ANZ RESEARCH

AGRI FOCUS

DECEMBER 2019

SPRINGING ALONG

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INSIDE

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Publication date: 6 December 2019

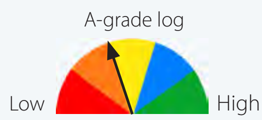
Meat prices have sky-rocketed due to the global shortage of meat primarily caused by the reduction in pork production in China. While prices have eased marginally both in-market and locally the price of meat is expected to remain elevated in the coming months.

Dairy prices have also lifted. Strength in milk powders combined with a subdued NZ dollar has allowed our milk price forecasts for the current season to lift to $7.45/kg MS.

Confidence at the farm level remains subdued despite returns being near record levels. Farmers remain concerned as to how future environmental legislation will impact the profitability of their business. Dairy land values are also under pressure for the same reason. These factors are more than offsetting the confidence that would normally be associated with a strong milk price. Rising costs of production are also a concern.

Farm operating costs have lifted nearly twice as much as the general rate of inflation. The Farm Expense Price index has increased by 6.1% in the two years to September 2019. Costs which have lifted the most in percentage terms are fertiliser, fuel, insurance premiums and shearing costs. Significant increases were also recorded in the cost of feed and the price of livestock. Interest rates are the only cost category to have fallen.

Confidence in the meat sector is strong due to returns for beef, lamb and mutton all being extremely high. While prices have eased marginally in the past week returns are still exceptional.

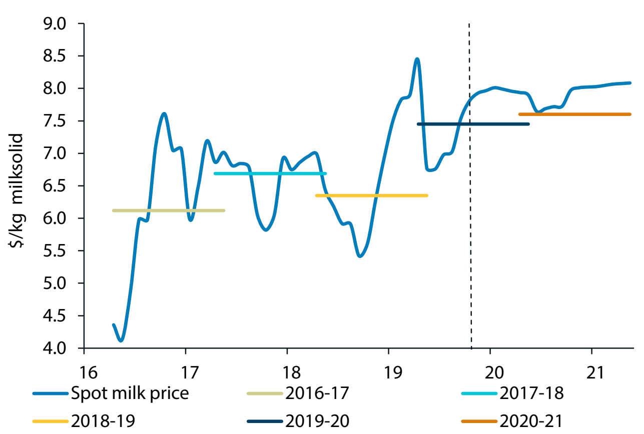
Prices at farm/orchard level relative to 10yr average		
Dairy	Dairy prices have continued to rise while the exchange rate remained subdued in recent months. This has bolstered our farmgate milk price forecast to $7.45/kg MS for the current season. Our 2020-21 forecast is up 10c to $7.60/kg MS.	
Sheep	Mutton prices have hit record levels both internationally and locally. Lamb schedules have just eased back below the record price of $9/kg CW attained in November.	
Beef	Strong competition between buyers from China and the United States has pushed beef manufacturing prices up significantly. Bulls are now worth more than prime steers.	
Forestry	Log prices are clawing their way back up following the sharp price correction in June, assisted by reduced harvest volumes and fewer logs being exported. But global markets remain uncertain.	

DAIRY

STARS ALIGN FOR STRONGER MILK PRICE

The ANZ milk price forecast for the current season has been increased by 30c to $7.45/kg MS. This puts our forecast at the upper end of the Fonterra's revised price guidance of $7.00-7.60/kg MS. Our forecast for next season has increased 10c to $7.60/kg MS.

FARMGATE MILK PRICE



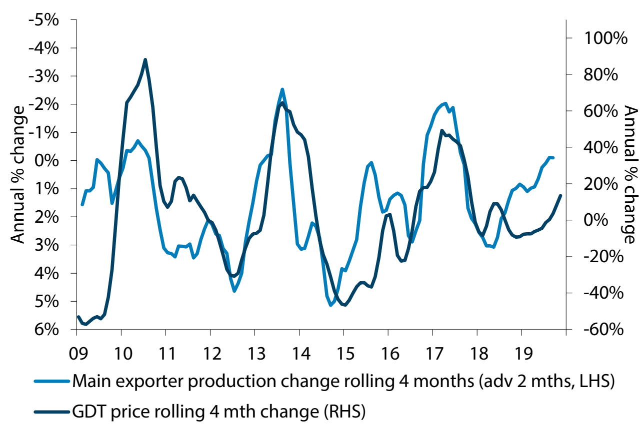
Source: ANZ Research, GDT

Fonterra is now paying an advance rate based on $7.30/kg MS – the mid-point of its revised forecast. This is a 25c lift from its previous forecast. The company acknowledges that the increase in the milk price does put pressure on earnings. At this stage Fonterra has retained its earnings guidance of 15-25c per share but has also acknowledged its earnings may be impacted by one-off adjustments such as the sale of assets.

Milk price forecasts for the current season and next have firmed on the back of stronger commodity prices coupled with a subdued exchange rate. It's unusual for the NZD to be low while commodity prices are high. Therefore it does beg the question, 'how long can it last?'

As shown in the graph below, changes in milk production are closely correlated with movements in dairy commodity prices. This indicates that while there is short-term upside potential for prices, it appears capped at about a 10% gain on current prices. Movements in milk volumes, particularly in the US and Europe in early 2020, will be critical to market sentiment, as will the portion of milk that is converted and exported as whole milk powder (WMP).

CHANGES IN GLOBAL MILK PRODUCTION AND GDT PRICE INDEX



Source: ANZ Research, GDT, DCANZ, Dairy Australia, CLAL, Datum, USDA

Movements in in-market stocks could also disrupt this picture. China typically buys strongly through to the end of November in order for product to be delivered early in January, as the preferential trade quotas are reset at the beginning of each year. Sometimes this results in a lull in demand from the market from December onward, due to ample stocks on hand.

Meanwhile, stronger buying than normal during November from the Middle East indicates this region is a little shorter of stocks than is typical.

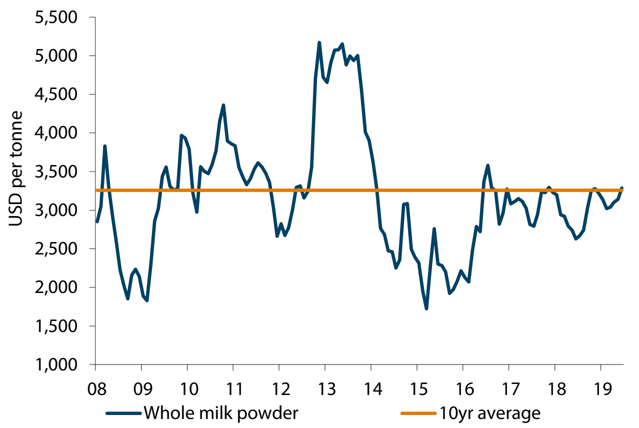
DAIRY

While the upward movement in dairy commodity prices may come to an end sometime during the first half of 2020, there is little to indicate a sharp fall in prices will occur. But weak global economic conditions remain a risk, certainly, as does consumption trending towards plant-based milk alternatives. This trend is primarily occurring in the developed markets, while demand for dairy products in the developing markets continues to be underpinned by growing populations and rising incomes.

DAIRY PRICES AT LONG-TERM AVERAGE

Dairy commodity prices are not particularly high at present. The price of whole milk powder is only about USD100/t above its 10-year average. It is, however, about 20% above the 5-year average due to this period encompassing the period of extremely low milk powder returns associated with the global oversupply that occurred after the European Commission abolished milk quotas in 2015.

WHOLE MILK POWDER PRICE



Source: ANZ Research, GDT

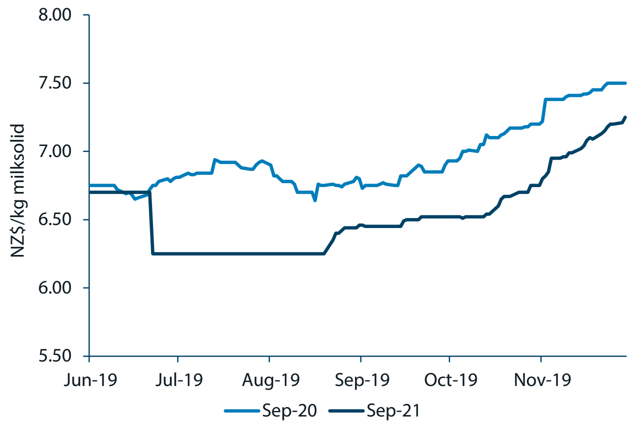
So in short, milk powder returns at present are good but not outstanding. A lot of the current strength in the farmgate milk price is derived from the soft NZD, with the NZD/USD currently priced about 10c below its 10-year average. The recent weakening of the NZD is assisting the milk price for both the current season and next season.

SHARP RISE IN FUTURES

Milk price futures for both the current season and next have lifted sharply in the past month. The September 2020 contract which relates to the current season has traded as high as $7.50/kg MS while next season's contract has lifted to $7.25/kg MS. In late August the contract for the 2020-21 season was priced a $1 cheaper than it is currently.

These higher prices are attracting additional interest in both these contracts as well as the Fonterra fixed milk prices which are priced off these contracts.

NZX MILK PRICE FUTURES



Source: Reuters

GLOBAL MILK SUPPLY HAS EASED

Global milk supply has been weaker than normal in 2019, and it is this easing of growth that has allowed dairy commodity prices to firm in recent months. While we are starting to see a small increase in year-on-year rates, milk production is generally expected to remain subdued in 2020.

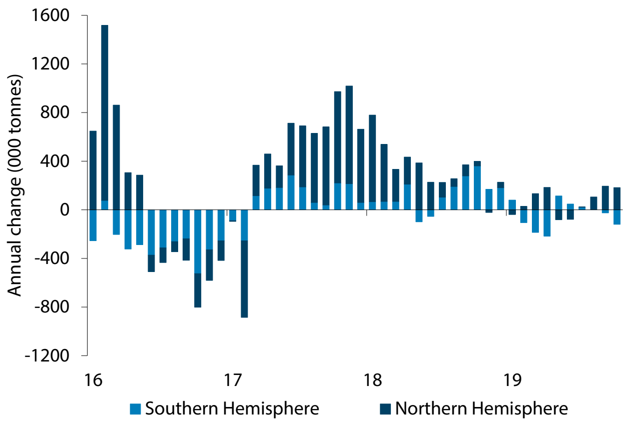
Milk supply growth in Europe is trending up towards 1% but is most likely to average about 0.7% across the 2019 calendar year. Historically the EU has increased its milk supply at an annual rate of 1.7%, highlighting that the current rates are relatively weak. Despite the weaker-than-normal growth in milk supply, the EU has managed to increase its export volumes this year. This has mainly been SMP and butter for which exports have lifted by 24% and 25% respectively this year. Meanwhile WMP exports have reduced by 16%. Any small change in European production and consumption can have a large impact on global dairy prices, so this remains the key region to watch.

The US is expected to increase its milk output in 2019 by just 0.3%, well short of its 10-year average growth rate of 1.4% per annum. While milk prices are favourable, rising costs of production continue to force small operators out of business and this is constraining the industry's ability to grow.

DAIRY

Milk output in the second- tier dairy exporting nations is expected to fall even further behind next year, as the dairy industries struggle for varying reasons. This group of exporters include Australia, Argentina and Uruguay.

MILK SUPPLY – MAIN DAIRY EXPORTING COUNTRIES



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

Australia's milk supply is rapidly dwindling as the impacts of drought and lack of industry confidence take their toll. On a calendar year basis Australia's milk production is back 7%. The reduction in milk intakes is disproportionally impacting milk powder production and exports as a larger portion of milk is consumed domestically. The volume of WMP exported in the first nine month of 2019 was 37% less than in the same time in 2018 and skim milk powder exports are back 15%.

Argentina's export figures paint a similar picture, with WMP volumes back 35% this year and SMP down 15%. The dairy industries in Argentina and Uruguay have been struggling to recover after some severe weather events set production back a couple of years ago. Milk production in Argentina is back 3.2% this year to date while Uruguay's milk collections are down 8.1%.

MILK SUPPLY SLOWING IN NZ

Changes in New Zealand's milk supply are also critical to global dairy prices as we are the second-largest dairy exporter behind the EU, and the largest exporter of WMP, butter and AMF.

The milk production season started a little stronger than last season but milk intakes during October, the peak production month, were back 1.5% y/y on a milksolid basis. On a season-to-date basis milk intakes are still up 0.5%. Fonterra's milk intakes for the season to date are down 0.5% y/y.

October production figures typically set the tone for the following months, meaning that milk flows through the final two months of 2019 are also expected to be down a little. Post-Christmas production is very weather dependent.

Soils are already drier than normal throughout most of the North Island and the top of the South Island. Meanwhile Canterbury and Southland are wetter than normal with soil moisture levels increasing the further south you head. Waikato, Northland and the eastern parts of Wairarapa and Hawke's Bay are at risk of a dry summer.

Milk intakes across the full 2019-20 season are forecast to be similar to last season, with risks skewed to the downside, meaning it is more likely milk intakes will be lower than last season rather than higher.

INDUSTRY CONFIDENCE STILL LOW

Despite milk prices being high, industry confidence remains subdued. The industry is facing increased regulation although exactly what that looks like for each farm is not yet fully clear.

How the industry manages its obligations to reduce its methane output is now in industry hands, at least for the next few years. This means we are more likely to see changes that will benefit low emitters and penalise higher emitters. This is a much more favourable outcome that simply taxing emissions at a processor level which treats every farm the same. But like many of the other legislative changes we are seeing it will becoming increasingly difficult for some farmers to continue to operate in the future.

There is a lot of change ahead in terms of managing greenhouse gas emissions, nutrient emissions and proposed changes to water allocation.

Costs of production are also rising and are expected to increase again in the future.

During the two years to September 2019 the cost of farm inputs increased by 5.9%, well above the average rate of inflation. The costs that increased the most in the Statistics NZ farm expenses price index were fuel (+20.6%), fertiliser (+13%), insurance (+12.9%), and livestock purchases (+12.5%). Local government rates lifted 7.3% while administration costs were up 5.4%. These increases only reflect price increases, not an increase in the quantity of a good or service used.

The only category to record a fall in price was the cost of borrowing with interest costs down 4.1%.

LAMB & WOOL

PRICES FIRM TO CHRISTMAS

Lamb returns are near record levels and are looking likely to remain elevated through to Christmas and possibly beyond. International markets remain exceptionally strong while slow growth rates mean very few new-season lambs have reached processing weights.

Schedule prices for lamb hit $9/kg carcass weight (CW) in November before easing slightly in early December. Strong underlying demand for lamb, particularly from China, combined with a weak NZ dollar is supporting the current returns.

More importantly, returns are expected to only gradually ease in the coming months, rather than crash, as more lambs become available for processing. An easing in procurement pressure this week has seen processors pull 10c off the schedule but lambs are not flowing as readily as processors would like. Therefore prices above $8/kg CW can be expected for lambs drafted before the end of the year.

Mutton prices are also at record levels, with the price paid by processors now above $6/kg CW in both islands. This price is at least 50% above the 5-year average, while the lamb price during November was 35% higher than normal for this time of the season.

CHINA STILL DRIVING DEMAND

Demand from China for alternative meat protein is the main driver of the high prices being paid for lamb and mutton cuts. China is soaking up all available alternative proteins as they look to fill the void in their domestic pork production caused by African Swine Fever. So far this demand appears insatiable but as more countries and more processing plants are approved to supply various types of meats to China the protein shortage will eventually be alleviated.

However, in China demand for lamb is expected to remain elevated even over the longer term as taste preferences change. We are now seeing chefs substituting lamb and beef in some traditional pork dishes. Therefore the demand for lamb and beef is likely to still be stronger than previously even when China domestic pork industry woes subside or they are able to source more pork from abroad.

The shortage of pork in China associated with the onslaught of African Swine Fever is difficult to accurately measure due to the lack of data from small-scale farmers. However, it has been estimated that China's pig population has decreased by about 40%. This has created a protein hole that is greater than New Zealand's total annual meat production.

China importers have been outbidding European buyers for leg cuts, while middle cuts are still moving into the European market. A lack of demand from Europe remains a key risk for lamb returns given the weak economic performance of this region and the ongoing uncertainty related to Brexit.

European GDP is expected to remain very weak in 2020. Germany, which has typically been a powerhouse of the European economy, is expected to grow its GDP by just 0.5% this year, well below world average growth of 3%.

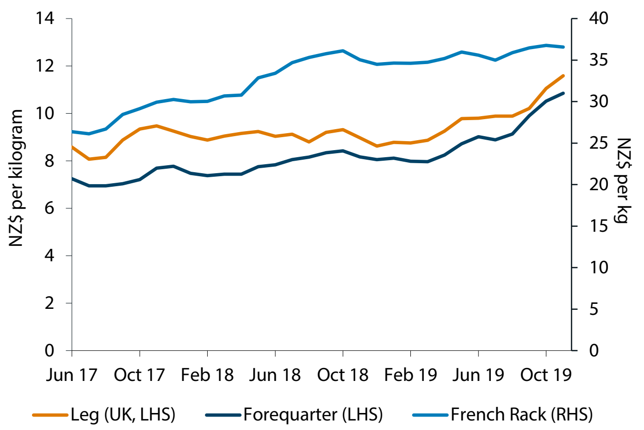
In contrast, China is expected to deliver GDP growth of 6.2% this year, easing to 6.0% next year. Demand for lamb from China relative to Europe is only likely to rise in the coming years. At present the average return from lamb exported to Europe still exceeds that shipped to China but the gap is diminishing and is driven by the difference in the choice of cuts rather than their relative purchasing power.

The value of our lamb exports to the UK has nearly halved over the past decade while returns from other markets have increased. A decade ago the UK accounted for 25% of the value of our lamb and mutton exports, while China

LAMB & WOOL

accounted for less than 5%. In the past 12 months the UK accounted for 10% of lamb export returns while China accounted for 38%.

LAMB CUT PRICES



Source: AgriHQ

Strong demand from China for the cheaper cuts such as forequarters and flaps has pushed the price of these cuts up relative to middle cuts, like French Racks, which are a favoured dish in European and US restaurants.

BREXIT RISKS FOR EASTER TRADE

Brexit remains a market risk as an disorderly exit by the UK from the EU would disrupt trade flows. However, the risk of a disruptive 'no-deal' Brexit has reduced. Brexit negotiations are now dependent on the outcome of the UK general election due to take place on 12 December.

If Boris Johnson's Conservative party wins the election they have promised to bring the Withdrawal Agreement Bill back to Parliament before Christmas. The Conservatives want this deal ratified before 31 January when the UK is scheduled to leave the EU, although a transition agreement means they would have until the end of 2020 to work out a permanent trade deal.

Should Labour win the election they have promised to negotiate a new Brexit deal within three months, which would then be voted on by the public in a legally binding referendum. Meanwhile the Liberal Democrats have vowed to cancel Brexit.

If the Conservatives win the election and they are able to get the Withdrawal Agreement through Parliament before Christmas then we shouldn't see too much disruption to the NZ lamb trade. However, if negotiations spill over into the New Year, as is highly likely, then this could negatively impact confidence of UK and European importers as we move into the main supply period for the Easter markets.

SLOW START TO NEW SEASON

The meat processing season officially got underway at the start of October. During October the number of lambs processed was 5% down on same time last year and was distinctively slower in the North Island. Old season lambs would have made up the majority of the kill during this period. The total number of lambs processed during the 2018-19 season was back about 6% on the previous season.

Beef & Lamb NZ estimates this season's lamb crop will be 2.4% (or 570,000 head) less than last season. A reduction in ewe numbers is partially responsible for the reduced forecast, while poorer ewe condition at mating is another factor. The number of breeding ewes at June 2019 was estimated to be 16.97 million, down 1.1% from a year ago. However, total sheep numbers are estimated to be up 0.4% to 27.4 million head due to more hoggets being retained.

Despite the lower expectations for the number of lambs born, lamb survival rates appear to be better the normal with some strong initial numbers being reported at docking (tailing).

The weather was generally kind through the main lambing period, resulting in good lamb survival rates, albeit with a few regional variations. However, lambs growth rates have been a little slow and very few lambs have reached processing weights. Lamb numbers are expected to remain subdued this side of Christmas despite processors being full this week.

The expectations of a strong schedule post-Christmas will do little to encourage lambs to come forward quickly.

STORE PRICES STRONG

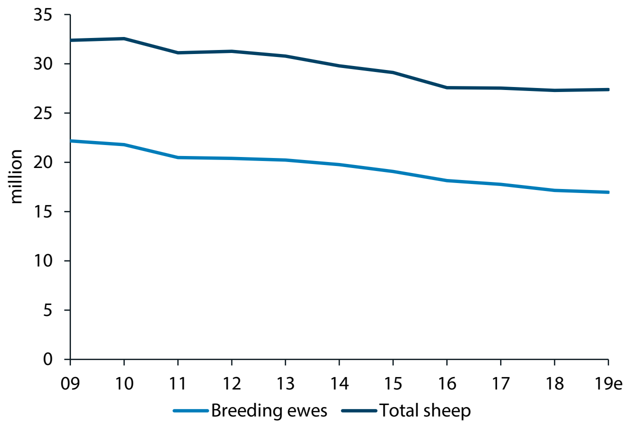
The store market for ewes and lambs has been strong this season. Store lamb prices have eased a tad as the numbers becoming available start to lift. Prices are in the vicinity of $4.50/kg LW, valuing a 25kg lamb well over $100. Drier conditions may take the edge of the store market in the coming weeks, but if forecast rains arrive then the market is likely to remain strong.

The current pricing is particularly favourable for breeding farms. The strong store prices will put some pressure on finishers but there are still margins to be made, particularly for lambs finished early this season.

Confidence in the sheep industry can be seen in an increase in the number of hoggets retained. Hogget numbers were up 3.4% at June 2019 to 9.55 million.

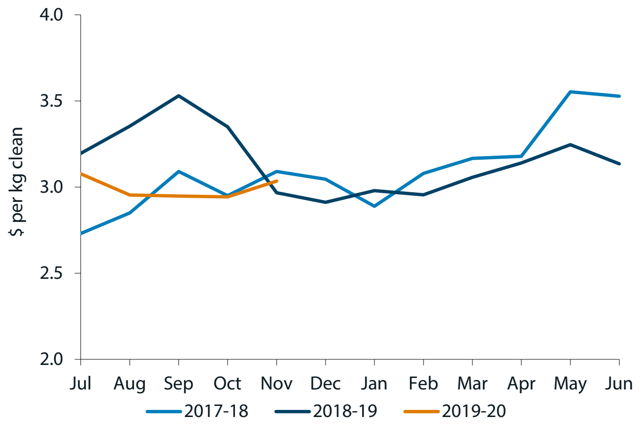
LAMB & WOOL

SHEEP NUMBERS



Source: Beef & Lamb NZ

STRONG WOOL (>35 MICRON)



Source: ANZ Research, NZWSI, PGG Wrightson

Sheep are likely to be favoured over cattle where changes to farming practices are required in order to meet tightening water quality rules. Water quality regulations aimed at keeping cattle out of waterways and reducing sediment runoff will generally have a greater impact on cattle farming than sheep farming.

However, the tighter regulation will have an even greater impact on the dairy sector. Any reduction in dairy intensity is likely to result in lower demand for grazing for young stock and wintering of cows. Therefore beef cattle numbers may need to increase to partially offset the reduction in dairy grazers.

Over the longer term, environmental regulations focussing on greenhouse gas emissions are likely to have the greatest impact on production systems, but in the near term, water quality is where the immediate focus sits for much of the industry. While there are many scientific solutions being worked on at present to mitigate impacts, there is still a huge amount of uncertainty as to whether any of these potential solutions will succeed.

What is known is that the farms that are efficient at turning pasture into meat and fibre will have lower emissions per stock unit than those that aren't. Therefore, continued focus on improving genetics and productivity measures such as lambing percentages and lamb growth rates will be beneficial.

WOOL RETURNS STEADY AT LOW LEVELS

Prices for coarse wool are stable at low levels and there doesn't appear to be anything on the horizon that will substantially improve returns in the short term.

Even the relatively weak NZ dollar is doing little to boost returns, rather just helping to maintain them at current levels.

On a slightly more positive note, wool is moving at current prices. Although there is no shortage of wool in stores, that being offered to the market is generally selling with good clearing rates being reported at sales held during November.

Buyers are still keen to secure good quality wool, but poorer grade wools are harder to move, as is wool with high levels of vegetable matter. Given the high costs of shearing and wool handling relative to the value of the wool, there is little incentive to spend extra time removing vegetable matter and stained wool. However the long-term viability of the industry does depend on being able to consistently deliver wool that meets the needs of buyers.

A small amount of merino wool and new season lamb wool sold well at recent auctions. Demand for merino wool is being curbed to some extend by the weak economic conditions in Europe where fine wool is used in high-priced goods such as jackets and coats. But we are also seeing Merino wool being increasingly been used in sports and casual clothing.

The amount of wool produced in Australia this year is expected to be down 5% on last year due to the decrease in sheep numbers. Any decrease in supply will be welcome in today's market environment and may provide some support to the market.

Consumer distaste for mulesing means a number of retailers, including Kmart, will only stock clothing made of wool grown on non-mulsed sheep. Mulesing remains a common practice in Australia which means some buyers now favour NZ merino wool over Australian wool.

BEEF

BULLISH BEEF MARKET

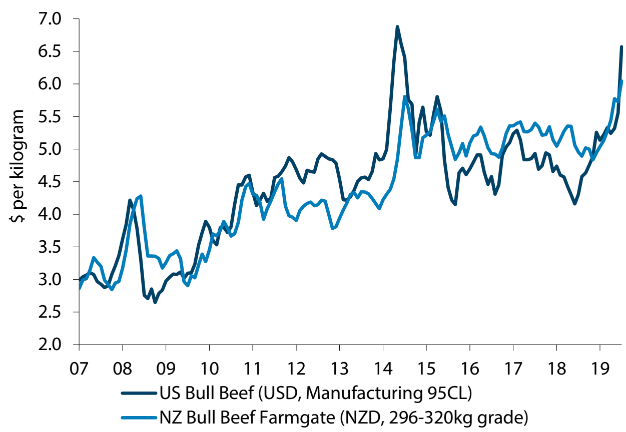
International prices for manufacturing bull beef reached record levels in November and this strength is being reflected in prices paid at the farmgate level.

Farmgate prices for bulls peaked at $6.50/kg CW for bulls, making them more valuable than prime steers. Even at these prices there are still sizeable profits for processors, and the potential for schedules to lift further, although this may be tempered by any increase in the volume of stock becoming available for processing.

New Zealand beef exporters are in the fortunate position of having two strong markets competing for our manufacturing beef. US buyers are used to being the main buyers of manufacturing grade beef supplied from Australia and New Zealand, but now that China is also in the market for this product buyers have had to compete much more strongly on price in order to secure the volumes they desire.

Normally at this time of the season the US market is well supplied by its own domestic beef and therefore prices on offer tend to be quite low. However, this season buyers are finding that in order to secure any beef from abroad they need to pay a much higher price. This has resulted in the price of manufacturing bull meat lifting to USD3.20/lb, which equates to NZD11/kg in late November. This price is a remarkable 60% higher than it was a year ago. However prices in the first week of December has softened slightly to USD3.05/lb

BULL BEEF RETURNS



Source: AgriHQ

The US price for imported cow meat is near record levels having eased to USD3.05/lb (or NZD10.00/kg). This is slightly below the record prices reached in the US for imported beef in late 2014, but due to the low NZD the price of cow meat hit record levels in local currency terms a couple of weeks ago.

There isn't a lot of manufacturing grade beef available in New Zealand at present due to strong demand from China keeping the freezers relatively empty. There is also not a lot of cattle being processed at this time of the season. The number of bulls available for processing is unlikely to increase until closer to Christmas, when the bulls used for dairy mating start to be withdrawn from herds.

Meanwhile manufacturing grade cows won't start to flow in large numbers until later in summer or into autumn unless dry conditions prompt early culling.

Cattle prices are typically high at this time due to the increase in pasture production prompting farmers to increase stock numbers, but store cattle pricing is about 10-15% stronger than historically seen at this time of the season.

BEEF

Prices for store cattle haven't yet lifted as far as the current end-market prices, but there is a risk that end markets won't be as buoyant as they currently are when these stock reach finished weights.

Traditional beef breeds are more sought after than dairy breeds. Stock from regions where herds are known to be infected with Mycoplasma Bovis are also being discounted heavily.

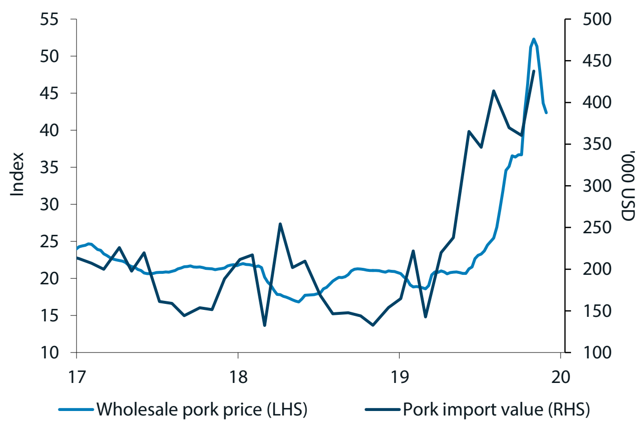
CHINA OPENS ITS DOORS

China has approved more countries and meat plants to supply it with various types of meat. New Zealand already enjoys relatively good access for our products due to our long-term trade relations with China and also the alliances between several of our meat processors and Chinese firms. The process of getting plants approved for exporting to China can be an arduous process but it is now in China's interest to get as many plants approved as possible. It is therefore relaxing its import rules. This will help fill the gap in its protein markets caused by the reduction in its own port production due to the outbreak of African Swine Fever (ASF).

For example, China has recently opened its doors to beef from Brazil – the world's largest beef exporter – and approved more exports from Argentina as well as Ireland and the UK. It has also reopened its doors to chicken from the US and pork from Canada and the United States.

China's beef imports for the season to date are up 55%, while its pork imports are up 50%. In October alone China imported 150,800t of beef. By comparison New Zealand exported approximately 450,000t of beef in the year to September.

CHINA PORK PRICES



Source: China Ministry of Commerce, Customs General Administration PRC, ANZ Research

The increase in import volumes appears to be starting to alleviate the supply shortages. Pork prices, which previously skyrocketed, have now eased a little.

The underlying issues with ASF are far from under control. Despite government efforts to rebuild their pork industry the disease remains rampant and pork production is expected to be compromised for years to come. However, as supply of alternative proteins (particularly beef) flow into China returns will start to ease and therefore it would be unwise to bank on schedule prices holding near current levels for too long. The seasonal lift in processing in the autumn will be a good test of market depth.

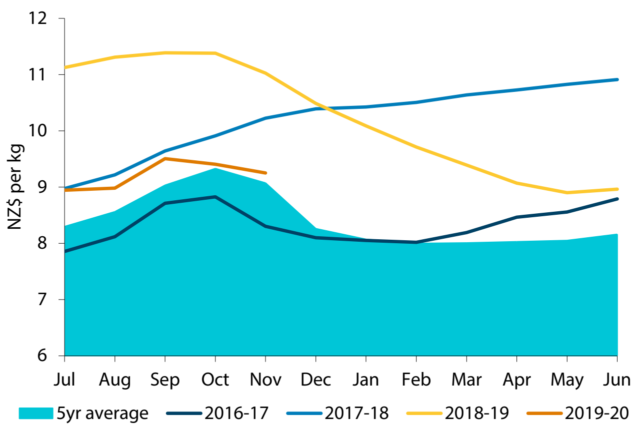
VENISON RETURNS SOFTER

Venison prices are being negatively impacted by tough economic conditions in its main European markets. Returns for by-products used in the pet food industry and the loss of a deer skin processor have also taken a toll on the schedule prices, which now sit just above the five-year average.

Velvet returns are holding up but it is becoming increasingly difficult to maintain prices as volumes lift.

The venison price schedule peaked in late September at $9.70/kg CW for young stags supplied to North Island processors. Since this time the farm-gate price has steadily trended down, with $9/kg CW now the going rate in both islands.

FARMGATE RETURNS 60 KG STAG

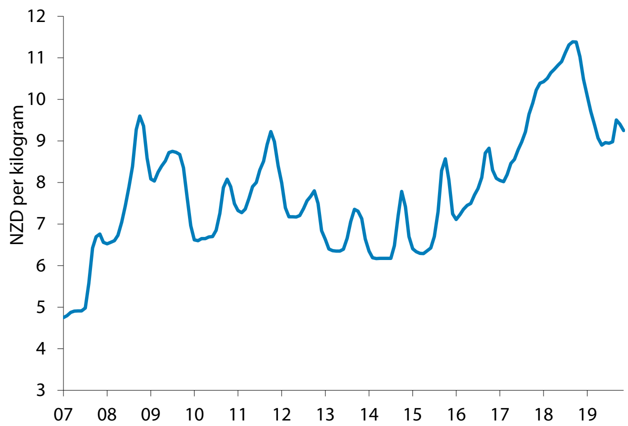


Source: ANZ Research, AgriHQ

Last year schedule prices peaked around $11.50/kg CW and held near $11 through much of November. This year the schedule was well off the lofty levels attained last season and the peak occurred earlier in the season.

Prices are still marginally above the five-year average but are expected to continue to fall in the coming months. By historical standards returns to deer farmers are still good.

FARMGATE RETURNS 60KG STAG



Source: ANZ Research, AgriHQ

Germany remains a key market for New Zealand venison but demand here is still very seasonal. Processors are therefore working hard to develop alternative markets in order to reduce concentration risks. They are also working on improving the awareness amongst Europeans of the opportunity to grill venison in summer.

The need for diversified markets is heightened at present due to Germany's poor economic performance of late. What was once the powerhouse of the Eurozone economies is now dragging its feet. Germany posted marginal GDP growth in Q3, meaning it has just managed to avoid falling into a recession.

In this environment selling high-end cuts of meat, mainly used by the restaurant trade, can be challenging. Also overhanging the market are stocks of frozen venison purchased last season, which is limiting current demand for chilled product.

DEER

Markets that our venison exporters are looking to develop further include North America, China, the UK, Sweden, and also some parts of the Middle East.

The United States is already a large market for venison. Exporters enjoy good demand from this market for chilled product all year round. In previous years there has also been strong demand from US importers for venison off-cuts used in pet food.

The high prices previously on offer for pet food grade meat have evaporated. There is still good demand from this industry for healthier types of meat for high-end pet food, but not at the prices previously offered.

NO MARKET FOR DEER SKINS

Another factor having some impact on schedule prices is the closure of the Timaru tannery, which previously finished deer leather. This tannery produced high-end goods and this additional value was built into the schedule price. But it has now become unviable for the tannery to continue to operate due to a lack of market demand for fine deer leather. In the year to September 2018 hides and leather exports were worth $11 million or about 3.5% of the total export value of deer products.

VELVET RETURNS STABLE

Velvet prices are expected to hold this season but the industry has warned that maintaining returns at current levels is getting more challenging as the volume of velvet produced increases.

Export earnings from the sale of velvet-related products continue to increase. This is a function of moving to higher-value products and an increase in the volume of velvet being produced.

Velvet production continues to increase due to more stags, improved genetic performance and better management practices.

GRAIN

ARABLE

Feed grain prices have eased slightly this season, which isn't surprising given there is still plenty of unsold wheat and barley available from the previous harvest. The area planted this year is estimated to be back slightly from last year with less feed wheat and feed barley planted. However, the area planted in malting barley and milling grade wheat has increased.

REDUCTION IN PLANTINGS

The area planted in cereal for harvest in 2020 is estimated at 96,900ha in the latest Arable Industry Marketing Initiative (AIMI) survey. The area intended to be planted this year is 5% less than that planted last year. This follows a similar reduction in the area planted the previous year.

Not all of last season's harvest has been sold, which may be weighing on the minds of some growers. Demand for feed grains has eased as dairy farmers take a 'wait and see' approach to feed purchases.

There are sizeable quantities of last season's grain yet to be sold, including 38,000t of feed wheat and 57,300t of feed barley. In addition there is plenty of grain that has been sold but is still being stored on farm by the grower.

Data collected in the AIMI survey indicated that as of 10 October there was 336,200t of grain on farm that was either unsold (108,500t) or sold but still stored on farm (227,000t).

This puts the total volume of grain on farm 35% higher than a year ago. Feed wheat (138,700t) and feed barley (116,00t) make up the majority of the grain stored on-farm.

MILLING WHEAT AND MALTING BARLEY FAVOURED

The area to be sown in feed wheat and feed barley has decreased this year. The area planted in feed wheat is down 7% from last year, while the area in barley is estimated to be back 12%.

The reduction in the area planted for livestock feed has been partially offset by more milling wheat and malting barley planted. Contracts by mills were offered early in the season, which provided growers with more certainty and the confidence to increase plantings of milling wheat.

Virtually all of last seasons' milling wheat has been sold while 2,900t of malting barley was yet to be traded as at October 10. Nearly all of the malting barley planted this year has already been forward sold.

There are also slightly higher volumes of milling oats unsold and there's been a substantial reduction in the area planted in milling oats this year, although this was offset a little by more feed oats being planted.

MAIZE IN THE GROUND

Maize planting is progressing well in the North Island, with most crops now sown. There is still plenty of surplus maize from last season's harvest available. The volume of maize imported this year is less than last year but further shipments are due. Recently released statistics from the NZ Feed Manufacturers shows an increased use of maize in manufactured feeds during Q2. This extra maize was used to replace wheat in some manufactured feeds.

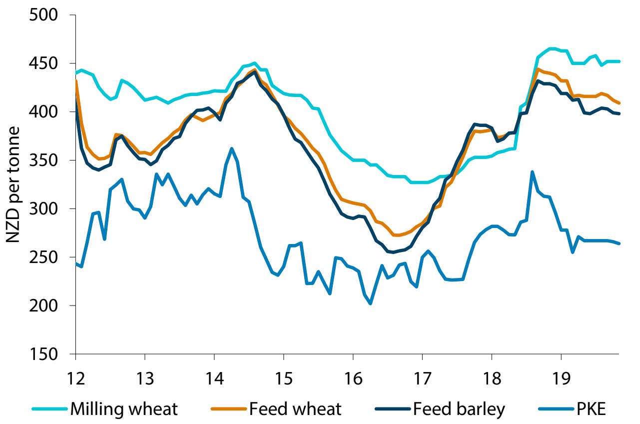
Planting of cereal crops in the North Island is also virtually completed. Wet conditions in Southland mean planting of cereals in this region has been slower than normal.

GRAINS

GRAIN PRICES EASING LOCALLY

Grain prices have generally eased over the past couple of months, particularly feed prices as there is little demand for immediate deliveries. Milling wheat prices are still strong relative to feed prices. The milling wheat spot price is sitting marginally above contract prices, which typically range from $430-$450/t depending on variety and grade.

NZ GRAIN PRICES



Source: NZX

LESS WHEAT IN WESTERN AUSTRALIA

In Australia prices are creeping up as crop size estimates fall. The wheat crop currently being harvested in Western Australia has yielded more poorly than expected and a large portion of the crop has been downgraded. This means less milling-grade wheat will be exported from Australia to Asia, with that market now turning to Argentina for supply. The poor harvest in Western Australia may result in more feed wheat being available in Australia than previously thought. Despite dry conditions crops are growing well in the Eastern states, with a larger harvest than last year still expected.

FORESTRY

Market prices for export logs have steadily recovered since the sharp fall in prices in the middle of the year. This trend is broadly expected to continue, but there are tentative signs we could see some price wobbles ahead.

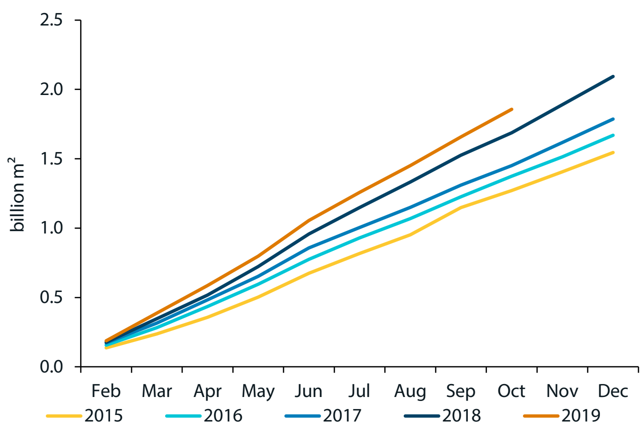
Competing supply from Europe shows no signs of letting up, and weak lumber prices in China indicate we could see some easing in demand for imported logs. But for now the market continues to trend upward.

LOG PRICE (UNPRUNED A GRADE)

Source: AgriHQ

Log returns are greatly influenced by the strength of Chinese demand for unpruned logs. Demand from this market collapsed in June due to a build-up of stock in-market. Buying resumed soon after and end-user demand has been steady throughout the year, as seen in the uptake of logs from Chinese wharves. This is also supported by steady growth in the housing market in China. The number of new homes being built continues to increase despite economic growth continuing to ease.

CHINA (MAINLAND) FLOOR SPACE OF HOUSES NEWLY STARTED, CUMULATIVE



Source: NBS, Reuters

The fluctuating supply of logs and lumber into China is primarily responsible for the price movements seen. New Zealand is the largest supplier of logs to China, but Russia and Europe also supply substantial volumes of both logs and lumber.

When prices abruptly dropped earlier this year it was no longer profitable to ship logs from South America to China, but prices are nearly back to the level where we could see supply resume from countries such as Uruguay.

During Q3 China log imports fell nearly 5%, but imports from New Zealand fell only 3%. The quantity of logs purchased from Russia and North America fell substantially. This was, however, offset by a 170% increase in the volume supplied by Europe. During Q3 28% of the logs imported by China were supplied by New Zealand, Europe supplied 17% and Russia supplied 11%.

FORESTRY

BARK BEETLE KEEPS EUROPEAN SUPPLY HIGH

The supply of logs from central and Eastern Europe has not eased, as forests in that region are being felled to try and stop the spread of bark beetle, which is killing large tracts of forest. Often the cost of felling the infected trees is greater than the log value but the motivation for felling is to preserve the remaining forests. This additional felling of beetle-infested timber has resulted in more spruce and fir logs becoming available for Chinese buyers.

The availability of cheap imported lumber is also adding to the oversupply situation in China. Sawn timber is reported to be available at prices with which it would be difficult for imported logs to compete. Therefore it is possible that we could see the market oversupplied once again, which would push prices back down.

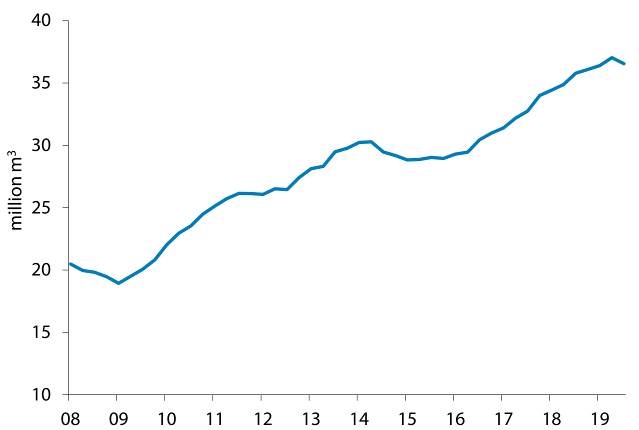
NEW ZEALAND SHIPS LESS LOGS

The supply of logs from New Zealand to international markets has eased but rates are still high by historic measures. During Q3 exports of timber (including logs) were down 14% y/y.

LOCAL HARVEST SLOWS A LITTLE

Timber harvested during Q3 was down 5% on the same time last year and 3.5% back on the previous quarter. Further easing in felling is occurring with some companies looking to extend the Christmas break for harvest crews as a way of managing down supply. Forestry companies are reluctant to lay crews off for fear of not being able to source the labour they require at a later date. Some harvest crew have been redeployed into planting roles.

ROUNDWOOD REMOVALS – ANNUAL RATE TO SEPTEMBER 2019



Source: MPI

ALTERNATIVE MARKET DEMAND STEADY

While China accounts for the bulk of logs shipped from New Zealand, and therefore has the largest influence on prices, other markets do also have some influence.

Demand from India for logs has been steady and the prices on offer in this market often exceed those on offer by China. However, doing business in this market remains challenging due to the lack of credit available for potential purchasers, who regularly report difficulties in obtaining letters of credit.

DOMESTIC MARKET STABLE

Returns from the domestic market have been relatively better than the export market, meaning a little more demand from mills for logs. This local demand has helped to reduce export volumes. Domestic prices are pretty flat at present, as pricing in this market tends to be more stable than international prices and tends to lag that market.

Building consent data has been strong recently although mills are reporting this hasn't transferred into as much timber demand as they would have expected. The total number of residential building consents issued in the three months to September 2019 was up 20% y/y. However, the percentage lift in the number of apartments and townhouses consented was greater than the number of houses, meaning the quantity of timber required won't be as great as the headline numbers indicate. Nevertheless the consent data indicates the uptick in local timber demand should be greater than what is occurring.

The price being paid locally for lumber is generally better than what is on offer in the export markets. Even with logs at slightly cheaper rates there is little incentive for mills to produce lumber for export markets. Therefore mills are trying to sell as much timber as possible on the local market. At present the normal seasonal increase in summer building projects is helping bolster immediate demand.

HIGHER SHIPPING COSTS

Shipping costs are expected to rise as the costs of low-sulphur fuels are passed on. While the new fuel regulations don't come into play until the beginning of January, additional costs have been added to container freight rates from the start of December. This will increase the cost of exporting lumber, further increasing the incentive for mills to sell timber locally.

HORTICULTURE

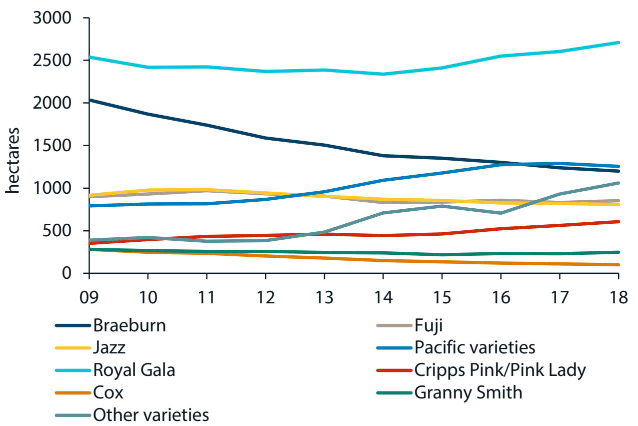
HORTICULTURE SECTOR GROWING STRONGLY

The horticultural sector is recording steady growth incentivised by strong returns. Kiwifruit green-field site developments are continuing while the apple industry is investing in newer varieties that deliver significantly better returns.

APPLES: INDUSTRY POISED FOR GROWTH

The pip fruit industry continues to expand, although future growth is expected to be curbed by access to water for irrigation and a shortage of labour for picking and packing.

AREA PLANTED FOR SELECTED APPLE VARIETIES



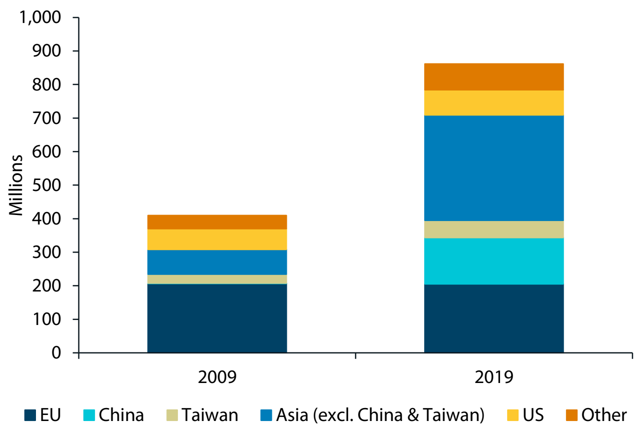
Source: NZ Apples & Pears Inc

The area planted in apples is estimated to have increased by 3.5% this year following a lift of approximately 4% last year. Strong returns from international markets, particularly for the newer varieties, are providing the confidence growers need to invest in their orchards. Not only is the area planted in apple trees increasing; planting regimes are intensifying, resulting in greater yields per hectare, and existing orchards are also transitioning to new varieties.

The popularity of Braeburn apples has fallen away sharply in recent years and this season Braeburn apples have been difficult to move, resulting in a large portion of the crop simply being juiced. Orchardist are rapidly replacing Braeburn trees with newer varieties more suited to the tastes of Asian buyers. This has resulted in an increase in planting of Jazz as well as the various Pacific varieties which include Pacific Queen, Pacific Rose, and Pacific Beauty. Other varieties in vogue at present include Rockit™ (a miniature apple), Envy™, Dazzle™, Posy, as well as a new variety of pear called Piqa®Boo®, which doesn't really look like a pear at all.

Virtually all of the increase in export volume and returns has come from increased sales to Asia. In the past decade returns from the European markets have fluctuated but returns from Europe are virtually unchanged from a decade ago. Asia now accounts for nearly 60% of export returns, with China alone responsible for 16% of export revenue.

APPLE EXPORT RETURNS BY MAIN MARKET (12 MONTHS TO SEPTEMBER)



Source: StatsNZ

HORTICULTURE

KIWIFRUIT: STRONG RETURNS FORECAST

The kiwifruit exporting season has drawn to a close with the last shipment of kiwifruit now on its way to market.

Over the course of the season Zespri supplied 74 million tonne of SunGold and 73 million tonne of Green fruit to local and international markets. The total volume of kiwifruit processed this year was the second largest on record and the first time that SunGold volumes were greater than Green.

The season hasn't been without its challenges. The long hot summer mean fruit matured earlier than normal but slightly below optimal size. The average size of SunGold harvested was 29.5 (based on the average number of fruit per tray) while Hayward averaged 32.9.

Now that local supply is exhausted for the season supply from the Northern Hemisphere growers will fill the gap, ensuring customers have access to Zespri fruit throughout the year.

Zespri report that over 2 million trays of Northern Hemisphere-produced SunGold have been delivered to date, noting that the transition to Northern Hemisphere product occurs at different times in each market based on the relative transit times.

Forecast orchard gate returns for fruit harvested earlier this year were revised in October, with the price of most varieties lifting slightly from previous guidance.

2019/20 FORECAST AVERAGE PRICES AS AT OCTOBER

Pool (variety)	Price per tray	Return per ha
Green	$6.54	$66,023
Organic Green	$9.45	$61,201
Green 14	$7.58	$43,088
Gold	$11.41	$155,889

Source: Zespri

Looking ahead, Zespri have lifted their five-year forecast orchard gate prices, but still maintain that the current price being attained for SunGold is not sustainable. For SunGold, the forecast range has been increased to $8-10 per tray from an earlier forecast of $7-9 per tray. The lower end of this range accounts for price risk associated with a higher volume season, a poor taste season, and/or market side risks.

At present Gold Organic fruit are priced at the same level as conventional SunGold, but once it moves into its own price pool the organic fruit is expected to attract a price premium of $1.40-$2.20 per tray.

Green kiwifruit is forecast to return between $5.50 and $7 per tray. This equates to an average price of $60,000-$70,000 per hectare. The price range allows for significant changes from year-to-year in terms of volumes and also material new plantings of Hayward fruit. Organic Green is forecast to return $9-10 per tray, or $55,000 to $70,000 per hectare.

The kiwifruit industry is expected to keep growing rapidly. Zespri has confirmed there will be 750 ha of SunGold license released in 2020, of which 50 ha will be organic. They also plan to release 150 ha of a new variety, Zespri Red, in 2020 but will not proceed with the Green11 variety which it deemed to be too similar to Hayward to earn a premium.

Zespri Red is an early maturing variety with a 4-5 week picking period commencing in mid-March. Modelling work done to date indicates it may yield about 10,000 trays per ha when mature. This is similar to the yields being achieved by Zespri Green, but considerably lower than SunGold.

Further work is needed to estimate orchard gate returns (OGR's) for this variety but early estimates by Zespri indicate a return of 100,000 per ha which would be less than SunGold but greater than returns from green kiwifruit.

Zespri shares traded between $8.80 and $9.00 during October and November. Zespri has announced an interim dividend of 8c per share will be paid in December. The company has not yet assessed the financial implications of the release of the new red variety.

RURAL PROPERTY MARKET

SALES VOLUMES STILL LOW

The rural real estate market has been active recently with elevated numbers of listings and a little more buyer interest, but it has still been difficult to secure sales. Differing price expectations between buyers and sellers continue to hinder deals being struck..

BUYERS' MARKET

The prices being attained for dairy properties vary considerably from property to property with little consistency in trends. Prices have generally eased but it is difficult to say by exactly how much.

Good-quality land is still selling well providing there is limited risk of future environmental regulations negatively impacting production. However, properties where production potential may be curbed by new regulations, or properties that require significant capital investment to meet these rules, are being heavily discounted. It remains a buyers' market.

REINZ data for the three months to October shows 260 rural properties changed hands, virtually the same level of activity as at the same time the previous year, when 263 farm sales occurred. Of these sales just 11 properties were dairy farms, which puts the volume of dairy properties traded at exactly the same levels as a year ago.

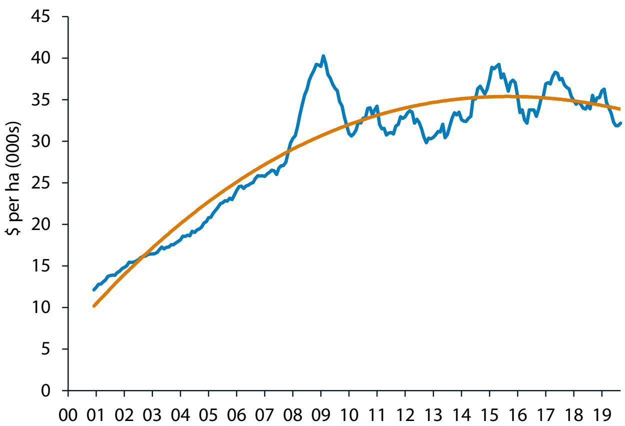
Finishing and grazing farms made up the majority of the farms sold in the three months to October 2019. Despite the current strength in the sheep and beef sectors, the number of farms changing hands was still lower than the corresponding period a year ago.

Horticulture blocks continue to attract interest from perspective buyers due to excellent cash-flow opportunities. The median price paid for horticultural blocks has lifted over the past 12 months by approximately 9%. However, there is huge variation in the type of blocks being sold and their prospective uses, meaning comparisons across the horticultural sector are of little value. The average size horticultural block sold in the past three months was seven hectares.

DAIRY PRICES EASING

Dairy land prices are generally easing but the limited number of sales, the differences in the quality of the properties, and the varying prices being achieved all make it difficult to ascertain current values.

DAIRY MEDIAN PRICE – 12 MONTH ROLLING AVERAGE



Source: REINZ, ANZ Research

Properties are being valued much more on their productive potential, rather than including a margin for capital gain as has previously been done. While just 11 dairy properties changed hands in the three months to October, we do expect to see a slight uptick in volumes in the coming months as the number of sales reported appears to have lifted in November.

The low number of sales means price indices have bounced around. The Dairy Price Index for October lifted 5.9% m/m. While the index supposedly accounts for variations in the quality of farms, the most recent upward movement in this data does seem to go against the current trend.

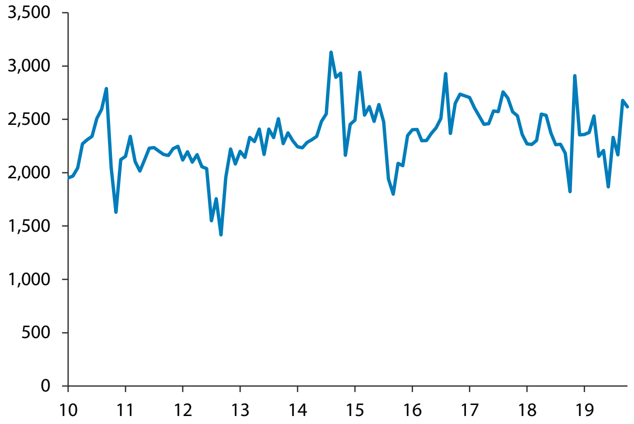
FARM PRICE INDICES

3-Month Seasonally Adjusted		Current Period	Previous Period	Last Year	Chg. P/P	Chg. Y/Y
Dairy	Median Price (per ha)	2,618	2,677	1,823	↓	↑
	Median Price	2,173	2,009	1,593	↑	↑
All farms	Median Price (per ha)	2,531	2,510	2,678	↑	↓
	Median Price	3,926	3,869	3,902	↑	↑

Source: REINZ

RURAL PROPERTY MARKET

DAIRY PRICE INDEX



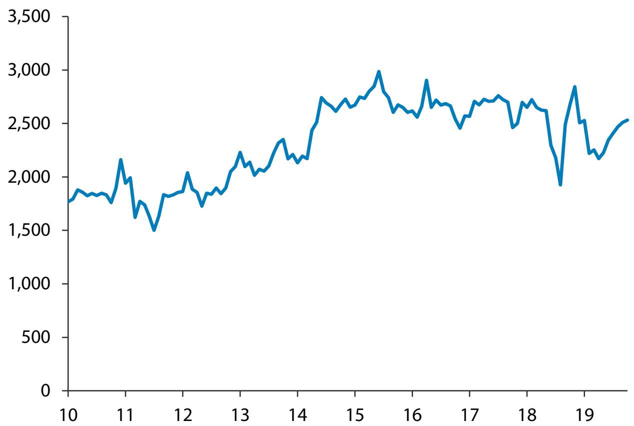
Source: REINZ

FINISHING FARMS IN DEMAND

Demand for finishing farms has seen the median sale price lift 4.8% over the past year. In the three months to October, 62 finishing properties changed hands, along with 86 grazing farms. While the number of sales was a little lower than the same time last year, there is plenty of interest in sheep and beef properties. Strong returns for meat are certainly adding some buoyancy to this sector.

The REINZ All Farm Price Index softened 0.5% y/y in October. Sales activity in the three months to October was stronger than normal in the Manawatu/Whanganui region and also in Bay of Plenty. Demand for blocks for greenfield development for kiwifruit continues to underpin the market in the Bay of Plenty.

ALL FARM PRICE INDEX



Source: REINZ

ECONOMIC OVERVIEW

GLOBAL ECONOMY REMAINS VULNERABLE

Global economic growth remains subdued but is showing tentative signs of improving. Trade tensions have eased somewhat but the US and China appear to be no closer in reality to reaching a trade deal than they were a year ago. Therefore plenty of uncertainty remains in the global markets.

Locally the 'hard' economic data is still pointing in a negative direction, but like the international data, there are some tentative signs the economy is starting to improve.

New Zealand's economy has benefited from strong food commodity prices, which, combined with the low exchange rate, is helping our terms of trade and pumping more money into our rural economies.

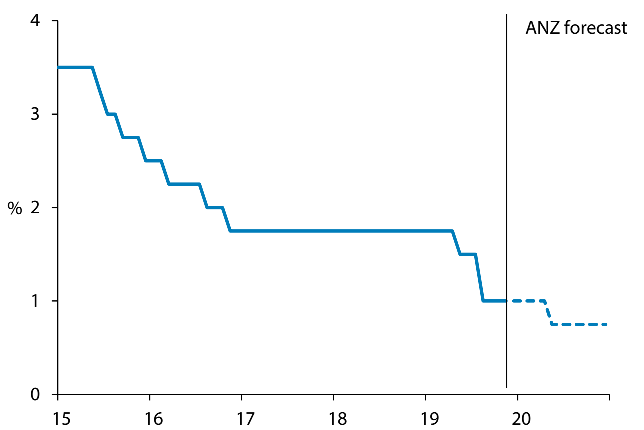
Employment levels remain high with the lack of available employees constraining economic growth. Net migration continues to contribute meaningfully to economic growth though it is off its highs.

Consumer spending in New Zealand remains robust, as it does in most parts of the world. However, business confidence remains subdued, despite a recent bounce, and parts of the service sector are not doing so well. The service sector has become an increasingly important part of New Zealand's economy.

MORE STIMULUS – IN TIME

Therefore we still believe the RBNZ will conclude that there is a need for more stimulatory policy next year. In addition the Government has indicated some fiscal stimulus, but thus far we've seen few details aside from promising more money for schools. Further details are expected to be revealed on in the Half-Year Economic and Fiscal Update, which will be released on December 11.

RBNZ OFFICIAL CASH RATE



Source: RBNZ, ANZ Research

We do not believe growth will accelerate as rapidly as the Reserve Bank anticipates. We therefore expect the Reserve Bank will cut interest rates by a further 25 basis points in May 2020.

GLOBAL GROWTH SLOWS

Global economic growth of 3% is forecast for 2020 by the International Monetary Fund, with the developing economies delivering a larger portion of growth than the developed nations.

Economic growth in most of Europe remains subdued, but with interest rates already very low, and in some cases in negative territory, there is little scope for the European Central Bank to use monetary policy to foster growth.

China is expected to achieve economic growth near its 6% target this year, but it may be more challenging to achieve this level next year. While questions are being asked about the way China's economy is being run and measured, there is no doubt this economy is growing. China current demand for food, particularly proteins, is certainly real and this demand is helping our own economy.

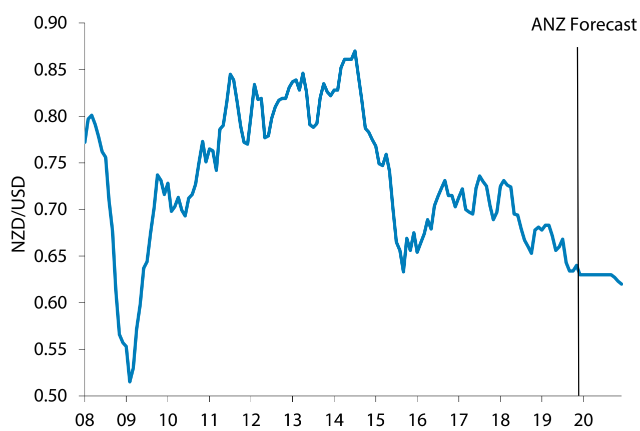
Demand from China for our food commodities has helped lift our terms of trade to near record levels.

NZD TO TREND DOWN FURTHER

Despite the Reserve Bank holding interest rates at 1% in November, against market expectations, the New Zealand dollar hasn't appreciated a lot. Our currency continues to be impacted by global risks, which are keeping its value subdued.

When global risks do genuinely fade then we would expect to see an upward response from our currency. But for now we expect to see further mild downside in the NZD relative to the USD.

NZD BUYS USD



Source: ANZ, Bloomberg

KEY FORECASTS

FX RATES	ACTUAL			FORECAST (END MONTH)					
	Oct-19	Nov-19	6-Dec	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
NZD/USD	0.641	0.642	0.654	0.63	0.63	0.63	0.63	0.62	0.62
NZD/AUD	0.930	0.950	0.958	0.94	0.94	0.95	0.95	0.94	0.94
NZD/EUR	0.575	0.583	0.589	0.57	0.58	0.57	0.57	0.55	0.55
NZD/JPY	69.28	70.31	71.15	68.7	69.9	70.6	70.6	69.4	69.4
NZD/GBP	0.496	0.497	0.497	0.49	0.48	0.47	0.47	0.46	0.45
NZ TWI	68.89	69.64	72.50	68.5	68.9	68.8	68.7	67.3	67.0

INTEREST RATES	ACTUAL			FORECAST (END MONTH)					
	Oct-19	Nov-19	6-Dec	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
NZ OCR	1.00	1.00	1.00	1.00	1.00	0.75	0.75	0.75	0.75
NZ 90 day bill	1.10	1.23	1.20	1.24	1.12	0.95	0.95	0.95	0.95
NZ 10-yr bond	1.31	1.29	1.47	1.20	1.30	1.17	1.40	1.30	1.55
US Fed Funds	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75
US 3-mth	1.90	1.91	1.89	2.05	1.90	1.90	1.90	1.90	1.90
AU Cash Rate	0.75	0.75	0.75	0.75	0.50	0.25	0.25	0.25	0.25
AU 3-mth	0.93	0.89	0.89	0.95	0.70	0.45	0.45	0.45	0.45

ECONOMIC INDICATORS	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21
GDP (% q/q)	0.5	**0.4**	**0.5**	**0.5**	**0.6**	**0.6**	**0.5**	**0.6**	**0.6**
GDP (% y/y)	2.1	**2.2**	**2.0**	**1.9**	**2.0**	**2.2**	**2.2**	**2.3**	**2.3**
CPI (% q/q)	0.6	0.7	**0.2**	**0.6**	**0.3**	**0.5**	**0.2**	**0.6**	**0.4**
CPI (% y/y)	1.7	1.5	**1.6**	**2.0**	**1.8**	**1.7**	**1.7**	**1.7**	**1.7**
LCI Wages (% q/q)	0.8	0.6	**0.6**	**0.4**	**0.8**	**0.6**	**0.6**	**0.4**	**0.8**
LCI Wages (% y/y)	2.2	2.3	**2.3**	**2.4**	**2.3**	**2.3**	**2.3**	**2.3**	**2.4**
Employment (% q/q)	0.6	0.2	**0.3**	**0.3**	**0.3**	**0.3**	**0.3**	**0.4**	**0.4**
Employment (% y/y)	1.4	0.9	**1.1**	**1.4**	**1.2**	**1.3**	**1.3**	**1.4**	**1.4**
Unemployment Rate (% sa)	3.9	4.2	**4.3**	**4.4**	**4.4**	**4.5**	**4.5**	**4.5**	**4.5**
Current Account (% GDP)	-3.4	**-3.4**	**-3.4**	**-3.6**	**-3.7**	**-3.8**	**-3.8**	**-3.7**	**-3.7**
Terms of Trade (% q/q)	1.4	1.9	**-1.1**	**1.2**	**0.3**	**0.1**	**0.3**	**0.0**	**0.1**
Terms of Trade (% y/y)	-1.0	1.0	**3.2**	**3.4**	**2.2**	**0.5**	**1.9**	**0.8**	**0.6**

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

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