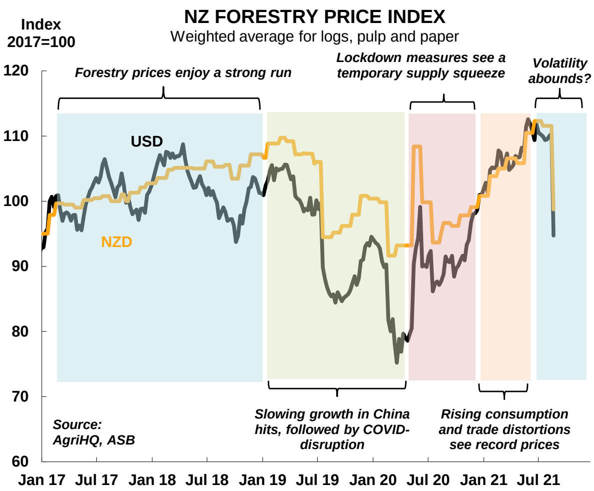
Commodities Weekly

For the week ending Friday 20th August

A week of it

We've re-evaluated a number of our forecasts in light of NZ's move back up Alert Levels last week. While the heavy restrictions under Alert Level 4 snuff out an enormous amount of economic activity, last years' experience suggests there tends to be an enormous amount of catch-up once we move down to level 2 or 3. On the other hand, the much more transmissible Delta variant is a whole different kettle of proverbial fish to the strain of the virus we supressed last year, and the risk of a more sustained lockdown that leaves deeper scars is certainly a possibility. Uncertainty remains high, but we have a few thoughts on the implications for NZ commodity producers below.



On the financial market front, we still expect interest rates to rise substantially by the end of the year. While the RBNZ opted to leave the OCR on hold last week, the tone of its statement clearly indicated the bank was preparing a hike given the strength of the labour market thus far and the likelihood the recent uptick in inflation will be sustained. Subsequent comments from RBNZ have also suggested the bank may hike even if the country remains at Alert Level 4 a while longer (provided we don't start to see the labour market deteriorate). We've pencilled in 75bps of OCR hikes by February next year. So, prepare for interest rates to move higher in the near term, even if there is still some uncertainty around the timing.

On the commodity front, we expect there to be relatively little impact on demand for most major NZ exports. Given food production is an essential service, in theory, much of the agri sector has been largely carrying on as normal (think dairy, meat, seafood and horticulture). And given its the export market that ultimately drives demand for NZ produce, it's the outlook for our major trading partners that's material here. On that front, forecasters still expect global growth to remain above trend over the remainder of 2021.

Having said that, supply chain pressure and anxieties among overseas buyers may drive a bit of near-term volatility. During the last lockdown, one of the most obvious examples of this was a brief surge in dairy prices at auction as overseas buyers bid up prices and rushed to secure supply amid fears of lockdown-driven disruption (we'll have to wait for next week's dairy auction to see if that gets repeated). Similarly, the partial close-down of the forestry industry triggered a log shortage that saw wharfgate prices spiral post-lockdown.

We expect forestry prices may be the among the most impacted commodities this time around too – and the

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lockdown has come at a time where log export prices have fallen sharply. AgriHQ's forestry index fell a whopping 14% in the latest monthly data, amid the usual seasonal slowdown in usage rates in China, a glut in log imports to China of late and perhaps a bit of correction driven by log prices rising too high relative to timber revenue. Given key parts of the industry are in scope of the Level 4 restrictions, sharply lower production should see prices find support over the near term, though that will only partly offset the revenue impact of lower production. Expect prices to be a bit swingy in other words.

Over the medium term, we retain our constructive view on log prices this year, particularly with the looming Russian export ban set to leave a big hole in the global log market. Note too that the domestic market remains strong, and despite the sharp fall this week, the AgriHQ forestry index remains very high in a historical sense.

Uncertainty remains very, very high. This may sound like an obvious truism, but its bears repeating in these circumstances. The key takeaway is still that there's lots we don't know about the path from here on out, and commodity exporters will need to employ some of the same resilience and flexibility they've employed thus far.

ASB Commodities Index

This week, our index was dominated by the fall in forestry prices, down 14.2% in USD terms as discussed above. Other moves in the index paled in comparison to the swing in forestry prices (around 20% of our total index). All-up, our USD index was down 3.8%.

There was a sizable fall in the NZD/USD last week in the aftermath of the step up in COVID Alert Levels and the RBNZ's decision to keep the OCR on hold, falling 3.1% (its since regained a bit of ground). **The upshot saw our NZD index down a modest 0.8%.**

ASB New Zealand Commodity Price Indices
As at Friday 20th August 2021

	Index*	Week %	Year %**
Total NZD	115.2	-0.8%	13.5%
Total SDR	109.1	-3.5%	18.0%
Total USD	111.3	-3.8%	18.5%
Dairy USD	114.8	-0.9%	21.7%
Sheep/beef USD	120.0	-2.3%	27.3%
Forestry USD	94.7	-14.2%	6.7%
Fruit USD	99.7	-3.1%	4.3%
NZD/USD	0.6824	-3.1%	4.4%

** For all indices 2017 average = 100*
*** Percentage change since same week last*

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