

Farmshed Economics

2017: surprises and comebacks

December 2017




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2017 was a year of surprises, consistency, comebacks and consolidation. Lamb prices surprised by surging over the year, while beef prices were consistently strong. Meanwhile butter made a stunning comeback over 2017, helping the dairy sector consolidate its position with another positive year.

The meat sector took centre stage over 2017. Indeed, 2017 was one out of the box for lamb prices. After a quiet start, per kg prices surged over the lucky \$7.00 mark, reaching their highest level since 2011.

The beef sector was not to be outdone. Beef prices have been consistently high over the year, continuing a stellar run since early 2015.

For both beef and lamb, we expect the good times to roll on. Although, we would caution that there is a risk that drought could spoil 2018's party.

Meanwhile in the dairy sector, butter and milk fat prices were on a tear over 2017. Indeed, both butter and anhydrous milk fat prices set multiple dairy auction record highs, over 2017. Eventually though, a butter price limit was reached, and as consumers reined in their butter demand, prices fell.

Our milk price forecast has reflected butter's movements over the year. For the most of 2017, we held our forecast at a healthy \$6.75/kg as butter prices continued their surge. However, as consumers began to resist the sky-high prices we dropped our forecast to \$6.50/kg. Either way, the 2017/18 season is shaping as a second successive positive one for dairy farmers.

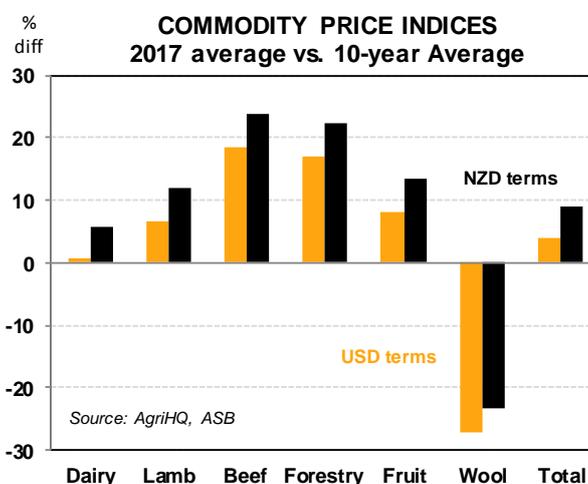
In contrast, financial markets had a quiet year. Interest rates remained low, while the NZD largely tracked within a tight range either side of US\$0.70. The biggest local development came with first the retirement of Graeme Wheeler and then the appointment of a new Reserve Bank Governor, Adrian Orr.

Lastly, rural land prices lifted over 2017 as we expected. Although somewhat surprisingly, it was the non-dairy sectors that drove the majority of the land price rise. Heading into 2018, we expect broad strength across a range of rural sectors to drive land prices higher still.

Key Rural Data:

Chart of the Month:

As at 15 December 2017	Current	4 wks ago	Year ago	Outlook*
Rural Commodity Prices:				
ASB Dairy Price Index (USD)	89.4	90.7	89.1	→
Lamb Price Index (NZD)	117.7	121.9	89.1	↘
Beef Price Index (NZD)	110.9	116.0	106.4	↘
Rural Land Price Index	3683	3341	3235	↗
Interest Rates:				
90-day bank bills	1.86	1.91	2.04	↗
2-year swap	2.18	2.16	2.41	↗
5-year swap	2.62	2.65	3.04	↑
Exchange Rates:				
NZD/USD	0.6990	0.6817	0.6971	↗
NZD/CNY	4.62	4.52	4.85	↗
NZD/GBP	0.5247	0.5159	0.5578	→
Milk solids production (ytd % chg]**	1.8	1.1	-3.7	↗
Fonterra Shareholders' Fund	6.40	6.30	5.95	↘



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



Rural Fact or Fiction?

New Reserve Bank Governor, Adrian Orr, will take a pay cut when he starts the job in March next year.

Answer on page 3

Rural Commodities Outlook

Dairy – 2017: the year butter came back

Dairy Index (USD), 15 Dec: 89.4 ↓-1.4 (mpc)

Butter and milk fat prices were on a tear over 2017. Indeed, both butter and anhydrous milk fat prices set multiple dairy auction record highs, over 2017.

A surge in global demand for milk fats drove the price surge. Indeed, much of this surge can be put down to an acknowledgement by the scientific community that fats are no longer as bad for your health as once feared. In short, butter came back over 2017!

As butter demand surged, supply struggled to keep pace, pushing prices to record highs. Eventually though, a price limit was reached, with some consumers then switching to butter substitutes like margarine and or removing butter from their diets completely.

Indeed, demand appears to have retreated, taking prices with it. From October through December, butter prices fell by over a quarter. Moreover, it seems that falling butter prices dragged general dairy prices lower too.

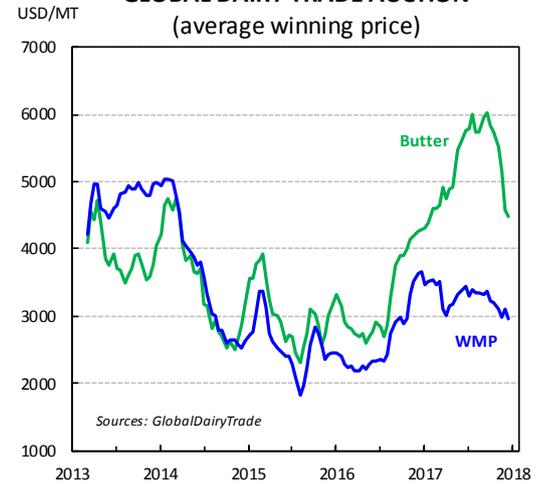
Our milk price forecast has reflected butter's movements over the year. For the most of 2017, we held our forecast at a healthy \$6.75/kg as butter prices continued their surge. However, as consumers began to resist the sky-high prices we dropped our forecast to \$6.50/kg. Either way, the 17/18 season is shaping as second successive positive one for dairy farmers.

Season End Milk Price Forecasts:

	2017/18		2018/19	Long Run
	Fonterra	ASB	ASB	ASB
Milk Price*	\$6.40	\$6.50	\$6.50	\$6.50-\$7.00

* per kg of milk solids (excluding dividend).

GLOBAL DAIRY TRADE AUCTION (average winning price)



Lamb – 2017: one out of the box

Lamb Index (NZD), 15 Dec: 117.7 ↓-3.4 (mpc)

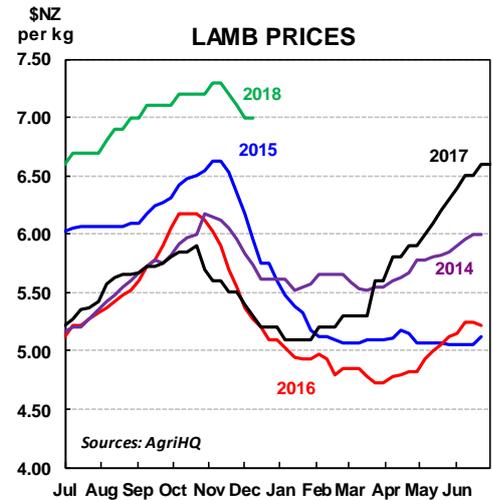
Wow! 2017 has been one out of the box for lamb prices. Just look at the chart! First from about April through June (black line), prices spiked well over \$6/kg. Then from July through to now (green line), prices kept going, peaking at \$7.30/kg. These prices are the best since 2011.

Moreover, the price surge came out of the blue. Most analysts, including the Farmshed Economics, didn't see the price surge coming. Indeed, prices started 2017 mediocre levels, giving no hint of the price surge to come.

Heading into 2018, we think prices can remain healthy. The majority of factors underpinning prices are likely to remain in play. Also, we are unlikely to see a pick up in supply from either here or across the Tasman.

That said, we still expect the normal seasonal price decline. Also, there is a risk that drought could see slaughter levels spike and lead prices lower than we expect. However despite the current dry, the long-range weather forecasts are benign and this season is still shaping as one to remember.

LAMB PRICES



Beef – 2017 star performer

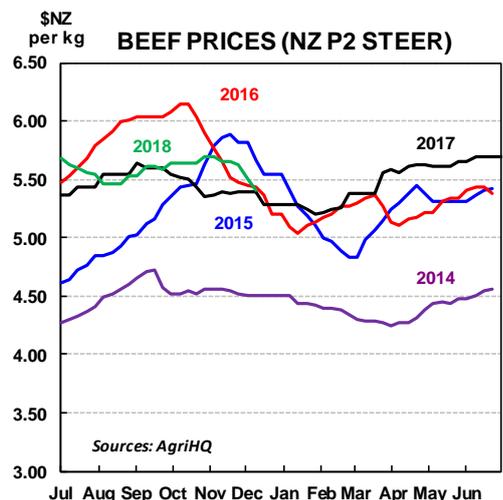
Beef Index (NZD), 15 Dec: 110.9 ↓-4.4 (mpc)

Beef prices have been a star performer over 2017. While not quite getting to the 2016 record highs, beef prices take out the prize for consistent strength. For example, the average price level over 2017 (as measured by the AgriHQ beef index in NZD) was 24% above the ten-year average.

Moreover, it seems that the more things change, the more they stay the same when it comes to beef prices. Indeed, despite recovering US production, Australian droughts and record slaughter (to name but a few events), per kg prices for P2 steers have rarely dipped below \$5 since early 2015.

With that in mind, we expect more of the same over the remainder of the 2017/18 season. Of course, we still expect a modest seasonal dip in prices over summer and autumn. But generally, we expect the underlying picture for beef prices to remain strong. In other words, it's roll on 2018 for beef cattle farmers.

BEEF PRICES (NZ P2 STEER)



Rural Commodities Outlook (continued)

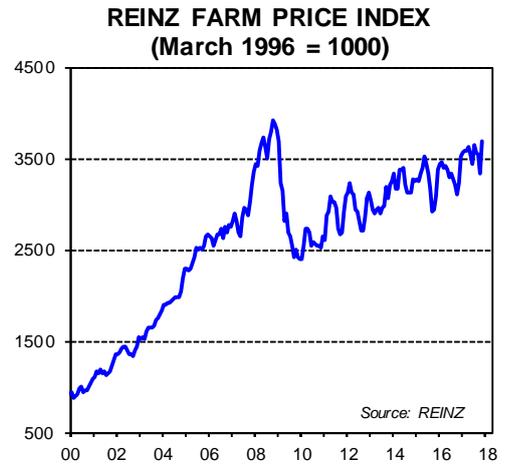
Rural Land Prices – More to come in 2018

Farm price index, Nov: 3683 ↑10.2% (mpc)

Rural land prices have lifted over 2017 as we expected. This time last year we hinted that prices would pick up over 2017. Indeed, that has been the case, with rural land prices (as measured by the REINZ index) lifting 13.8% between November 2016 and November 2017.

We had expected, however, that the dairy sector would drive the lift. Dairy land prices did lift, but at a 6.2%, the rise was less than the overall lift in rural land prices. This indicates that it was other sectors that drove the majority of the land price rise.

Heading into 2018, we expect broad strength across a range of rural sectors to drive land prices higher still. In particular, the meat sector has had a good year, with that strength likely to continue into early 2018. Similarly, horticulture sector incomes are also strong, with this strength is also likely to continue to underpin prices for orchards. Also, with another solid dairy season ahead, we expect there is more to come for land prices.



Financial Markets Outlook

Interest Rates – A new sheriff in town

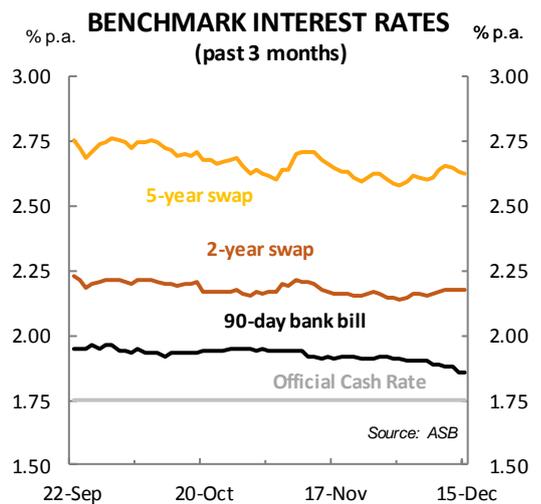
90-day bank bills, 15 Dec: 1.86% ↓-0.05 (mc)

Benchmark interest rates have fallen over 2017. The 90-day bank bill has fallen 12 basis points (bps) this year, while 2- and 5-year swap rates have dipped approximately 25 and 40 bps, respectively, over the year.

There was also change at the Reserve Bank (RBNZ) over 2017. Governor Graeme Wheeler announced his resignation in February, with Grant Spencer temporarily filling in from September. Then this month, Adrian Orr, was appointed to the Governor role from March 2018.

Adrian Orr is likely to provide a steady hand at the RBNZ. With that in mind, we continue to expect the RBNZ to remain on hold through next year before starting to lift the OCR in early 2019.

In terms of interest rates, the RBNZ's stance will help keep short-term interest rates near current lows. However, we expect long-term interest rates to drift higher in line with rising global rates. That said, we expect interest rates to remain low by historical standards over 2018.



NZ Dollar – A new sheriff in town II

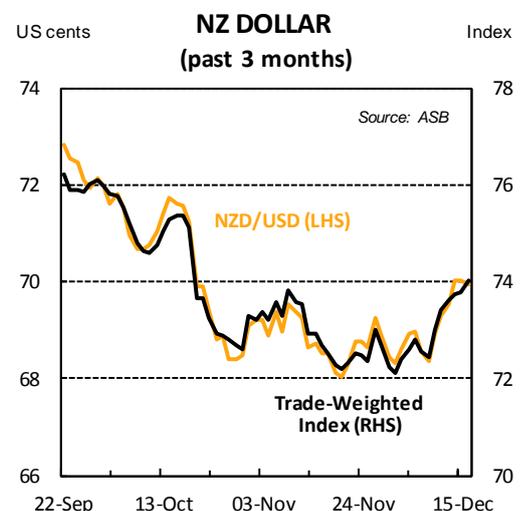
NZD/USD, 15 Dec: 0.6990 ↑0.0173 (mc)

The NZD has come full circle over 2017. It ended 2016 at 0.6960 against the USD. And as at 20 December, it is back at that exact same level.

The NZD also traded in a relatively tight range over the course of the year. In July, it reached as high as 0.75 against the USD, while last month it dipped as low as 0.68.

This month, the NZD has strengthened following the appointment of Adrian Orr as new Reserve Bank Governor. Adrian Orr is well-known to financial markets and was seen as a logical choice for the Governor role. His experience as CEO of the NZ Super Fund will also stand him in good stead given he is familiar with the workings of Government, particularly as the new Government looks to make changes to the Reserve Bank's targets.

Looking to 2018, we expect the NZD to firm against the USD. Indeed, we expect it to lift to around 0.75 US cents by the end of 2018. Meanwhile, against the other main currencies we current levels to largely hold.



Rural Fact or Fiction?



Answer: Fact! As Chief Executive of the New Zealand Super Fund Orr reportedly earned \$1.2m, whereas recently-retired Reserve Bank Governor Graeme Wheeler earned between 850,000 and 900,000 in 2016/17.

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