# Farmshed Economics

## Six dollar trifecta

April 2017

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**In what is a very rare occurrence, NZ beef, lamb and dairy prices all look similarly healthy. In fact, there is a better than fair chance that all three sectors surpass the $6/kg mark simultaneously at some stage this year.**

The first leg of this trifecta is already in place. This season's milk price is essentially locked and loaded at or slightly above $6.00/kg, while we have $6.75/kg pencilled in for 2017/18.

The second leg of the trifecta is also in place as at the end of April. Indeed, lamb's remarkable price rise this year actually picked pace over the month. Per kg prices (for a 17.5kg lamb) recorded a 7.1% jump over April to $6.00/kg, compared to 5.7% and 3.9% rises over the two months prior, respectively.

Beef prices are, so far, the missing leg. Prices certainly remain healthy, but have yet to rise far enough to confirm the 3rd leg of the $6 trifecta. Indeed, looking at P2 steer prices, the magical $6 mark is still 37 cents or 7% away. So can all three prices get to $6 simultaneously?

We think they can. But in terms of timing, we anticipate that the shortest odds on offer would be for August this year. So is there anything on the horizon that could prevent the beef, lamb and dairy $6 trifecta?

In short yes. At the same time these prices are healthy, there is a risk that a stronger NZD could erode the price gains, delaying the trifecta for another day.

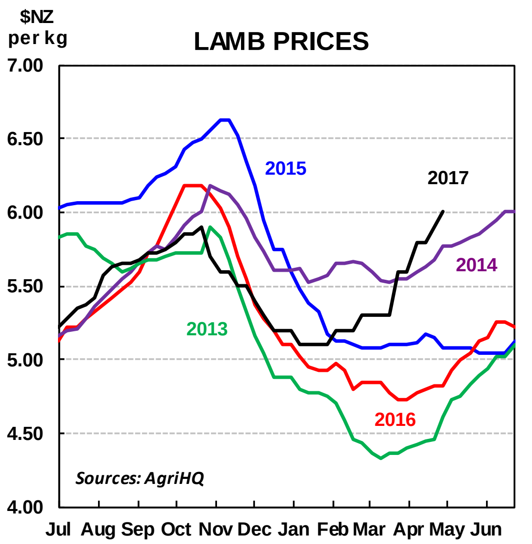
While the price outlook is rosy, we note that these higher prices will induce a supply response at some stage. In particular, we expect lamb supply to rebound in the spring and improved demand may not be able to offset the extra supply. This is likely to see prices moderate. The other cautionary tale is around input prices. With prices (and incomes) in all three sectors healthy (or improving), demand for inputs is likely to rise. In turn, input prices are likely to rise, putting pressure on profit margins. In the case of the beef sector, for example, this dynamic is already underway.

### Key Rural Data:

| *As at 28 April 2017* | Current | 4 wks ago | Year ago | Outlook* |
|---|---|---|---|---|
| **Rural Commodity Prices:** | | | | |
| ASB Dairy Price Index (USD) | 190.4 | 184.6 | 132.9 | ↗ |
| Lamb Price Index (NZD) | 189.9 | 179.5 | 151.7 | → |
| Beef Price Index (NZD) | 259.2 | 268.7 | 238.0 | ↗ |
| Feed Wheat Prices ($NZ/tonne) | 304.0 | 302.0 | 297.0 | → |
| **Interest Rates:** | | | | |
| 90-day bank bills | 1.98 | 2.00 | 2.39 | → |
| 2 year swap | 2.35 | 2.36 | 2.29 | → |
| 5 year swap | 2.93 | 2.97 | 2.55 | ↗ |
| **Exchange Rates:** | | | | |
| NZD/USD | 0.6868 | 0.7007 | 0.6853 | ↗ |
| NZD/CNY | 4.73 | 4.83 | 4.46 | ↗ |
| NZD/GBP | 0.5304 | 0.5583 | 0.4758 | ↗ |
| Milk solids production (ytd % chg]** | -1.3 | -2.6 | -1.5 | ↗ |
| Fonterra Shareholders' Fund | 5.98 | 6.06 | 5.83 | → |

*Direction of change over the next 6 months. **As at March 2017.

### Chart of the Month:




## ? *Rural/Food Fact or Fiction?*

In NZ, the most popular ice-cream flavours are, in order, vanilla, chocolate, and strawberry.

*Answer on page 3*

Nick Tuffley – Chief Economist – 649 301 5659 – nick.tuffley@asb.co.nz Nathan Penny – Senior Rural Economist – 649 448 8778 – nathan.penny@asb.co.nz

# Rural Commodities Outlook

## *Dairy* – 1st leg of the trifecta

| ASB Dairy Index (USD), 28 Apr: | 190.4 ↑3.2% (mpc) |
|---|---|

As a small island nation in the middle of the Pacific, NZ is susceptible to weather shocks. April has been a clear reminder of this fact, with the month just gone likely be the wettest April on record.

Indeed, with Cyclone Cook following quickly in the wake of Cyclone Debbie, the country has been in storm mode for most of the past month. However, the saving grace is that it has come late in the season and followed generally good growing conditions over summer and early autumn (see the March spike in annual production growth). In addition, the major dairying regions have escaped the worst of the production impacts.

That is cold comfort to some areas, though. Dairy farmers in the Bay of Plenty, for example, will be counting the cost of the twin cylcones well into next season.

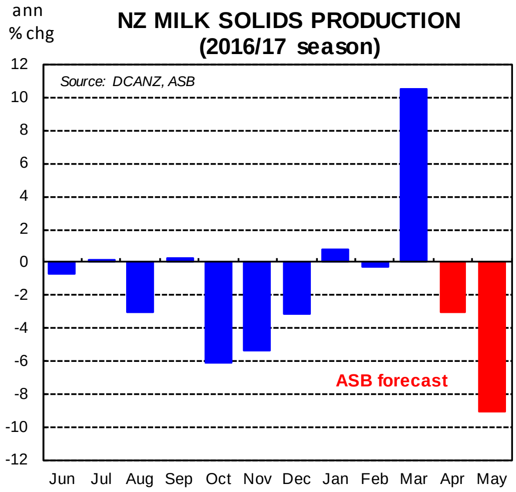
That said, there is a silver lining to the lost production - we now see upside to our $6.00/kg milk price forecast for this season. The recent auction results also bode well for a second-successive firm milk price next season.

In that sense, the first leg of the $6 trifecta has been in place for a while. Indeed in light of our outlook, we expect the first leg to remain in place for the season ahead.

**Season End Milk Price Forecasts:**

| | 2016/17 | | 2017/18 | Long Run |
|---|---|---|---|---|
| | Fonterra | ASB | ASB | ASB |
| Milk Price* | $6.00 | $6.00 | $6.75 | $6.50-$7.00 |

* per kg of milk solids (excluding dividend).




## *Lamb* – 2nd leg of the trifecta

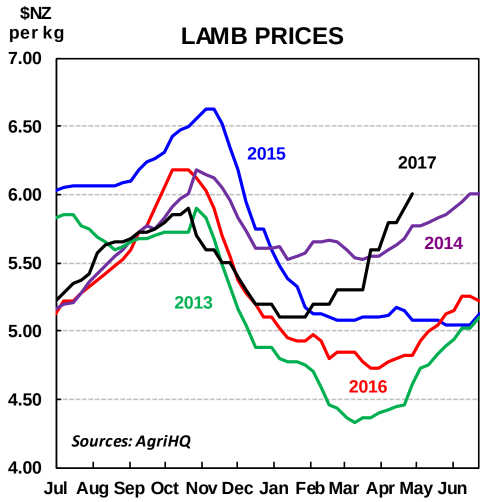
| Lamb Index (NZD), 28 Apr: | 189.9 ↑5.8% (mpc) |
|---|---|

Lamb prices have reached the rarefied air of $6.00/kg (based on 17.5 kg lamb price) as at the end of April – this completes the 2nd leg of the $6 trifecta. Indeed, the already surprising price rise has actually gathered pace; in reaching $6,00/kg, prices recorded a 7.1% jump over April, compared to 5.7% and 3.9% rises over the two months prior, respectively.

The only other time prices have been this high at this time of the year was 2011. Moreover, prices have diverged further from year-ago levels, sitting 24% higher than this time a year ago.

Driving prices higher are very low slaughter rates and the outlook for a further reduction in the NZ lamb crop. For example Beef+Lamb NZ expect a 3.2% fall in lamb export volumes over the remainder of 2016/17.

Looking ahead to the new season, we expect prices to moderate but to remain relatively healthy. Eventually, the support for prices from low slaughter rates will fade. However, we anticipate that improving demand can pick up some of this slack, keeping prices above their recent averages.



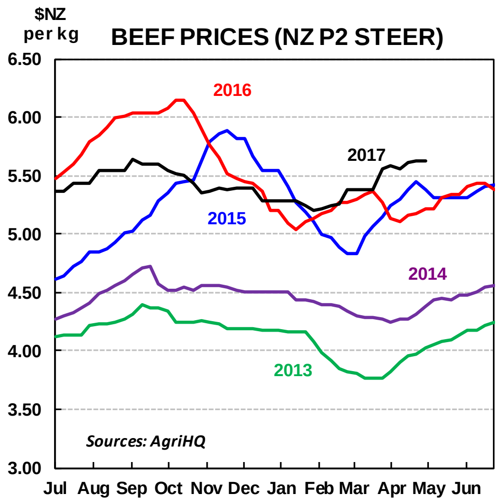

## *Beef* – 3rd leg of the trifecta: awaiting photo finish

| Beef Index (NZD), 28 Apr: | 259.2 ↓-3.5% (mpc) |
|---|---|

Beef prices remain healthy, but have yet to rise far enough to confirm the 3rd leg of the $6 trifecta. Indeed looking at P2 steer prices, the magical $6 mark is still 37 cents or 7% away. So can prices get to $6?

The short answer is yes. The longer answer is also yes, but probably not until spring. With that in mind, it is worth remembering that while beef prices traditionally lift over late autumn and winter, these lifts are normally off the seasonal lows through early autumn. Prices then peak on a seasonal basis come spring.

In other words, the fundamentals supporting beef prices that we have discussed in previous editions of Farmshed Economics largely remain in place. As a result, we expect beef prices to remain healthy heading into next season as well. As to when P2 steer prices reach $6.00/kg – we anticipate that the shortest odds on offer would be for August this year, with a month either side distinct possibilities as well.



# Rural Commodities Outlook (continued)

## *Grains* – Grinding higher

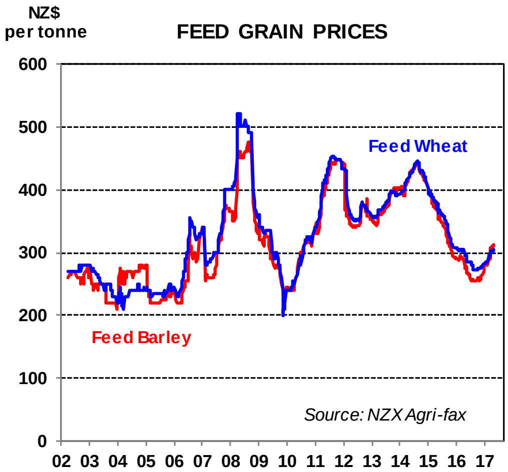
| Feed Wheat, 28 Apr: | $304/tonne ↑0.7% (mpc) |
|---|---|

Feed grain prices have continued to grind higher. Feed barley prices have lifted by a healthy 22% since their September 2016 lows, while feed wheat prices have risen by a more modest, but still significant, 12%.

The continued lift is very much in line with our view back in January. As we noted back in the January edition of Farmshed Economics the steady improvement in dairy farm fortunes have given grain prices a steady boost this year.

Meanwhile, the recent wet weather is also likely to prove a double-edged sword. For some grain producers, the wet weather has delayed or prevented harvest, with grain quality also taking a hit. The flipside of that fact is that the poor harvest is likely to push grain prices higher yet.

All up, we expect grain prices to continue their recent improvement well into the new dairy season, with feed grain prices likely to be back near their 10-year averages by season end.




# Financial Markets Outlook

## *Interest Rates* – Reserve Bank sitting pretty

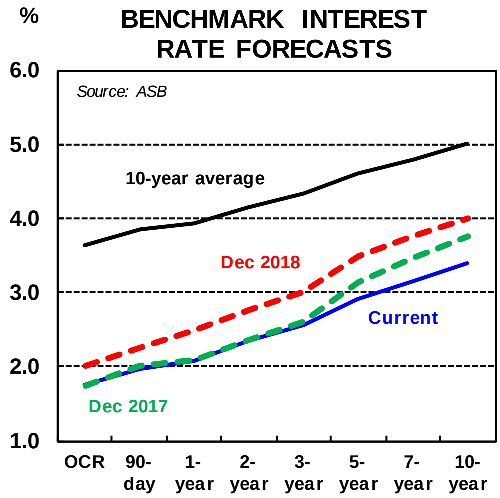
| 90-day bank bills, 28 Apr: | 1.98% ↓ 0.02 (mc) |
|---|---|

Things haven't looked this good for the Reserve Bank (RBNZ) for quite some time. In fact, the March quarter inflation release marked the first time in over five years that inflation printed above the midpoint of the RBNZ's 1%-3% target range.

The RBNZ will be very relieved that with inflation off recent lows, firms' pricing and wage setting decisions all now have a materially higher inflation benchmark to build in. In other words, inflation is likely to beget inflation.

Looking ahead, we expect annual inflation to hover around 1.5% and 2% over the next few years – this firm inflation outlook effectively rules out additional Official Cash Rate (OCR) interest rate cuts.

At the same time, we anticipate that the RBNZ won't be rushing to raise the OCR either. We expect the next move in annual inflation is most likely down. Also, there are few signs of widespread capacity pressures. As a result, we expect the RBNZ to remain on hold over 2017 and most of 2018.




## *NZ Dollar* – As good (low) as it gets

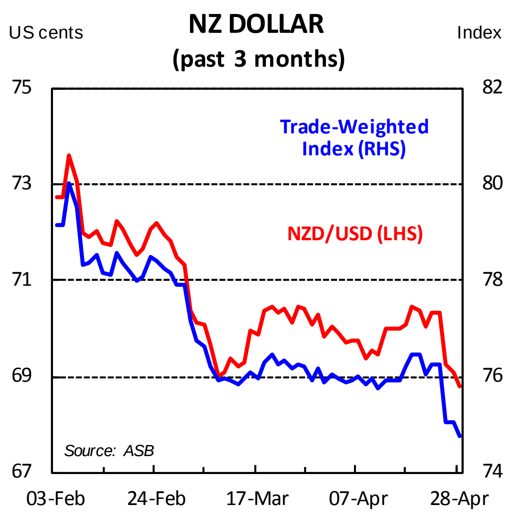
| NZD/USD, 28 Apr: | 0.6868 ↓ -0.0139 (mc) |
|---|---|

Since the last edition of Farmshed Economics, the NZD has dipped further against most currencies. For example, on a trade-weighted basis, the NZD has fallen around 2% over the month.

However, we anticipate that this may be as good (or low) as it gets. In other words, we expect the NZD to drift higher over 2017 and into 2018.

Firstly, as explained above the risks of further Reserve Bank cuts have fallen. This lower risk means that if NZ interest rates do move one way or another, they are more likely to rise; any rise will support a higher NZD.

Secondly, the USD is unlikely to get as much support from President Trump's spending and tax cuts plans as previously thought. So far Trump has had very limited success in getting his policies through Congress. Implementation of his fiscal plans is likely to be delayed until 2018 or even 2019. All up, the risk is that a stronger NZD derails the possibility of the dairy, lamb and beef $6 trifecta.




**Rural/Food Fact or Fiction?**

?

*Answer:* Fiction! While that's the worldwide ice-cream flavour ranking, here in NZ, hokey pokey comes in at number 2, behind vanilla, but ahead of chocolate and strawberry.

| ASB Economics & Research | | | Phone |
|---|---|---|---|
| Chief Economist | Nick Tuffley | nick.tuffley@asb.co.nz | (649) 301 5659 |
| Senior Economist | Jane Turner | jane.turner@asb.co.nz | (649) 301 5853 |
| Senior Rural Economist | Nathan Penny | nathan.penny@asb.co.nz | (649) 448 8778 |
| Senior Wealth Economist | Chris Tennent-Brown | chris.tennent-brown@asb.co.nz | (649) 301 5915 |
| Economist | Kim Mundy | kim.mundy@asb.co.nz | (649) 301 5661 |
| Economist | Daniel Snowden | daniel.snowden@asb.co.nz | (649) 301 5657 |
| Publication & Data Manager | Judith Pinto | judith.pinto@asb.co.nz | (649) 301 5660 |



https://reports.asb.co.nz/index.html
@ASBMarkets

ASB Economics
ASB North Wharf, 12 Jellicoe Street, Auckland