

# Farmshed Economics

## Farewelling a legend

August 2017



ASB

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**In this month's edition of Farmshed Economics we pay tribute to Sir Colin Meads, undoubtedly ASB Rural's favourite All Black.**

Prices for butter took a breather over August. After setting a whopping seven auction record highs this year, butter prices dipped a little over 6% for the month. However, in our view, butter's fall during August is akin to a motor racing pit stop. Pull over, refuel, change tyres and then go again. In other words, we think that butter and milk fat prices can go higher yet.

Importantly for Pinetree's beloved King Country, lamb prices have cracked the \$7.00/kg mark. And there may be more to come as the traditional peak demand period for prices is still a month or two away.

News isn't as good for beef prices, which continue to soften. For example, since the last edition of Farmshed Economics, the per kg price of P2 steers has dipped 1.8%. That said, the outlook for prices is firm for 2017/18, albeit a touch back from the highs seen over the last season or two.

Expenses on farm remain in check, with farm input inflation low. However, watch out for feed-related costs; these are set to rise this season.

The Reserve Bank kept the Official Cash Rate at 1.75% as widely expected on 10 August. In terms of interest rates, the Reserve Bank's stance should help keep NZ short-term interest rates around current low levels. However, longer-term rates may still drift higher, particularly if US benchmark interest rates continue their gradual lift.

Rate of exchange for the NZD has fallen steadily over August. This fall follows a strong July when the NZD reached a high for the year of around US\$0.7540. However, since then the NZD has fallen around three cents against the USD.

Election uncertainty is likely to keep the NZD volatile until a clear election winner emerges.

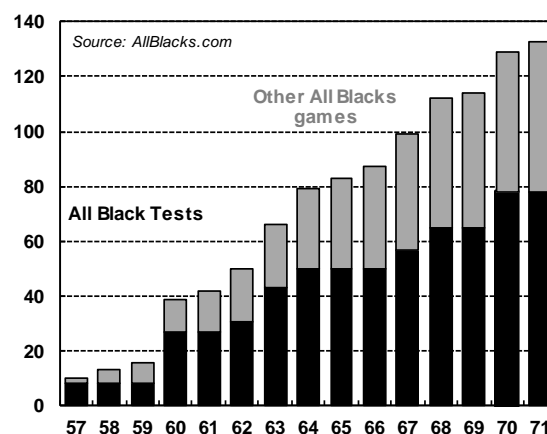
Everyone will agree that there will never be another All Black like Pinetree!

### Key Rural Data:

### Chart of the Month:

As at 25 August 2017	Current	4 wks ago	Year ago	Outlook*
<b>Rural Commodity Prices:</b>				
ASB Dairy Price Index (USD)	202.2	205.1	156.2	↗
Lamb Price Index (NZD)	211.2	208.2	176.1	→
Beef Price Index (NZD)	270.4	273.4	258.0	→
Farm Input Inflation (annual % change)	1.1	0.6	1.6	↗
<b>Interest Rates:</b>				
90-day bank bills	1.94	1.94	2.23	→
2-year swap	2.18	2.22	1.97	→
5-year swap	2.64	2.76	2.08	↗
<b>Exchange Rates:</b>				
NZD/USD	0.7240	0.7513	0.7281	→
NZD/CNY	4.81	5.06	4.84	→
NZD/GBP	0.5618	0.5720	0.5569	→
Milk solids production (ytd % chg)**	20.4	-0.6	-0.7	↘
Fonterra Shareholders' Fund	6.22	6.05	5.94	→

**COLIN 'PINETREE' MEADS  
GAMES PLAYED FOR THE ALL BLACKS**



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



### Rural Rugby Fact or Fiction?

Pinetree made his King Country debut, aged 19. Moreover, it was a debut to remember as he scored a try and a dropped goal.

Answer on page 3

## Rural Commodities Outlook

### Dairy – Pit stop

ASB Dairy Index (USD), 25 Aug: 202.2 ↓ -1.4% (mpc)

Butter prices took a breather over August. After setting a whopping seven auction record highs this year, butter prices dipped a little over 6% for the month.

In the context of this year's price surge, a modest retracement does not come as a surprise. After all, and despite August's price fall, butter prices have still surged by a third to date in 2017 and jumped by around 75% compared to August last year.

The question then becomes where to next for butter. Are prices going to consolidate around this new level or is there something left in butter's tank?

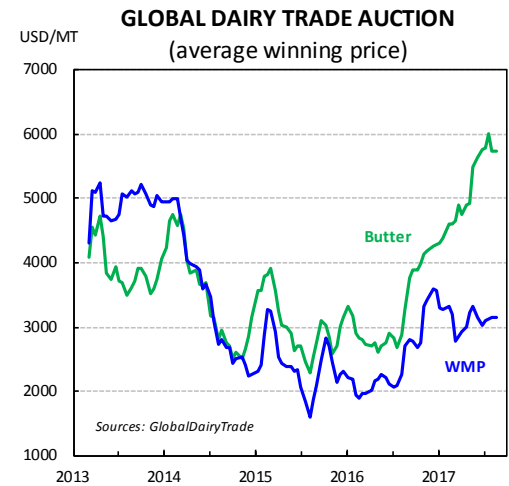
In our view, butter's fall during August is akin to a motor racing pit stop. Pull over, refuel, change tyres and then go again. In other words, we think that butter and milk fat prices can go higher yet.

If we are right, a further surge in butter prices is likely to lift all dairy prices more generally. In turn, such a general price lift would also lift our milk price forecast above \$6.75/kg. Of course time will tell, but in our view butter's race higher is still worth watching.

#### Season End Milk Price Forecasts:

	2016/17		2017/18		Long Run
	Fonterra/ASB	Fonterra	ASB	ASB	
Milk Price*	\$6.15	\$6.75	\$6.75	\$6.50-\$7.00	

\* per kg of milk solids (excluding dividend).



### Lamb – Lucky Seven

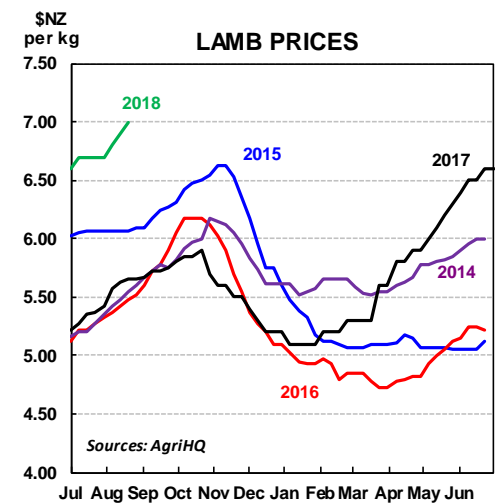
Lamb Index (NZD), 25 Aug: 211.2 ↑ 1.4% (mpc)

Lamb prices have cracked the \$7.00/kg mark. And there may be more to come as the traditional peak demand period for prices is still a month or two away.

Indeed, fears of a lamb export market downturn post the Brexit vote are proving unfounded. Other markets, have picked up the export volume slack. The Middle East, in particular, has increased its share of NZ exports from 6.6% to 9.1% over the period. China and the US too have increased their shares.

Actually, rather than fall, demand has lifted this year. Overall lamb export prices, for example, have lifted 6.6% on the back of firm demand so far this season. Prices have lifted in all markets except the UK.

Heading into the new season, the price outlook is strong. Lamb supply is likely to lift, so prices may come off the boil. But with such a high starting point for prices, the 2017/18 outlook is rosy.



### Beef – Softer, but still firm

Beef Index (NZD), 25 Aug: 270.4 ↓ -1.1% (mpc)

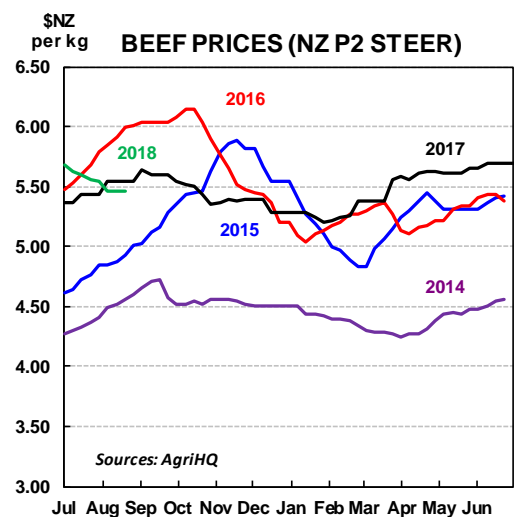
Beef prices continue to soften. For example, since the last edition of Farmshed Economics, the per kg price of P2 steers has dipped 1.8%.

First up, demand from the key US market has pulled back from earlier highs. The other factor in play as we described last month is the lift in Japanese tariffs on frozen beef imports.

That said, beef market fundamentals remain firm. And while prices have softened a touch over the last month, prices remain comparable with a year ago.

As a result, we expect prices to largely track sideways over the remainder of 2017. Supply remains relatively tight here in NZ and is similarly tight across the Tasman. Meanwhile, demand remains supportive of prices at current levels.

All up, the outlook for prices is firm for 2017/18, albeit a touch back from the highs seen over the last season or two.



## Rural Commodities Outlook (continued)

### Farm Input Costs – Input inflation low, but rising

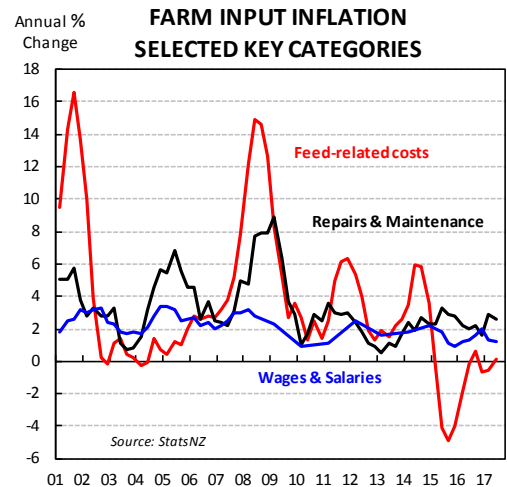
Annual Farm Input Inflation, June qtr: 1.1% ↑ 0.5 %pts

Farm input inflation remains low. On an annual basis, the farm expenses price index for all farms rose 1.1% for the June quarter. Excluding livestock purchases, farm expenses rose just 0.3% in annual terms.

However, generally farm input inflation is on the rise. For example, back in mid-2016, farm expenses were actually falling. Looking at some key categories, both wages & salaries and repairs & maintenance remain relatively subdued. In particular, wages & salaries rose a modest 1.2% in annual terms.

However, feed costs appear to be on the up. While feed prices were flat for the year, back in 2015 feed prices were falling 5% in annual terms.

From here, we expect feed costs to rise further, and for overall farm input inflation to rise too. In particular, the lift in the milk price will drive feed demand from the dairy sector. Lastly, poor weather and growing conditions may see farms look to source extra feed from off-farm.



## Financial Markets Outlook

### Interest Rates – Stuck in neutral

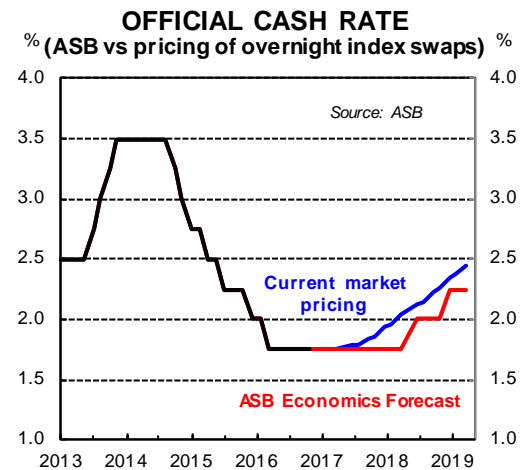
90-day bank bills, 25 Aug: 1.94% (No change)

On 10 August, the Reserve Bank (RBNZ) kept the Official Cash Rate (OCR) at 1.75% as widely expected. In addition, the RBNZ kept its neutral bias. In other words, the RBNZ expects that there is roughly an equal chance of the next interest rate move being up or down.

For our part, we still expect the RBNZ to start lifting the OCR at the start of 2019. In particular, we expect stronger economic growth and inflation over 2018 and 2019 than the RBNZ forecasts. But the start of 2019 is still a “considerable” time away, and later than that indicated by market pricing.

In terms of interest rates, the RBNZ’s stance should help keep NZ short-term interest rates around current low levels. However, longer-term rates may still drift higher, particularly if US benchmark interest rates continue their gradual lift.

All up, we expect that we are in for a lengthy period of low interest rates by historical standards.



### NZ Dollar – North Korea and election jitters

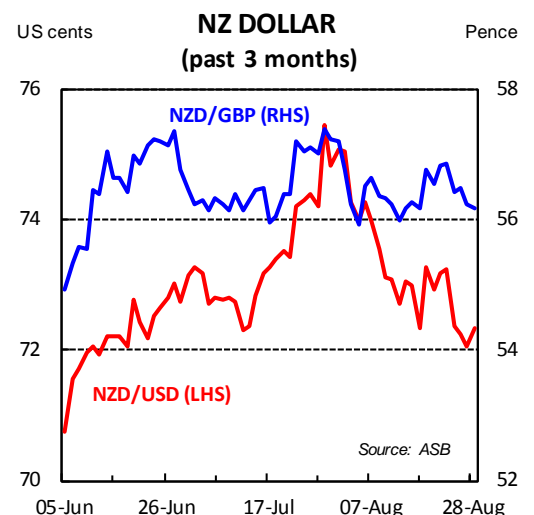
NZD/USD, 25 Aug: 0.7240 ↓ 0.0273 (mc)

The NZD has fallen steadily over August. This fall follows a strong July where the NZD reached a high for the year of around US\$0.7540. However, since then the NZD has fallen around three cents against the USD.

A flare up in US-North Korea tensions explains much of the fall. Fighting talk from both US President Trump and North Korean leader Kim Jong-un has currency markets on edge. Indeed, at these times markets prefer to buy safe haven currencies like yen and Swiss franc and to sell others like the NZD.

More recently, a less rosy than expected fiscal picture has furthered weakened the NZD. Moreover, with an increasingly unpredictable election looming, markets are starting to price in the possibility of a change in NZ government.

All up, we expect the NZD to remain volatile until a clear election winner emerges.



### Rural Rugby Fact or Fiction?

Answer: Fact! Also, in his 133 games for the All Blacks, he managed to add a conversion to go with his 28 tries.

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