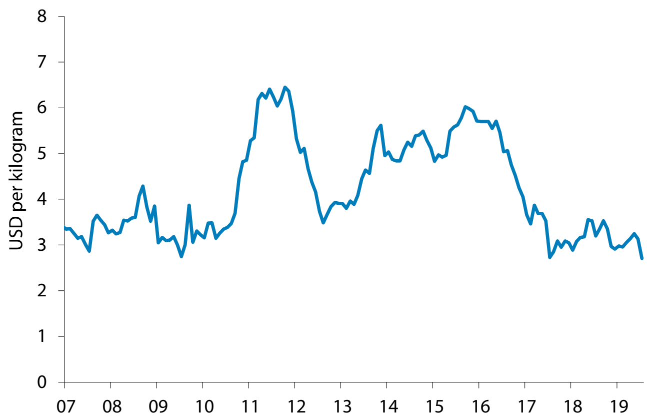
South Island growers are generally doing better than their North Island compatriots due to their finer grades of wool being more closely aligned with buyer demand. Fine and mid-micron wools and good-quality lamb wool continue to be in demand. It remains difficult to find buyers for poorer quality wool or any types and coarser grades of wool, resulting in low returns.

Interest from Asian buyers remains subdued, which is a concern given China alone accounts for half of our wool export revenue. Chinese buyers have been dipping in and out of the market in recent months, likely impacted by trade tensions with the US reducing demand for their end products. This has left the buying bench rather bare.

Offerings are relatively heavy with pre-lamb shearing adding extra volumes. This is not helping prices recover but clearance rates at recent auctions have been solid.

At current prices returns from coarse wool are not covering shearing costs, which doesn't bode well for the future of the industry. More innovative uses have been found for mid-micron and finer wool but generating higher returns from coarse wool remains a challenge.

STRONG WOOL (>35 MICRON)



Source: ANZ Research, NZWSI, PGG Wrightson

BEEF

BEEF – STABLE RETURNS

Beef continues to benefit from the serious problems in China's pork industry. Demand from China has kept prices high and reduced NZ reliance on the US market, although international prices are now stabilising.

Schedule prices are starting to pick up again now that the peak processing period is behind us. Prices are similar to year-ago levels, with the exception of local trade, which is attracting premiums.

Store prices have crept up over the past month with quality cattle well sought after.

Buyers are taking a more cautious approach to dairy-cross cattle or any cattle that have a higher risk of carrying Mycoplasma bovis (M.bovis). There are still Friesian bulls being moved from the South Island up to the North Island, but buyers are being much more vigilant about traceability.

As at 24 July there are 22 properties which have been confirmed to currently have M.bovis, while 158 properties have now been cleared. There are 605 properties under active surveillance and 236 that have been issued a notice of direction, meaning stock can't be moved. Of the properties previously issued with notice of directions 70-80% return negative results. Some properties have now been infected more than once.

Additional levies are now being charged by industry bodies to cover the costs of the M.bovis eradication programme. DairyNZ will charge a levy of 2.9c/kgMS from the beginning of September, after approving an annual Biosecurity Response Levy of up to 3.9c/kg MS. Beef+Lamb NZ have lifted their maximum levy to $2.00/head, and plan to charge $1.80/head for cattle, but dairy cull cows will be excluded due to the dairy industry paying its share through DairyNZ.

Winter conditions have been relatively mild to date. The autumn was the fourth-mildest on record, with most regions recording higher-than-normal temperatures through June. Rainfall was lower than normal in June but lifted in July. Conditions underfoot have been firmer than normal. This weather has been conducive for pasture production through the winter months, meaning there has been little urgency to offload cattle.

In the store market quality cattle are in short supply, which is keeping prices buoyant on limited trading. The relatively kind winter has bolstered demand and some buyers are already looking to secure cattle ahead of the normal seasonal increase in demand that occurs later in spring when pasture production surges.

HEAVIER WEIGHTS MAKE UP FOR LOWER NUMBERS

The number of cattle processed this season is marginally down on last season but heavier slaughter weights have more than compensated for the lower numbers. The number of stock processed in May was down slightly on the previous season but June numbers were up. This was mainly due to a slight change in the pattern of the dairy cow cull. More dairy cows were culled in March than normal, while culling in the later months of the season was down. This season to date the number of dairy cows culled is 1% less than the previous season.

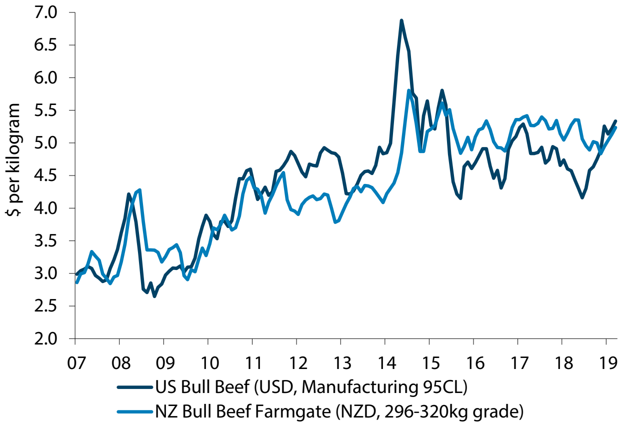
CHINA DEMAND UNDERPINNING PRICES

International markets for beef continue to be underpinned by strong demand from China. China is continuing to buy beef in large quantities from a range of countries as it looks for alternative protein sources to replace a portion of its domestic pork supply. African Swine Flu continues to plague pig farms in China and surrounding countries. The disease is far from under control and has a high mortality rate. It is likely to hamper China's pork industry for years to come.

BEEF

This has provided an opportunity for international beef suppliers to fill some of the gap resulting from the reduction in pork production. Beef is gaining space on restaurant menus and specific beef restaurants are popping up throughout major cities. This bodes well for ongoing demand from China.

BULL BEEF PRICES



Source: USDA, AgriHQ

International prices have held up very well this season to date due to strong competition between the US and China for our beef. Prices in the US market for imported bull and cow meat are the strongest they have been for at least four years.

However, there are signs that prices are now plateauing as Chinese demand may have reached its maximum price point. New Zealand is supplying only a small proportion of China's total demand for imported beef, and with our beef supply falling seasonally there is not a lot of pressure on processors to move product right now.

DEER

VENISON SCHEDULES TO LIFT

Venison schedules look set to return to a more normal seasonal pattern this year with prices at strong levels, but back from last season. An economic slowdown in some key markets is a concern, given the discretionary nature of this product. Market diversification is an ongoing challenge for the industry but some headway is being made with higher volumes now being exported to the US.

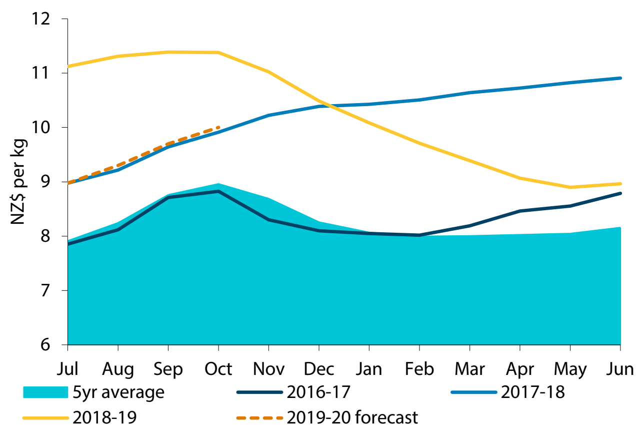
Venison prices look set to peak near $10/kg this spring. Prices are expected to return to their typical seasonal pattern again this year with premiums being paid for early-season supply. Venison processed early in the season is supplied in chilled format to the high-value European markets.

By supplying early season markets growers miss out on the opportunity to grow their stock out to heavier weights. In the past couple of seasons schedule patterns deviated from normal, which encouraged more processing later in the season. So that exporters have sufficient product to meet the needs of the European pre-Christmas markets, processors will be looking to reward growers by paying a higher price for early-season delivery.

Traditionally the schedule price has lifted by $1 between July and October, indicating a schedule price of about $10 should be on offer this season. Prices are currently sitting near $9/kg CW in both islands. Contracts have already been written for spring delivery at $10 with some growers set to receive scale and loyalty bonuses, pushing their contracted prices even higher.

There are some concerns that demand from Europe may be subdued this year. Buyers are reported to be slow to commit to chilled purchases. Venison is a high-value discretionary item that may struggle to gain a place on menus this year due to the economic downturn in Germany. Germany's economy is sluggish, with manufacturing activity slowing. Economic data shows Germany is hovering near recession.

FARMGATE RETURNS 60 KG STAG

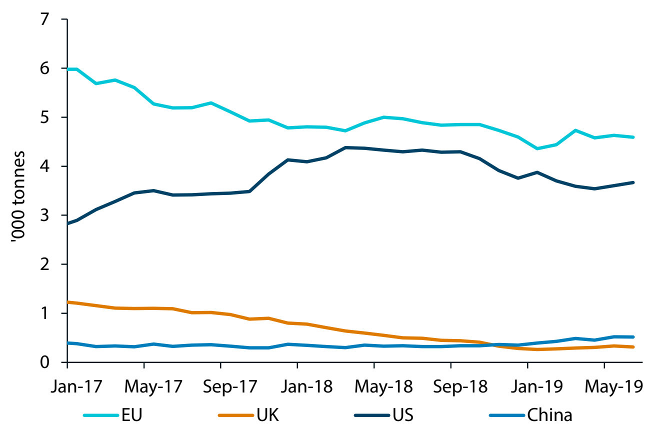


Source: ANZ Research, AgriHQ

MARKET DIVERSIFICATION

The venison industry continues to work hard to diversify its export markets and reduce its reliance on the European markets. This will help reduce the seasonality of returns.

VENISON EXPORT VOLUMES – ROLLING 12 MONTH



Source: Statistics NZ

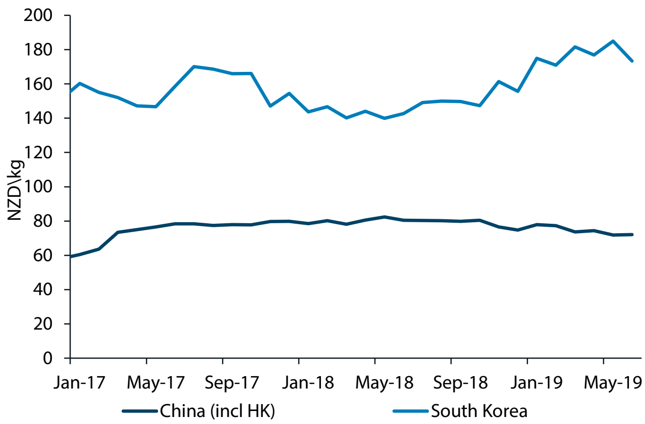
DEER

The value of the US market has grown considerably in recent years due to product being sold at a higher price point than previously. The European markets still return higher value than the US market but this is partially due to the cuts sold into the respective markets. The US is a significant market for lower-value cuts used in pet food production.

VELVET RETURNS LIFT

China remains by far our largest market for velvet but the end-user market is primarily in South Korea. In quantity terms more than 80% of our velvet is exported to China. Direct exports to South Korea are more valuable and the quality of the product can be better managed. When it goes directly to South Korea product is also often further processed here in New Zealand before being exported.

VELVET EXPORT PRICES



Source: Statistics NZ

South Korea velvet users are looking for high-quality products and by importing directly from New Zealand supply chain integrity can be better managed.

GRAIN

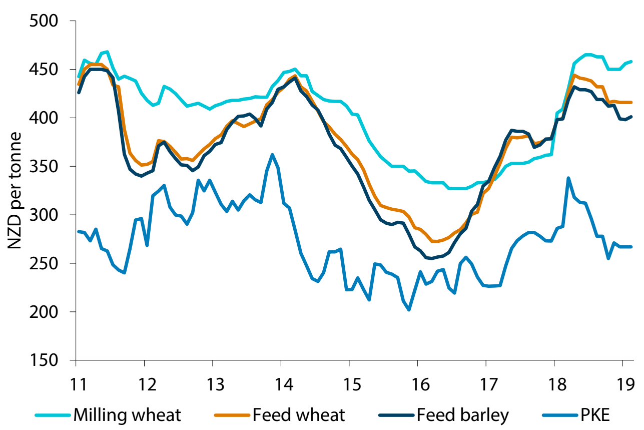
ARABLE

There is a limited volume of feed wheat and barley changing hands at present. Feed wheat pricing is firm but the quantity of feed barley available means pricing is softer. Demand from the dairy industry is steady but not exceptional. Less barley is expected to be planted this spring, but new-season wheat contracts are being written at prices above $400/t, which is favourable for growers.

BARLEY ABUNDANT BUT WHEAT SUPPLY TIGHT

Feed grain prices are relatively stable at present. Feed wheat has firmed slightly but high supplies of feed barley are weighing on the market. Data from the latest Arable Industry Market Initiative (AIMI) survey shows a 36% increase in the stocks of unsold barley as at the beginning of April.

NZ GRAIN PRICES



Source: AgriHQ

The area planted in winter barley is estimated by be down about 10% on the previous season.

Last season's harvest was poor in some parts of the country, but data from the latest AIMI survey shows yields for both malting and feed barley were good. Wheat yields were nothing exceptional, but similar to the previous season.

Poor weather at last season's harvest does mean that some of the barley currently available is of varying quality. High levels of screenings (undersized grain) are present in some of the barley crops harvested last season. The nutritional value of this barley will be considerably less than higher-quality crops and is a factor that should be considered when negotiating prices.

NEW SEASON CROPS

Feed wheat is being contracted near the $400/t level, a level with which growers will generally be content. Barley contracts for next season are yet to find a market level but given the existing stocks there could be some downward pressure on prices. At a result the area planted in barley this season is expected to be smaller than last season.

TREND AWAY FROM PALM KERNEL

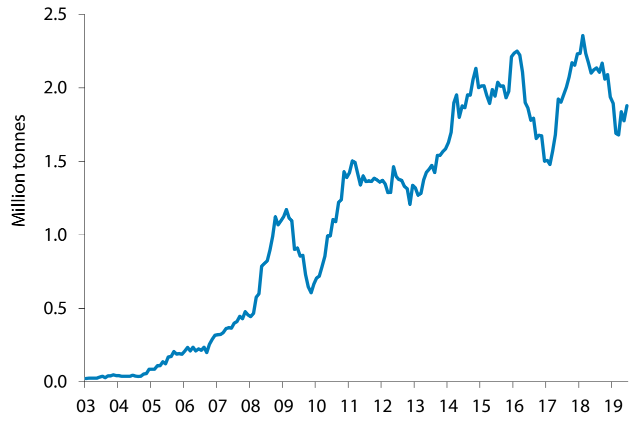
The dairy industry is starting to trend away from using palm kernel, due to both incentives and disincentives from dairy processors. Last season Fonterra introduced a Fat Evaluation Index (FEI) that effectively measures the amount of PKE being used. Poor FEI grades, associated with high PKE use, result in farmers being charged penalties. Other dairy companies are paying suppliers an incentive not to use PKE. Synlait has stepped up its payments in this area for the season ahead.

The reduction in demand for PKE has been partially replaced by higher use of distillers dried grains (DDGS), typically imported from the US or Australia. DDGS is a by-product from the use of either corn or sorghum to produce ethanol. It is favoured for its high protein levels.

GRAINS

There has been considerable growth in the quantity of DDGS imported in recent years. The volume imported is only about 15% of PKE imports, but it is a higher-quality feed.

PKE IMPORT VOLUMES ROLLING 12 MONTH AVERAGE



Source: AgriHQ

MORE LAND IN VEGES

Competition from vegetable growers for arable land is expected to reduce the area of land available for growing grains. More land in mid-Canterbury is expected to be contracted for planting peas this season.

The area in small seed production has grown in recent years but is expected to stabilise this year.

FORESTRY

LOG PRICE DIVE NOW FLATTENING

The sudden drop in export log prices that occurred in late June took the forestry industry by surprise. The local response has included laying off harvesting crews as small woodlot owners look to delay felling until market conditions improve.

On a more positive note, prices of export logs now appear to have stabilised. Prices fell significantly in late June with in-market prices for A-grade logs landed in China falling from US$130/JASm^3 in early June to approximately US$105 – US$110/JASm^3. Exporters are now reporting slightly stronger prices but agree it will take some time for the market to fully recover.

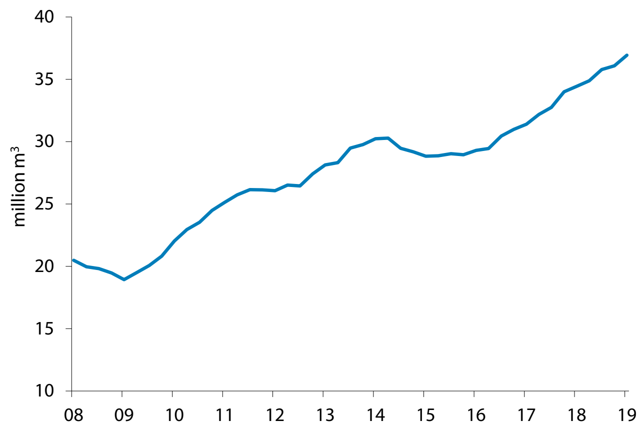
LOG PRICE (UNPRUNED A GRADE)

Source: AgriHQ

Export prices are unlikely to recover to the lofty levels seen in the first half of this year. But this may not be such a bad thing, as the excessively high prices attracted additional supply of logs and lumber from competing regions into China.

There has been plenty of talk of cuts in harvesting with many crews laid off. However, the bigger corporate-owned forests are continuing to be harvested at previously planned levels and there really has only been a meaningful change in harvest patterns at the woodlot level. The larger firms are better positioned to manage through a period of lower returns and therefore are more concerned about retaining harvesting crews rather than starting and stopping harvesting in an attempt to manage market conditions.

ROUNDWOOD REMOVALS – ANNUAL RATE



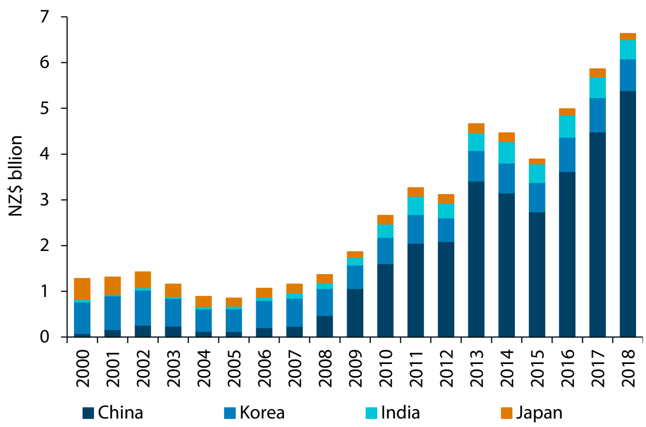
Source: MPI

Small woodlot owners are impacted to a much greater degree, as for many of them, harvesting is a once in a lifetime opportunity to secure a return on their investment. There was a flurry of small woodlots planted mainly on farms in the early 1990s and it is these blocks that are currently ready for harvest.

Harvesting has been running at elevated levels for the past few years. Up until recently China's appetite for logs was virtually insatiable, but the point of saturation has now evidently been reached. The excessively high prices attracted additional supply from other nations, while New Zealand exporters directed a larger proportion of our elevated export volumes to China. In recent years China has accounted for over half of New Zealand's total exports of logs and lumber, and more than 80% of New Zealand's log export revenue.

FORESTRY

LOG EXPORT REVENUE



Source: Statistics NZ

The prices on offer from buyers in China have typically been much stronger than those from other markets; hence they have received the lion's share of export logs.

The current oversupply situation has largely been supply-led, as opposed to collapsing demand. Demand for logs has in fact been pretty stable throughout this year. Seasonal falls in activity typically happen during the Chinese New Year holiday period, and also in summer when construction activity slows due to the hot weather.

Therefore, assuming the off-take of logs from Chinese wharves continues near current levels, then some improvement in prices should occur later in the season. There is a risk the market won't substantially recover before Chinese New Year as in 2020 this holiday period commences in January.

Another factor that will impact the forestry industry from next year is the requirement for ships to use low-emitting fuels or fit ships with exhaust devices to capture sulphur emissions. The cleaner-burning fuel is considerably more expensive and there may not be sufficient supply of it to meet demand when the new regulations are applied at the beginning of January. Exactly how this will impact the cost of shipping is yet to be ascertained, but it will have a greater influence on heavy bulk objects like logs than it will on higher-value products such as butter or meat.

There are numerous factors that impact shipping costs, with the volume of goods traded globally a major influence. The Baltic Dry Index tumbled recently, indicating reduced demand from global traders. Therefore the higher costs associated with the new fuel emissions legislation may be mitigated by lower global demand for shipping. There is a risk, however, that the shipping fleet may be reduced while ships are dry docked to have the 'scrubber' devices fitted to their exhaust systems and/or there won't be sufficient quantities of higher grade fuel available to meet demand. If this occurs then shipping costs are likely to rise.

BALTIC DRY INDEX

Source: Reuters

The quantity of logs sitting on wharves in China has increased but not as substantial as previously thought. Volumes are estimated to be up about 10% from a few months ago but this is not particularly unusual for this time of the year, given the slowdown in log uptakes.

The fall in the price of export logs has flowed into the domestic log market as well. However, the local market hasn't been impacted to the extent the export market has been. For sawmills it provides some reprieve, as they have had to compete on price with the export market.

There has been a slight upward bump recently in export pricing but it is too early to say if this will be sustained. The cutbacks in harvesting in New Zealand have left some ships short of freight so they have been a little more aggressive on pricing to ensure they sail with a full load. Therefore it may simply be this short-term demand that is pushing prices up a little, rather than the underlying market.

It is difficult to ascertain exactly how much harvesting has slowed in New Zealand. It has tended to be the crews harvesting some of the smaller woodlots that have stopped work. Due to the nature of these smaller jobs the quantity of timber harvested from these woodlots tends to be substantially less from the larger-scale forests, so the decrease in harvest volumes won't be as great as the decrease in crews operating. It is likely that harvest volumes have slowed by less than 10%.

Forestry companies are pushing more timber into the local domestic markets and doing their best to keep crews in work. There is a large risk that forestry workers will find other occupations if they are out of work for an extended period of time.

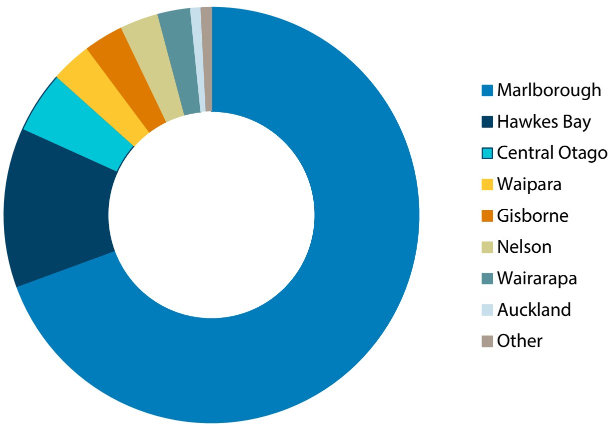
HORTICULTURE

WINE: HOT SUMMER LIMITS HARVEST

The volume of grapes harvested this season was poor relative to previous years due to a number of regions experiencing adverse weather at various times during the growing season.

Overall the harvest across New Zealand is estimated to be down just 1% on the 2018 harvest, based on data collected by NZ Wine Growers. As more vines reached productive age the harvest had the potential to be higher.

WINE PRODUCING AREA BY REGION



Source: NZ Wine Growers

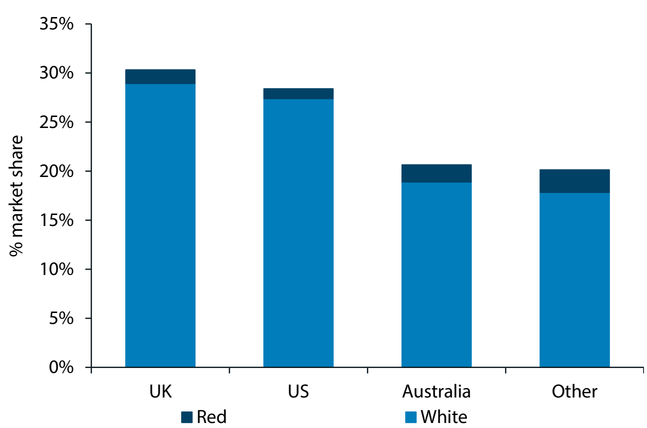
Marlborough was impacted by very dry conditions leading up to harvest. Growers struggled to provide vines with enough water during the hot summer months due to the high levels of evaporation, while water restrictions meant some growers didn't have access to sufficient water.

The result was 2% less grapes harvested in Marlborough compared with the previous season. For some growers the impact was significantly worse than the regional average. Marlborough is New Zealand's largest wine-producing region, accounting for approximately 75% of the wine produced, so the weak harvest for Marlborough made a significant contribution to the fall in national production. Despite the poor harvest the quantity of Sauvignon Blanc produced in Marlborough this year is estimated to be 1% higher, while national production of this iconic variety lifted 2%.

Meanwhile, many wine makers in Wairarapa experienced a quiet harvest as frost damage earlier in the season slashed grape production for some vineyards. The area struck by frost was localised, so production varied considerably from vineyard to vineyard, but the regional figures indicate production fell by an estimated 4%.

Hawke's Bay production was also down 9%, which primarily impacted Sauvignon Blanc and Merlot production, these being the predominant varieties grown in this region. But the 2019 vintage is being hailed as one of the best, so what was lost in volume may be made up in price.

WINE EXPORTS BY TYPE AND MARKET



Source: Statistics NZ

HORTICULTURE

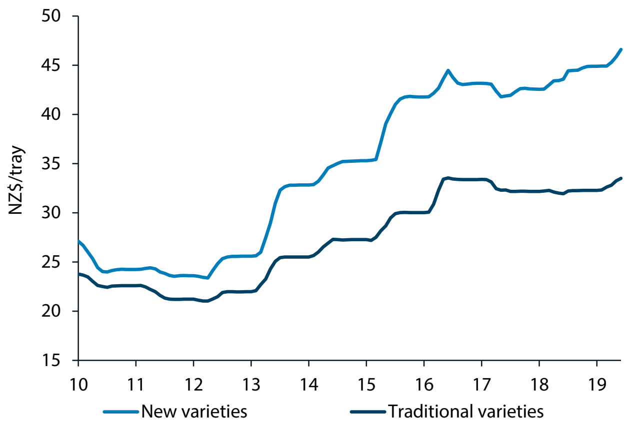
Export returns have steadily increased, with prices received in the past 12 months continuing to lift. Export data shows a 9c/litre increase in the average price in the year to May 2019. Stronger prices were attained, on average, in all three of our main export markets (the UK, US and Australia). Of the wine exported in the 12 months to May, 93% of this was white varieties, primarily Sauvignon Blanc.

Prices paid for wine at the grower level are expected to be relatively stable looking forward. The area of land in productive grapes is starting to stabilise. The area of land in vines of a productive age is expected to continue to increase slowly for the next few years as vines planted earlier come on stream. Sauvignon Blanc production is expected to grow at approximately 1% for the next couple of vintages.

APPLES

The apple-growing sector is enjoying a period of high returns. Growth is occurring in both export volumes and the prices being paid for export-grade fruit. This is partially due to a larger proportion of orchards now growing new varieties of apples that are more in line with consumer tastes.

APPLE EXPORT PRICES – 12 MONTH ROLLING AVERAGE

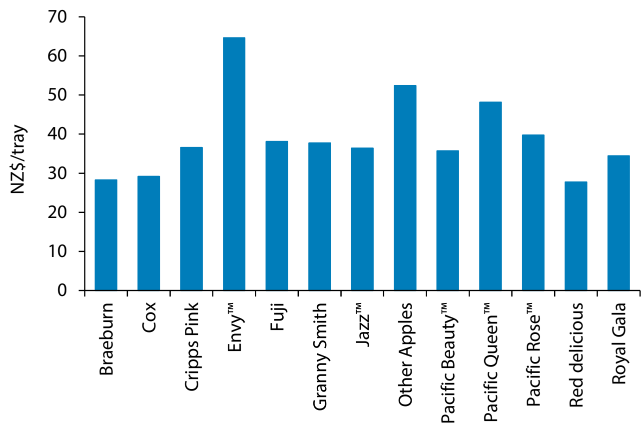


Source: Statistics NZ

In the past 12 months export returns for pipfruit have lifted by 7%. The average price received for export apples was $39/tray in the year to June 2019. This is $16, or 40% higher, than returns nine years ago.

The quantity of apples exported has increased by more than 10% over the past two years. Pear exports are trending down at present as growers favour expanding apple production.

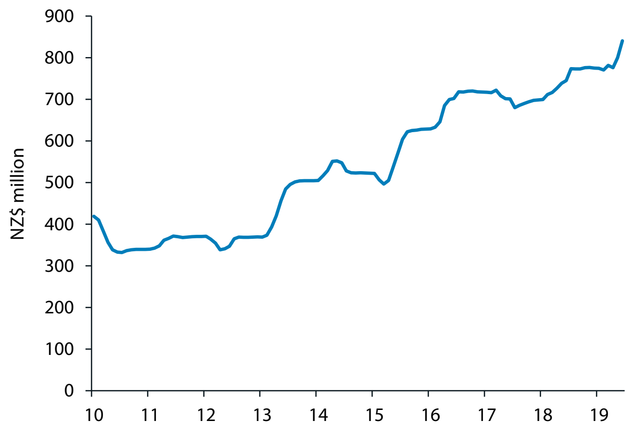
APPLE EXPORT PRICES



Source: Statistics NZ

Envy™ comes at the top of the list in terms of export pricing, and the quantity of these apples exported has grown at one of the quickest rates in the past 12 months. The 'other apple' category is also showing strong growth in volumes and delivering high prices. This includes the snack-sized Rockit™ apple variety, for which the Hawke's Bay based company Rockit Global Ltd holds global distribution rights.

APPLE EXPORT RETURNS – 12 MONTH ROLLING AVERAGE



Source: Statistics NZ

KIWIFRUIT

SunGold kiwifruit continue to deliver strong returns for growers. Zespri currently forecasts a price range of $10.20 - $11.20 per tray for the current season's produce. This equates to a forecast of $137,000 - $151,000 per hectare. Last season SunGold returned $10.89 per tray, or $145,991 per hectare. Therefore current season returns are expected to come close to matching last season.

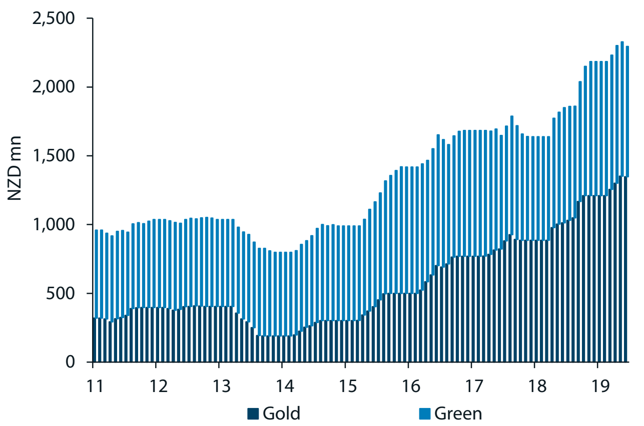
HORTICULTURE

The per-tray price for green varieties is forecast to be in the range of $5.50 - $6.50. This is an improvement on last season, when green fruit achieved $5.45 per tray as the bumper harvest impacted sales prices.

This season's harvest was slightly earlier than usual. The fruit harvested tended to be smaller than normal, but has great taste attributes. Zespri has indicated it will be a challenge to deliver strong returns due to the lower fruit size.

Exports are ahead for the season to date, with export volume returns peaking in May. The increase in the proportion of gold fruit harvested and the early season means fruit was shipped a little earlier than normal.

NZ KIWIFRUIT EXPORTS



Sources: Statistics NZ, ANZ Research

Zespri now has a market capitalisation of just over $1.5 billion. Zespri has announced it will pay a final dividend for 2019 of 17c per share on 16 August, and an interim 2020 dividend of 67c. Zespri shares traded at $8.20 on 23 July. The share price has been relatively stable this season with the exception of lifts and falls either side of the dates which the dividend payments apply to.

Zespri has a goal of achieving 4.5 billion sales by 2025.

RURAL PROPERTY MARKET

HORTICULTURE PROPERTIES SELLING QUICKLY

Dairy farms are still proving a challenge to sell, with those that are selling priced well below year-ago levels. There is renewed interest in livestock grazing properties due to the higher income streams being generated from this sector and demand from forestry investors. Horticulture properties remain in hot demand with prices elevated and quick sales times.

FEWER PROPERTIES TRADED

The number of rural properties changing hands in the three months to June 2019 slowed, but prices lifted. Sales volumes were 3% off the 10-year average with fewer sales than normal recorded across in virtually all sectors excluding horticulture.

Horticulture returns have been elevated recently but the huge variation in property types makes comparisons across the sector of little value. But it does highlight the current interest in this sector.

The number of dairy farm sales negotiated in the three months to June was only half that of the same period the previous year. The dairy farms that did sell sold at an average discount of 21% year-on-year, when priced on a per hectare basis. Dairy properties traded were priced 17% below the 10-year average. Dairy farms are currently taking longer to sell than other types of properties.

On a seasonally adjusted basis the dairy farms that changed hands in the three months to June were listed for 134 days on average. Meanwhile livestock farms are changing hands after 100 days, while horticulture properties are in hot demand, finding new owners in 53 days on average.

TARANAKI AND WEST COAST PROPERTIES SLOW TO SELL

Properties in Taranaki and the West Coast regions are generally taking longer to sell than properties listed in other regions. This data will be impacted by the high concentration of dairy farms in these regions. West Coast sales are likely to pick up now that the future of Westland Milk Products is more certain. The economic viability of West Coast dairy farms has improved substantially due to the price suppliers received for their shares and the certainty suppliers now have that they will receive a milk price aligned with Fonterra's.

DAIRY PRICE INDEX

Source: REINZ

FARM SALES BY FARM TYPE

3-Month Seasonally Adjusted		Current Period	Previous Period	Last Year	10 - Year Av.	Chg. P/P	Chg. Y/Y	Chg. P/10yr
Dairy	Number of Sales	29	29	58	51	↑	↓	↓
	Median Price ($ per ha)	24,698	22,771	31,223	29,703	↑	↓	↓
Livestock	Number of Sales	186	203	240	238	↓	↓	↓
	Median Price ($ per ha)	16,941	16,206	15,622	17,069	↑	↑	↓
Horticulture	Number of Sales	42	49	49	44	↓	↓	↓
	Median Price ($ per ha)	267,448	267,170	239,067	166,267	↑	↑	↑
Arable	Number of Sales	16	15	28	22	↑	↓	↓
	Median Price ($ per ha)	13,521	19,051	27,160	27,188	↓	↓	↓
Forestry	Number of Sales	7	8	13	12	↓	↓	↓
	Median Price ($ per ha)	n/a*	8,943	2,969	2,807	n/a*	↑	↑
All Farms	Number of Sales	285	310	387	367	↓	↓	↓
		23,421	22,144	23,284	23,252	↑	↑	↑

* Data has been made confidential by REINZ

RURAL PROPERTY MARKET

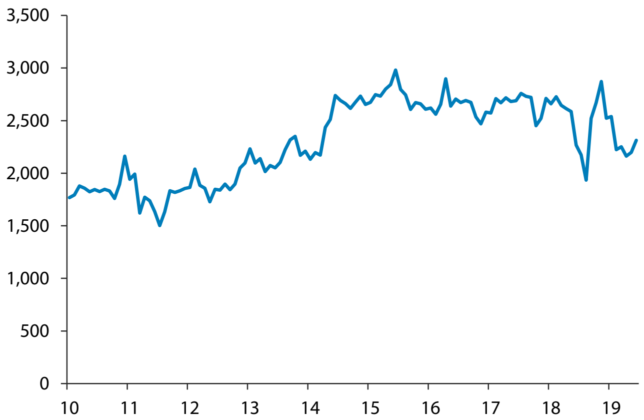
Returns from livestock properties have firmed, with those changing hands priced 8% above year-ago levels. Strong returns from sheep and beef farming have bolstered confidence in this sector and this is starting to translate into more investment in the livestock sector.

FORESTRY DEMAND BOLSTERS PRICES

Demand from forestry investors for bare land properties is also underpinning prices in the livestock sector, with forestry interests out-bidding farmers in same cases. Log prices have recently weakened but this won't necessarily impact forestry investor intentions, due to the long investment term. Some of the current investment in forestry is aimed at carbon farming rather than harvesting trees, or a combination of these income streams.

Carbon revenue provides a way to generate higher returns from land that is currently unproductive or generating very little return. In many cases only a portion of the property may return higher value when planted in trees, but it will help to increase the total value of the property due to the additional income stream available.

ALL FARM PRICE INDEX



Source: REINZ

Prices when measured over all types of properties firmed slightly in recent months but the number of sales achieved remains well below the 10 year average.

ECONOMIC OVERVIEW

GLOBAL ECONOMY

Global economic growth is softening and global trade is being restricted by tensions between several key trading nations. Such an outlook typically does not bode well for New Zealand due to our high dependence on exports, but as discussed in the previous sections, New Zealand's commodity prices are currently proving resilient, for a range of reasons.

The International Monetary Fund (IMF) has revised down its global growth forecast from 3.3% to 3.2% for 2019. Key risks to economic growth include additional tariffs being applied and the uncertainty that a 'no-deal' Brexit would bring.

By 2020 world economic growth is expected to pick up to 3.5%. Central banks across the globe are easing monetary policy or finding alternative ways to stimulate economic growth.

Tensions from the US-China trade dispute are spilling into other jurisdictions. Manufacturing activity is subdued across the globe as orders for new products start to fall away. Manufacturing activity was already slowing before the trade wars got underway, but the current trade environment is amplifying the contraction.

Inflation is running at very low rates in most countries, which means central banks risk missing inflation targets unless they are able to find ways to stimulate their economies.

INTEREST RATES

Interest rates are already at very low levels in many countries. Central banks therefore have limited ammunition when it comes to cutting official cash rates, and will want to use this monetary policy tool strategically. A movement in the overnight policy rate doesn't automatically mean a similar movement in interest rates for deposits or loans. Longer-term wholesale interest rates often move differently. Also, banks fund themselves from a variety of sources and competition between banks also plays a role in interest rate decisions. New Zealand banks must fund a certain portion of their borrowing from local deposits. Although cuts in the OCR are forecast, banks may need to hold deposit rates at higher levels so that they can attract sufficient deposits to meet regulatory requirements. This would put offsetting upward pressure on lending rates, all else equal.

We expect the Reserve Bank to cut the OCR two more times this year, once in August and once in November. This would reduce the OCR rate from 1.5% to just 1%.

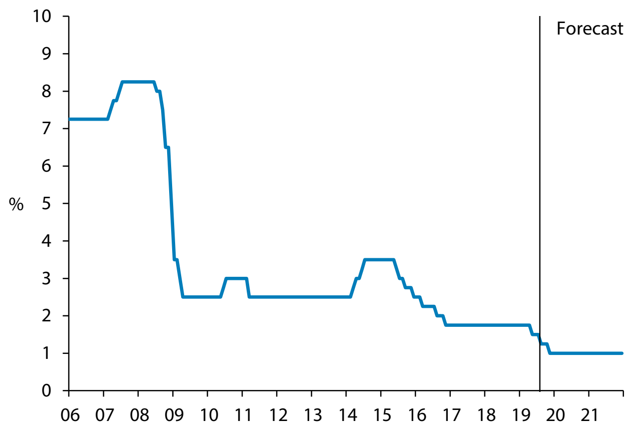
EXCHANGE RATES

The NZD generally traded up through June and early July. The currency fell the previous month when the Reserve Bank cut the OCR rate from 1.75% to 1.5%. The NZ dollar then peaked at US67.7c on 19 July, before easing back below US66.5c by the end of July. The NZD is expected to weaken as the year progresses. The weaker outlook for global growth is expected to weigh on our currency. Investors tend to steer clear of 'risk' currencies such as the NZD during times of uncertainty, and there is plenty of uncertainty in the global markets at present.

If the Reserve Bank eases monetary policy this will also impact the value of the NZD. Further OCR cuts will reduce the appetite of investors looking for higher-yield countries where they can earn a higher return on their investment. But to be fair, those are increasingly few and far between, so the typical currency reaction may or may not occur.

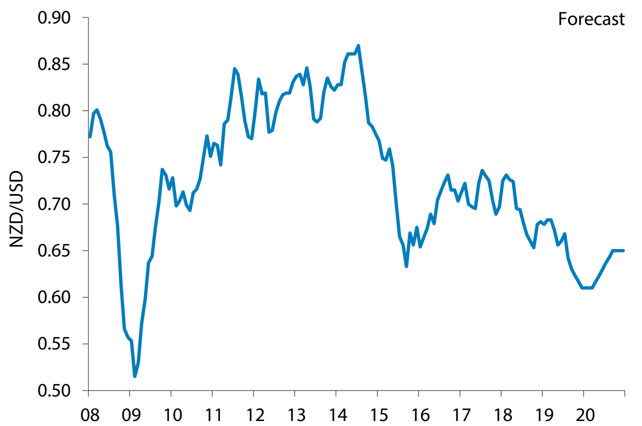
We currently forecast the NZD to fall to USD0.61 by the end of 2019, before starting to recover in 2020.

RBNZ OCR



Source: RBNZ, ANZ Research

NZD BUYS USD



Source: ANZ, Bloomberg

KEY FORECASTS

FX RATES	ACTUAL			FORECAST (END MONTH)					
	Jun-19	Jul-19	1-Aug	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20
NZD/USD	0.672	0.656	0.66	0.63	0.61	0.61	0.63	0.65	0.65
NZD/AUD	0.957	0.958	0.96	0.94	0.94	0.92	0.93	0.94	0.93
NZD/EUR	0.591	0.592	0.59	0.58	0.56	0.56	0.57	0.57	0.56
NZD/JPY	72.45	71.35	71.36	68.0	65.9	64.1	66.2	68.3	68.3
NZD/GBP	0.529	0.539	0.54	0.52	0.50	0.51	0.52	0.51	0.49
NZ TWI	71.6	71.0	72.6	68.8	67.2	66.8	68.2	69.2	68.3

INTEREST RATES	ACTUAL			FORECAST (END MONTH)					
	Jun-19	Jul-19	1-Aug	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20
NZ OCR	1.50	1.50	1.50	1.25	1.00	1.00	1.00	1.00	1.00
NZ 90 day bill	1.64	1.50	1.50	1.32	1.15	1.15	1.15	1.15	1.15
NZ 10-yr bond	1.57	1.44	1.43	1.50	1.45	1.35	1.35	1.35	1.35
US Fed Funds	2.50	2.25	2.25	2.25	2.00	2.00	2.00	2.00	2.00
US 3-mth	2.32	2.25	2.27	2.40	2.15	2.15	2.15	2.15	2.15
AU Cash Rate	1.25	1.00	1.00	1.00	0.75	0.75	0.75	0.75	0.75
AU 3-mth	1.20	1.01	1.01	0.95	0.95	0.95	0.95	0.95	0.95

ECONOMIC INDICATORS	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
GDP (% q/q)	0.6	**0.4**	**0.6**	**0.6**	**0.6**	**0.7**	**0.6**	**0.7**	**0.7**
GDP (% y/y)	2.5	**2.0**	**2.2**	**2.2**	**2.2**	**2.5**	**2.5**	**2.6**	**2.7**
CPI (% q/q)	0.1	0.6	**0.4**	**0.1**	**0.7**	**0.4**	**0.4**	**0.2**	**0.7**
CPI (% y/y)	1.5	1.7	**1.2**	**1.2**	**1.8**	**1.6**	**1.7**	**1.8**	**1.8**
LCI Wages (% q/q)	0.3	**0.6**	**0.5**	**0.5**	**0.4**	**0.7**	**0.5**	**0.5**	**0.4**
LCI Wages (% y/y)	2.0	**2.0**	**2.0**	**2.0**	**2.0**	**2.1**	**2.1**	**2.1**	**2.1**
Employment (% q/q)	-0.2	**0.2**	**0.4**	**0.4**	**0.4**	**0.4**	**0.4**	**0.4**	**0.4**
Employment (% y/y)	1.5	**1.1**	**0.5**	**0.8**	**1.3**	**1.5**	**1.5**	**1.5**	**1.5**
Unemployment Rate (% sa)	4.2	**4.4**	**4.5**	**4.5**	**4.5**	**4.5**	**4.5**	**4.5**	**4.4**
Current Account (% GDP)	-3.6	**-3.6**	**-3.7**	**-3.8**	**-3.9**	**-4.0**	**-4.0**	**-4.0**	**-4.0**
Terms of Trade (% q/q)	1.0	**0.5**	**0.1**	**-0.4**	**0.4**	**0.2**	**0.1**	**0.1**	**0.0**
Terms of Trade (% y/y)	-2.0	**-1.9**	**-1.7**	**1.1**	**0.6**	**0.4**	**0.4**	**0.8**	**0.4**

Figures in bold are forecasts. q/q: Quarter-on-Quarter, y/y: Year-on-Year

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