

1st Quarter 2009

Dairy Farm Prices Likely to Drop Back

➡ World Commodity Prices Still Down; Reduced Payout to Impact

Dairy farm prices across New Zealand surged dramatically during 2008 as the spin off from high world commodity prices and a record payout to farmers generated strong confidence in rural markets. But in 2009, market forces appear to be heading in a different direction. The deepening global recession, depressed commodity prices and a succession of revised lower payouts (which manifested itself in the latter half of 2008) are expected to result in weaker rural statistics later this year.



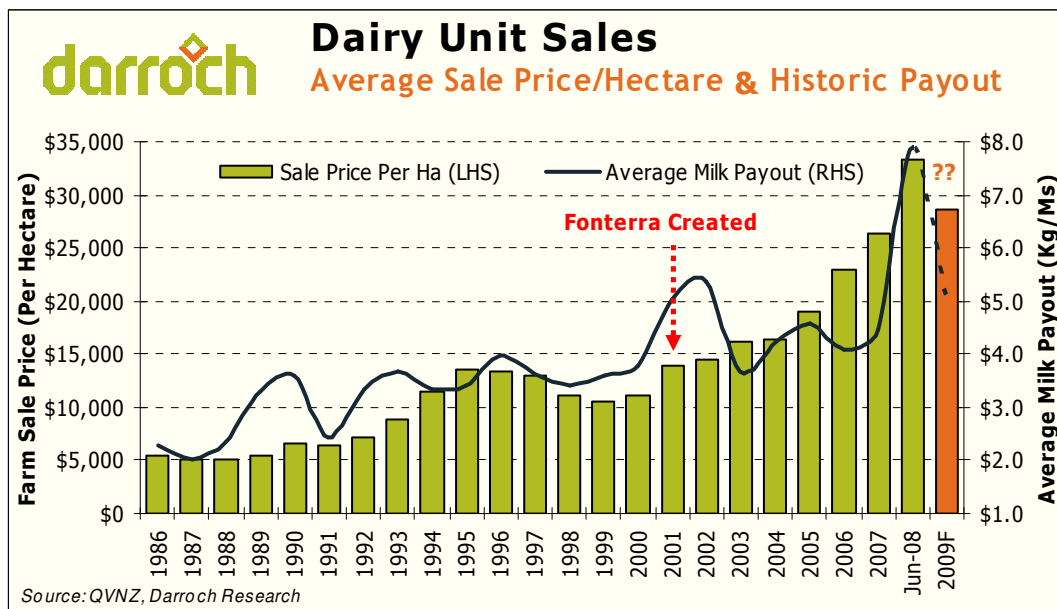
According to QV data, the average price of a dairy unit sold during the first half of 2008 was \$4.8 million (6 months ending 30 June 2008). This is the highest price recorded by QV, and is well up on the \$3.8 million achieved during all of 2007. The dramatic rise in the price of dairying land reflected the unexpected boost to dairy farmers' income by way of a record payout of \$7.90 per kilogram of milk solids (kg ms) for the 2007/2008 season where the average farmer received \$800,000. With more income available from the payout, competition for dairying land amongst potential purchasers heightened. Existing farmers sought to increase their land holdings (especially amalgamation), while share-milkers also found themselves in the best financial position in years to buy a farm. Some older, established farmers took the opportunity to exit while market conditions were in their favour. Along with a shortage in available farms, demand for dairying land surged, and so too did price.

Now 2009 looks set to test dairy farmers' resolve on paying top prices for dairy farms. With projected income to be slashed (latest forecasted payout of \$5.10 per kg ms for the 2008/2009 season), and no real improvement in world commodity prices, it seems logical that farmers will adjust their expectations of price to meet current income generation. Dairy farm prices fell by about 15% during the Asian Crisis of the late 1990's; a time when commodity prices also declined. Economists are predicting commodity prices to remain weak for most of 2009. In the past, many farmers have been able to shake off short term income issues by adopting a long term strategic view, but the dramatic fluctuations in market price/revenue experienced in the past two years is unprecedented. Given the gloomy outlook, farmers (and other investors) are likely to adopt a more conservative stance until more stable economic conditions return.

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Growth in farm prices has been a feature of the New Zealand agricultural landscape since Fonterra was established in 2001. Now the sixth largest dairy company in the world, the cooperative has consolidated New Zealand's dairy farming community and spearheaded the drive to seek out new markets. The growth in dairy farming has been in contrast to the sheep/beef sector, which has spent most of this decade enduring static commodity prices for beef and wool with rising overheads. Attempts to develop a cooperative similar in size and scale to Fonterra remain in the pipeline. The past decade has already witnessed a high number of sheep and beef farms being converted to dairying, where land contour, access and water supply has been suitable to facilitate this. Other smaller dairy farms have been snapped up by adjoining dairy owners for amalgamation as they strive for economies of scale.

Although demand for dairy farm prices has been exceptionally strong over the past decade, comparing average price is (strictly speaking) not the best indicator of price growth. This is largely because the average farm size has been increasing, and ceteris paribus, one would expect overall prices to rise as well. The best indicator is perhaps "rates per hectare" (see chart below), which helps to overcome the issue of size. In particular, the chart illustrates just how spectacular the growth in dairy farm prices has been over the past four years.



At the beginning of this millennium, the average sale price for a New Zealand dairy unit equated to \$11,100 per hectare. By 2004 this had risen to \$16,300 per hectare, before rising dramatically to \$33,000 per hectare in 2008. Amalgamation is effectively reducing the number of farms available for sale as each year passes (see chart over) which contributes to scarcity. However, Darroch Valuations feels that prices are likely to reduce in the short run until economic conditions recover. We anticipate that the price will probably fall back under \$30,000 per hectare, although the severity of the fall could be cushioned if the export outlook improves. Likewise, a sustained global outlook might depress land prices further.

Dairy commodity prices have fallen back to levels seen in early-mid 2007, and farm prices appear to be heading in the same direction. According to ANZ Commodity Price Index, dairy prices are down -40% from the September 2007 peak of 203.3 (now 122.0), which highlights a loss of real income. Only falling interest rates are perhaps providing partial relief to farmers at this time.

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| World Price Indices (July 1986=100) | | | | NZD Price Indices (July 1986=100) | | | | |
|-------------------------------------|-------------------------|----------------|--------------------|-----------------------------------|-----------------------|----------------|--------------------|----------------|
| | World Price Index (USD) | Monthly Change | Dairy Prices (USD) | Monthly Change | NZ Dollar Index (NZD) | Monthly Change | Dairy Prices (NZD) | Monthly Change |
| Dec 06 | 164.0 | | 159.7 | | 128.7 | | 119.4 | |
| Jan 07 | 166.2 | 1% | 167.5 | 5% | 129.7 | 1% | 124.9 | 5% |
| Feb 07 | 168.6 | 1% | 176.9 | 6% | 131.9 | 2% | 132.1 | 6% |
| Mar 07 | 172.0 | 2% | 189.1 | 7% | 134.0 | 2% | 140.3 | 6% |
| Apr 07 | 180.4 | 5% | 211.3 | 12% | 133.9 | 0% | 149.1 | 6% |
| May 07 | 185.1 | 3% | 223.6 | 6% | 137.5 | 3% | 158.0 | 6% |
| Jun 07 | 196.7 | 6% | 252.7 | 13% | 141.2 | 3% | 172.8 | 9% |
| Jul 07 | 205.7 | 5% | 272.4 | 8% | 142.7 | 1% | 179.4 | 4% |
| Aug 07 | 208.6 | 1% | 280.9 | 3% | 156.9 | 10% | 200.7 | 12% |
| Sep 07 | 209.4 | 0% | 281.8 | 0% | 159.3 | 2% | 203.3 | 1% |
| Oct 07 | 213.1 | 2% | 289.4 | 3% | 153.2 | -4% | 197.0 | -3% |
| Nov 07 | 214.7 | 1% | 291.9 | 1% | 154.5 | 1% | 197.8 | 0% |
| Dec 07 | 214.7 | 0% | 286.6 | -2% | 153.1 | -1% | 192.9 | -3% |
| Jan 08 | 211.7 | -1% | 277.5 | -3% | 150.3 | -2% | 186.3 | -3% |
| Feb 08 | 214.0 | 1% | 272.7 | -2% | 147.0 | -2% | 177.1 | -5% |
| Mar 08 | 218.3 | 2% | 275.7 | 1% | 150.1 | 2% | 178.1 | 1% |
| Apr 08 | 217.7 | 0% | 262.3 | -5% | 151.8 | 1% | 171.7 | -4% |
| May 08 | 219.7 | 1% | 259.7 | -1% | 155.6 | 3% | 172.9 | 1% |
| Jun 08 | 219.6 | 0% | 256.7 | -1% | 158.8 | 2% | 174.6 | 1% |
| Jul 08 | 223.5 | 2% | 258.0 | 0% | 163.2 | 3% | 176.8 | 1% |
| Aug 08 | 216.0 | -3% | 238.6 | -8% | 166.4 | 2% | 174.2 | -2% |
| Sep 08 | 204.9 | -5% | 211.6 | -11% | 164.6 | -1% | 162.5 | -7% |
| Oct 08 | 189.4 | -8% | 190.6 | -10% | 165.3 | 0% | 161.2 | -1% |
| Nov 08 | 175.4 | -7% | 167.3 | -12% | 162.9 | -1% | 153.5 | -5% |
| Dec 08 | 162.5 | -7% | 146.5 | -12% | 153.0 | -6% | 136.0 | -11% |
| Jan 09 | 155.5 | -4% | 128.5 | -12% | 146.4 | -4% | 120.6 | -11% |
| Feb 09 | 148.3 | -5% | 121.3 | -6% | 149.2 | 2% | 122.0 | 1% |

Source: ANZ Commodity Price Index

As the records show, 2007 was an exceptional year for world dairy prices; they jumped a staggering 83% between December 2006 (159.6) and November 2007 (291.9). The NZ Index itself (adjusted for currency fluctuations) rose 70% between December 2006 (119.4) and September 2007 (203.3).

Farm sizes are getting bigger, meaning the number of farm sales is declining

