

# Commodities Weekly

## Commodity Price Index still up YOY, retreats short term

ECONOMICS

24 Sep. 08

### CBA NZ Commodity Price Indices

As at Friday, 19 September 2008.

Series	Index *	Week %	Year % **
Total NZD	164.3	-2.9%	2.2%
Total SDR	150.9	-0.9%	-5.8%
Total USD	171.1	0.1%	-5.2%
Dairy USD	194.3	-2.3%	-25.8%
Sheep/beef	182.7	3.7%	23.7%
Forestry	125.3	1.2%	0.9%
NZD/USD	0.6690	-4.7%	-3.2%

\* For all indices 1997 average = 100

\*\* Percentage change since same week last year

Sheep and Beef prices once again held the CBA NZ Commodity Price Indices up over the past week, with Dairy sliding again. Fonterra has confirmed last year's record shareholder payout of \$7.90/kg and decreased 2009 season payouts to \$6.60 following a weakening in world dairy markets.

The Sheep and Beef index is up considerably year on year, although some recent upwards movement has been offset by a slight increase in the NZD over the past week following the world financial market turmoil. NZX Agrifax reports that its Lamb Indicator is up 152c per head in local currency. A 16 kg lamb is now fetching \$81.07, significantly higher than in previous years. Indication of numbers of lambs will soon be available and contract prices for EU supply will soon be negotiated for Christmas feasts. The next few weeks should provide a good indication of the lamb price expectations for the coming year.

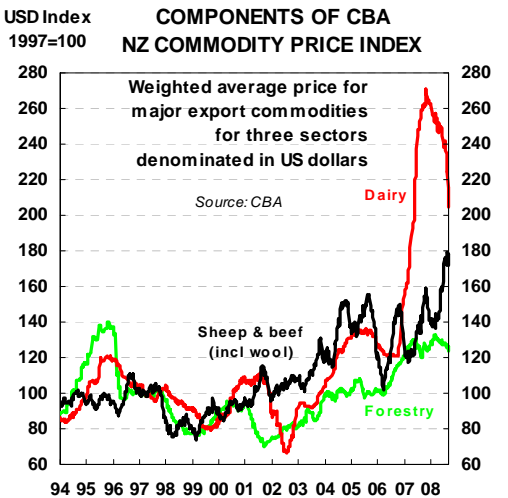
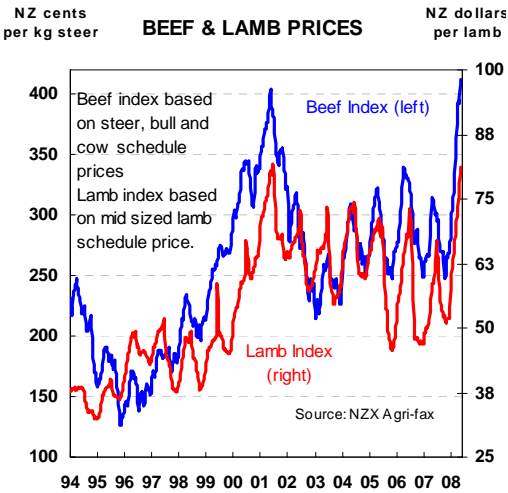
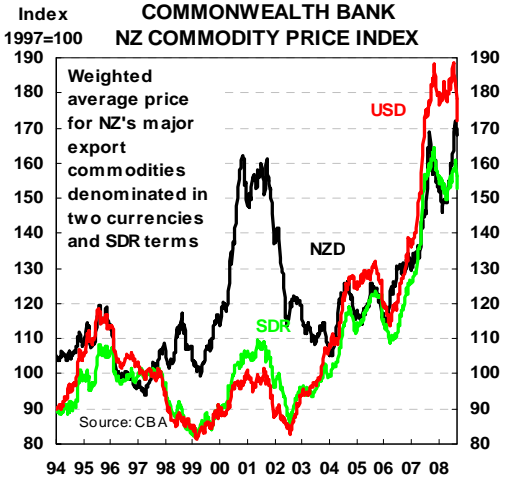
Beef prices remain strong, although there has been little movement in the price during the past few weeks as demand in the US has eased off. We note that Beef prices in local currency are up 25.2% on this time last year.

Dairy prices have eased again, with Whole Milk Powder now joining Skim Milk priced under \$3,000 USD per tonne mark. Fat-based product seems more resilient in the current market, with Butter actually increasing in NZD terms over this time last year.

Over time we expect the NZD to continue to gradually weaken further against the USD, but has a good bounce in the short term.

**Guest dairy comment from Professor William C Bailey, Chair, Department of Agriculture, Western Illinois University.**

Although world dairy prices were down again from previous **See over.**



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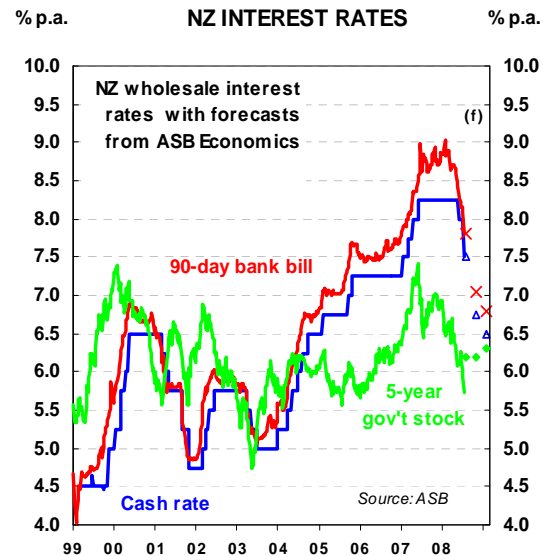
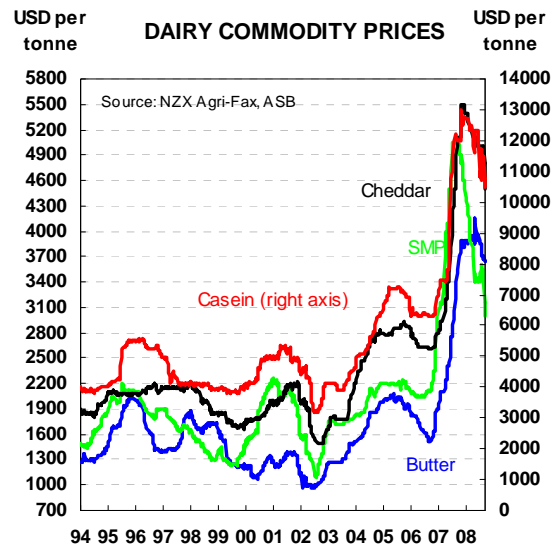
levels, the decline was not as large as seen in the past several weeks. US butter prices, differing from world price trends, moved up to the highest level seen for several years. How long the higher US butter prices will last is another question, in view of reported weak butter demand – both domestically and internationally. Adding to downward price pressure is the drop in corn and soybean prices, which have declined about 30% from the highs seen earlier in the year, potentially providing a boost to production.

US milk production for August was up 1.5% from last year, with the boost a result of more cows being milked rather than an increase in productivity. August output per cow was actually down from last August levels. The modest production increases in July and August, after good growth in May and June, points toward US production for the year growing about 1% above last year's level. Elsewhere, last week there was not much additional moisture for dairy areas in Australia and Argentina. Brazil and Uruguay both received some good rains.

The contaminated milk situation in China continues to evolve. Two aspects of the problem are: 1) What happens to the companies, such as Fonterra-owned Sanlu, which are subsidiaries of overseas entities? and, 2) What are the potential impacts on world dairy prices? Current indications are that the Chinese government will slow, if not halt, domestic Chinese dairy production, for a period of time. This reduction in output will clearly put an unexpected drain on the resources of the investors, such as Fonterra. And, with domestic production most likely declining for a period of time, China will need to turn to the world market to source product, helping to boost international dairy prices.

**Interest Rates**

- Following the RBNZ's surprise 50 basis point cut, **Bank Bill Yields** continued to fall, particularly as expectations of another 50 basis point cut in October increased. However, following the Fed bailout of AIG liquidity concerns resulted in bank bills spiking up in the latter part of the week, finishing 9 bp up on last week.
- We expect another **50 basis point** cut in October, as we are putting weight on the Governor wanting to keep driving effective lending rates down. Recent failures, buy-outs and rescue packages of US and UK financial institutions have put risk aversion at extremely high levels. This spells potential for further pressure on global funding costs, which the RBNZ will want to try offset by as much as is practicable. Chance of a **further 50bp cut in December** is rising, although much can still happen between now and December.



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