

Farmshed Economics

Commonwealth Games Special

April 2018




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In this month's edition of Farmshed Economics, we get into the spirit of the Commonwealth Games and hand out medals to the best performing sectors. In a dead-heat, lamb and forestry share the gold medal, while dairy grabs the silver. Beef picks up the bronze, and just out of the medals, but finishing fast, is the New Zealand dollar.

In the end, we couldn't split lamb and forestry, so we ended up giving them both a share of gold. Lamb prices remain very healthy. Also, following a similar record in March, our data suggest that lamb prices were the highest ever recorded during an April month. Meanwhile, forestry prices are sitting at record highs in NZD terms. Indeed, forestry prices as measured by the AgriHQ Index set a fresh record high in mid-March, and prices stayed there over the month of April.

Dairy grabbed the silver medal. Indeed, the milk price is coming home with a wet sail this season and the fast finish bodes well for the new season too. Specifically, for 2017/18, there is perhaps 10 cents additional upside to our current forecast of \$6.55/kg. In the case of 2018/19, we expect \$6.50/kg, but wouldn't rule \$7.00/kg if the current favourable combination of dairy prices and NZD persists well into the season.

Beef prices ran out of a little puff over the month, with beef ending up settling for the bronze. For example, per kg P2 steer prices fell close to 2% over April. In addition, P2 steer prices are now tracking closer to 2015 and 2016 prices rather than the heady highs of 2017.

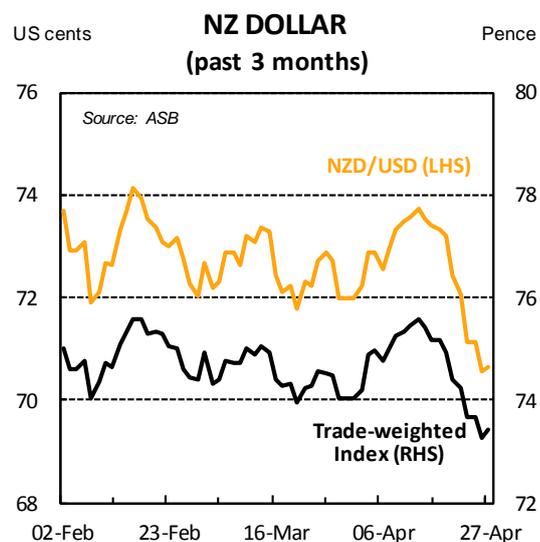
Finishing fast, although just out of the medals, was the NZ dollar. Indeed the speed of the decline in the NZD against the USD over late April (and early May) was impressive. After approaching US\$0.74 in mid-April, the NZD/USD has now fallen to below 0.7000. As a result, the lower NZD is giving a shot in the arm for commodity prices in NZD terms. However from here, the question is can this fall be sustained? We are a little sceptical that it will, but watch this space.

Key Rural Data:

As at 27 April 2018	Current	4 wks ago	Year ago	Outlook*
Rural Commodity Prices:				
ASB Dairy Price Index (USD)	92.4	89.8	88.9	↗
Lamb Price Index (NZD)	119.9	119.1	99.6	→
Beef Price Index (NZD)	106.4	109.7	113.5	↘
Forestry Price Index (USD)	104.5	106.7	95.4	→
Interest Rates:				
90-day bank bills	2.02	1.96	1.98	→
2-year swap	2.31	2.22	2.31	→
5-year swap	2.76	2.62	2.89	↗
Exchange Rates:				
NZD/USD	0.7085	0.7236	0.6868	↗
NZD/CNY	4.49	4.54	4.73	↗
NZD/GBP	0.5142	0.5162	0.5304	↗
Milk solids production (ytd % chg]**	-1.3	-1.2	-1.3	↗
Fonterra Shareholders' Fund	5.72	5.91	5.98	→

*Direction of change over the next 6 months. **As at February 2018.

Chart of the Month:



Rural Fact or Fiction?

New Zealand won a record-high 15 gold medals at the Gold Coast Games.

Answer on page 3

Rural Commodities Outlook

Dairy – Silver

Dairy Index (USD), 27 Apr: 92.4 ↑2.9% (mpc)

The squeeze is back on global butter prices. Butter prices have lifted 27% so far this year and are well ahead of the where they were this time last year. Moreover, butter prices are only 6% below the record levels set back in September 2017.

Indeed, we anticipate butter prices will shatter last year's records over coming months. This expectation is based on the fact that NZ is the world's leading butter exporter, exporting more than 1.5 times the amount of butter of other leading dairy exporters (EU, the US, Australia and Argentina) combined.

With this in mind, it's no coincidence that butter prices peaked last year during the period where NZ production and exports are at their weakest i.e. over the NZ winter and early spring. All up, it still appears that the world faces an ongoing and acute shortage of milk fat.

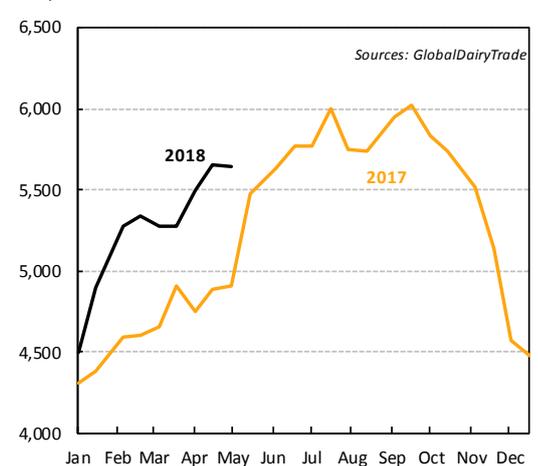
This milk fat price strength and the recent tumble in the NZD/USD bodes well for our milk price forecasts. We see upside to our 2018/19 and to a lesser degree our 2017/18 milk price forecasts. For 2017/18, there is perhaps 10 cents additional upside, given how late it is in the season. In the case of 2018/19, we expect \$6.50/kg, but wouldn't rule \$7.00/kg if the current favourable combination of dairy prices and NZD persists well into the season.

Season End Milk Price Forecasts:

	2017/18		2018/19		Long Run
	Fonterra	ASB	ASB	ASB	ASB
Milk Price*	\$6.55	\$6.55	\$6.50	\$6.50	\$6.50-\$7.00

* per kg of milk solids (excluding dividend).

BUTTER PRICES BY YEAR



Lamb – Share of gold

Lamb Index (NZD), 27 Apr: 119.1 (No change)

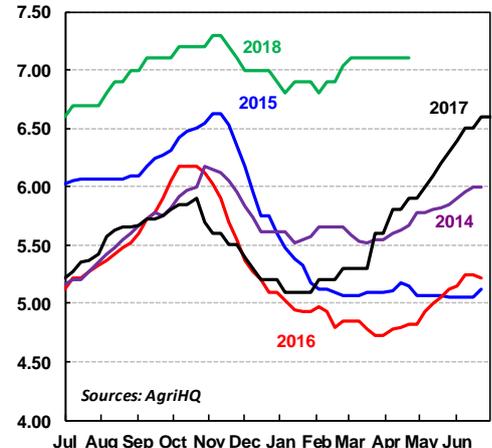
There is not much to report from lamb markets aside from stating the obvious: prices remain very healthy. Also, following a similar record in March, our data suggest that lamb prices were the highest ever recorded during an April month.

AgriHQ reports lamb supply remains tight. Indeed, competition among processors is keen given the still relatively low levels of slaughter.

It follows that underlying demand is also solid. Indeed, all key export markets are paying 14% or more so far this season compared to last season. In particular, Chinese markets look robust, delivering not only higher prices but also a healthy increase in NZ lamb export volumes.

On this basis, we expect lamb prices to remain very strong heading into the start of the new season. Moreover, the possibility of an ongoing weakness in the NZD adds weight to this view. For us and as it stands, it's a case of rollin', rollin', rollin', raw hide for lamb prices over 2018.

LAMB PRICES



Beef – Bronze

Beef Index (NZD), 27 Apr: 106.4 ↓-3.1% (mpc)

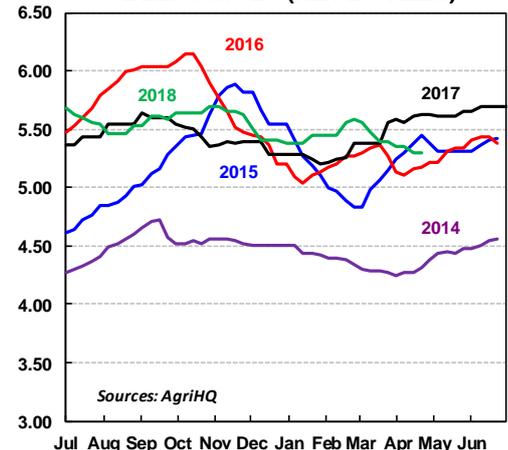
Beef prices are coming back to the pack. For example, per kg P2 steer fell close to 2% over the month. In addition, P2 steer prices are now tracking closer to 2015 and 2016 prices rather than the heady highs of 2017.

And broader beef prices are also weak. In particular, manufacturing beef prices are soft as the end of season cow cull progresses. Indeed, AgriHQ reports that cow prices have fallen by 40-50c/kg this season compared to only 15-20c/kg this time last season.

Meanwhile, demand also appears soft. US import prices remain under pressure from additional domestic supply as well as the lift in NZ supply.

All up, we continue to expect beef prices to drift lower over the next few months. That said, we suspect that the per kg P2 steer price, for example to hold above \$5.00/kg mark as underlying demand is still solid. The other factor that may also underpin prices going forward is the recent weakening of the NZD/USD. On that front, watch this space.

BEEF PRICES (NZ P2 STEER)



Rural Commodities Outlook (continued)

Forestry – Share of gold

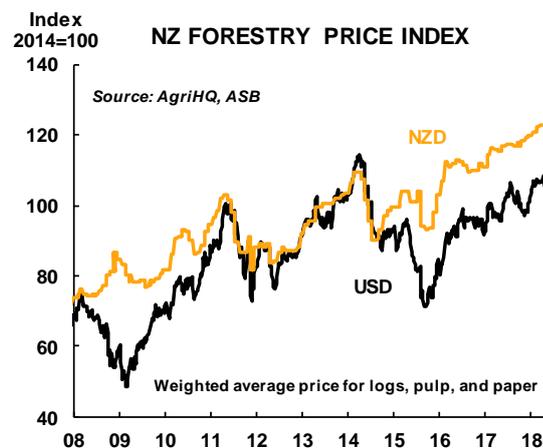
Log & Pulp Index (USD), 27 Apr: 104.5 ↓-3.1% (mpc)

Forestry prices are sitting at record highs in NZD terms. Indeed, forestry prices as measured by the AgriHQ Index set a fresh record high in mid-March, and prices have stayed there since.

We've long had a view that forestry prices would moderate, but now we expect prices to remain near record highs for some time yet.

Firstly, we expect firm global growth to support demand for wood and in turn export prices. In particular, we note the improving growth outlooks in the US, China, Korea and Japan. Secondly, we also expect local demand to remain high. That said, a shortage of workers may cap activity at current high levels.

Although, it's not all one-way traffic for forestry prices. For example, shipping costs appear to be lifting. Also, the US-China trade tensions pose a broad risk to the global economic outlook. All things considered, we expect the good times to roll on over the remainder of 2018.



Financial Markets Outlook

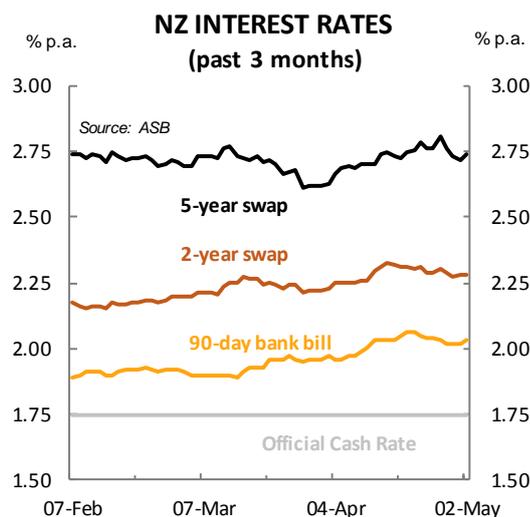
Interest Rates – New face, same message

90-day bank bills, 27 Apr: 2.02% ↑ 0.06 (mc)

Adrian Orr makes his first Official Cash Rate (OCR) announcement as Governor of the Reserve Bank (RBNZ) on 10 May. However, despite the new face, we expect the RBNZ's message on interest rates to remain the very similar to previous announcements. In other words, we expect the RBNZ to keep the Official Cash Rate (OCR) unchanged at 1.75% and to restate that it was likely remain there "for a considerable period."

In other words, OCR hikes remain a long way off. For our part, we don't expect RBNZ to begin hiking the OCR until August 2019.

In terms of interest rates, the RBNZ's stance should help keep NZ short-term interest rates near current low levels for most of 2018. In contrast, long-term interest rates may drift higher in line with rising global rates. In fact, we expect two more US Federal Reserve interest rate hikes this year on top of the hike earlier this month. All up and normal fluctuations aside, we expect interest rates to remain low by historical standards over the next six months.



NZ Dollar – Fast finisher

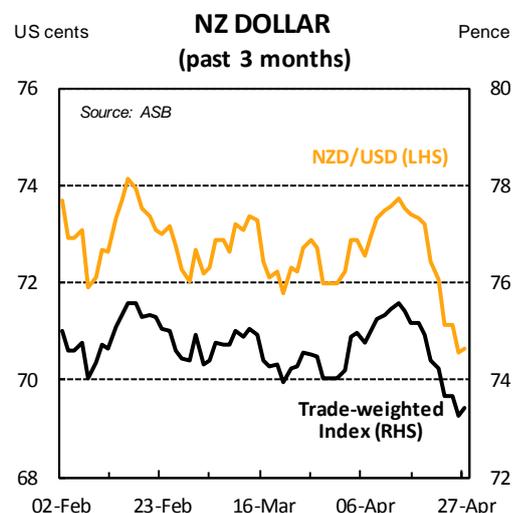
NZD/USD, 27 Apr: 0.7085 ↓ -0.0151 (mc)

The NZ dollar has taken a tumble against the USD. After approaching US\$0.74 in mid-April, the NZD/USD has now fallen to 0.7040. Moreover, this fall has taken the NZD/USD to its lowest level over 2018.

Notably, the drop owes more to USD strength than it does to NZD weakness. In particular, the USD has strengthened as US benchmark interest rates have surged. For example, the US 10-year Treasury bond yield has risen above the NZ equivalent for the first time since the 1990s.

As a result, the lower NZD is boosting commodity prices in NZD terms. For example, 2018/19 milk price futures surged 35 cents to \$6.60/kg last week.

However from here, we expect the NZD to strengthen, particularly as NZ commodity prices remain firm. On this basis, we expect the NZD/USD to average between 0.73 and 0.74 over the next six months. That said, rising US interest rates could continue to drive the NZD/USD lower. If that proves the case, then commodity prices in NZD terms could be higher as well. Watch this space.



Rural Fact or Fiction?

Answer: Fiction! While NZ did win 15 gold medals, the record number of golds of 17 was set back in Auckland in 1990.

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