

Farmshed Economics

2018: a year of two halves

December 2018




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Happy Holidays!

From all the team at Farmshed Economics

2018 was a year of two halves. The weather has been at the heart of this contrast. Indeed, the first half of the year was punctuated by drought in many parts of the country, while the second half has seen generally excellent weather and growing conditions. Sector fortunes have also diverged, although by and large it has been a positive year for the rural economy.

The sheepmeat sector took centre stage over 2018. The year broke fresh ground for lamb prices, setting records along the way. Indeed, what has been surprising is that 2018 prices built further on a very good 2017.

The dairy sector has epitomised the year of two halves. Production was very weak over the first of half the year; while in the second half production has steamed ahead, setting records along the way. Milk prices, however, have headed in the opposite direction i.e. healthy in the first half, followed by a more subdued milk price (forecast) in the second.

Meanwhile, beef prices have been solid over 2018. Indeed, the 2018 average price has been effectively the same as the 2017 average price. The solid year has been helped by solid Chinese demand and a supportive NZ dollar.

Speaking of the dollar, it has boosted farmgate prices over the year. In fact, the NZD/USD fell as low as US\$0.64, after starting the year above US\$0.70.

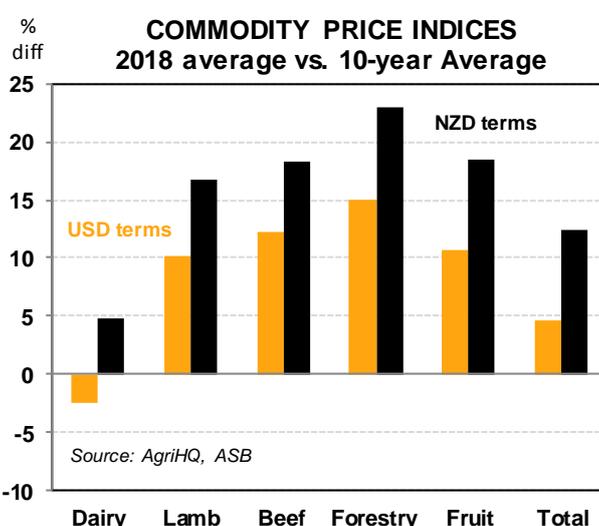
Interest rates have also been at very supportive levels over 2018, with some rates approaching record lows. Moreover, it seems that interest rates are likely to remain at historically-low levels well into 2019.

Lastly, rural land prices lifted over 2018 as we expected. But there were diverging sector fortunes, with dairy land prices actually falling. Heading into 2019, we expect this theme to continue with sheep and beef farms and orchard prices lifting further, while dairy land prices are likely to remain subdued.

Key Rural Data:

Chart of the Month:

As at 14 December 2018	Current	5 wks ago	Year ago	Outlook*
Rural Commodity Prices:				
ASB Dairy Price Index (USD)	76.5	78.0	84.1	→
Lamb Price Index (NZD)	131.2	133.7	119.4	↘
Beef Price Index (NZD)	105.7	108.4	114.5	↘
Rural Land Price Index	3775	3645	3683	↗
Interest Rates:				
90-day bank bills	1.97	2.00	1.86	→
2-year swap	2.08	2.18	2.18	↗
5-year swap	2.36	2.57	2.63	↗
Exchange Rates:				
NZD/USD	0.6797	0.6878	0.6841	→
NZD/CNY	4.70	4.77	4.53	→
NZD/GBP	0.5402	0.5357	0.5108	→
Milk solids production (ytd % chg]**	4.9	6.0	1.8	→
Fonterra Shareholders' Fund	4.61	4.84	6.39	↗



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



Rural Fact or Fiction?

The Pohutukawa is the floral emblem of a city in Spain.

Answer on page 3

Rural Commodities Outlook

Dairy – 2018: a year of two halves

Dairy Index (USD), 14 Dec: 76.5 ↓-2.0 (mpc)

It's been a year of two halves for the dairy sector. The weather has been at the heart of the contrast. Indeed, the first half of the year was punctuated by drought in many parts of the country, while the second half has seen generally excellent weather and growing conditions.

Production has mirrored the swings in weather. 2017/18 season production ended down 0.6% on 2016/17. Whereas, the 2018/19 season has started with a hiss and roar, with production to date running nearly 5% ahead of the same stage last season. In fact, October production set a new monthly record high, and the season is on track to set a record high as well.

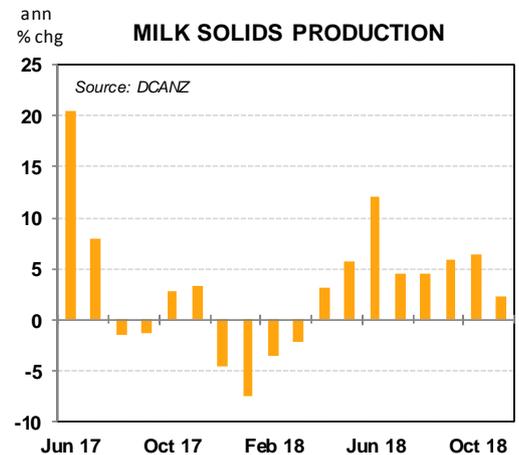
Prices, however, have headed in the opposite direction. In the first half of 2018, prices were firm, helping the 2017/18 milk price end at a healthy \$6.69/kg. In contrast and as the milk has started to flow in the new season, dairy prices have fallen to around 17% below where they started. We've also reflected these falls in our milk price forecast, starting out at season at \$6.50/kg, but finishing 2018 at \$6.00/kg. In this sense, production giveth and taketh away.

Despite the lower milk price forecast for 2018/19, we remain positive about dairy's longer-term outlook. Recall that our long-run forecast is \$6.50/kg to \$7.00/kg.

Season End Milk Price Forecasts:

	2018/19		Long Run
	Fonterra	ASB	ASB
Milk Price*	\$6.00-\$6.30	\$6.00	\$6.50-\$7.00

* per kg of milk solids (excluding dividend).



Lamb – 2018's star performer

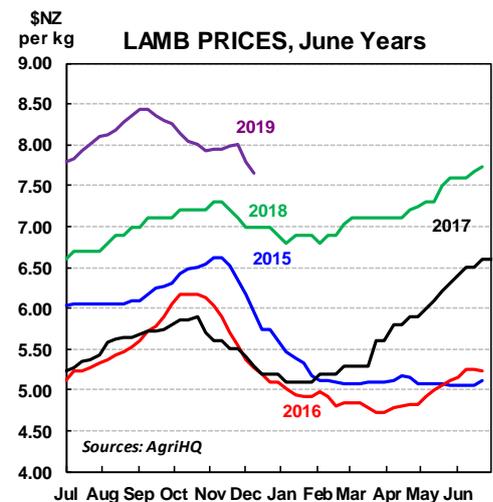
Lamb Index (NZD), 14 Dec: 131.2 ↓-19 (mpc)

Boom! 2018 has broken fresh ground for lamb prices, setting records along the way. Indeed, what has been surprising is that prices built further on a very good year over 2017.

Prices peaked in September at a whopping \$8.43/kg. Since then prices have declined, but remain at very healthy levels. For example current prices are 0.65/kg or 9.3% above year-ago levels, remembering that 2017 was also a very good year for lamb prices.

Heading into 2019, we expect prices to remain healthy. Supply remains tight and supportive of prices. Moreover, we don't anticipate that dynamic to change locally and or over the Tasman. Meanwhile, demand has held up despite slowing economic growth globally and particularly in China.

Nonetheless, we still anticipate that prices will decline in line with the normal seasonal pattern. All up, the lamb price outlook remains positive and farmers can look forward to healthy returns over 2019.



Beef – 2018: holding up

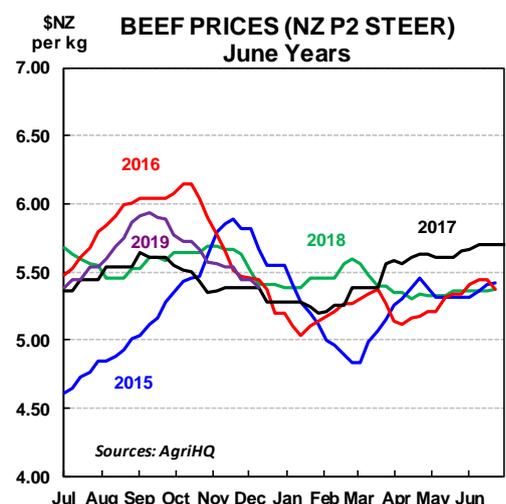
Beef Index (NZD), 14 Dec: 105.7 ↓-2.5 (mpc)

Beef prices have by and large been solid over 2018. For example, the 2018 average P2 steer price has been just 0.3% below the 2017 average price.

Moreover, beef prices have held up better over 2018 than we expected. In particular, farmgate prices have been resilient to strengthening US production and falling US domestic prices. In addition, drought across the Tasman has translated into additional beef cattle slaughter and supply coming out of Australia.

One of the reasons prices have remained firm has been solid demand coming out of China. Indeed, export volumes to China grew by over 38% in the 2018/19 season to September compared to the 2017/18 season.

However, looking ahead, we anticipate that 2019 prices are likely to be softer. First up, US production continues to strengthen, while Chinese demand is likely to slow as Chinese economic growth eases. In addition, beef farmgate prices are unlikely to receive the same boost from the NZD in 2019 as they did in 2018.



Rural Commodities Outlook (continued)

Rural Land Prices – 2018: diverging fortunes

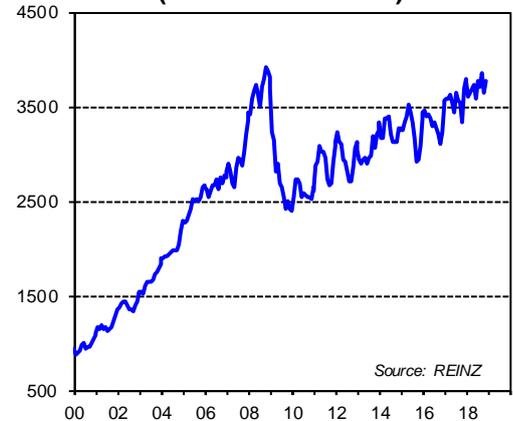
Farm price index, Nov: 3775 ↑3.6% (mpc)

Rural land prices lifted over 2018 as we expected. This time last year we hinted that prices would pick up over 2018. Indeed, that has been the case, with rural land prices (as measured by the REINZ index) lifting 4.6% between the year to November 2017 and the year to November 2018.

However, 2018 has seen diverging sector fortunes. In contrast to the overall rise, dairy land prices have fallen, slipping around 10% over the same period. This dairy land price fall indicates that it was other sectors that drove the majority of the land price rise.

Heading into 2018, we expect this trend to continue. In particular, the meat and horticulture sectors have had good years, with that strength likely to continue into early 2019. This strength is likely to underpin prices for sheep and beef farms and orchards. However, with the milk price forecast to be modest, we anticipate that dairy prices will remain subdued at least over the first half of the year.

REINZ FARM PRICE INDEX
(March 1996 = 1000)



Financial Markets Outlook

Interest Rates – 2018: low and falling

90-day bank bills, 14 Dec: 1.97% ↓-0.03 (mc)

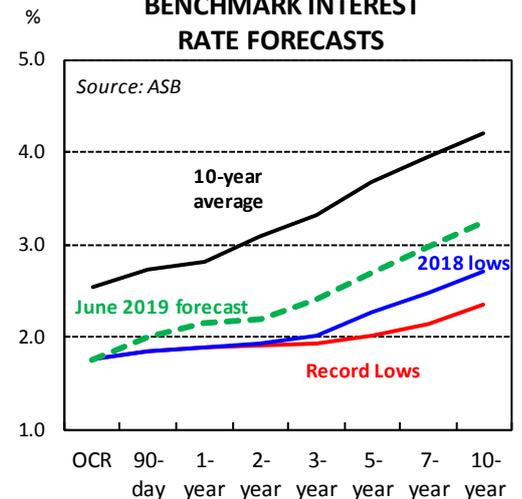
Benchmark interest rates have mostly fallen over 2018. 2- and 5-year swap rates have dipped approximately 16 and 36 bps, respectively, over the year. The only main exception is 90-day bank bills, which have lifted 9bps.

Moreover, some benchmark rates have been at or near record low levels. Indeed, 1-year swap rates set a record low of 1.93 in August, while 2-year swap rates came within 3bps of their all-time lows.

While the benchmark rates have been low and falling, rates have also been volatile over 2018. 5-year swap rates, for example, have been as high as 2.81% and as low as 2.28%.

Looking ahead, we expect short-term interest rates to remain near current lows in 2019 as the Reserve Bank seems on course to keep the Official Cash Rate on hold through the year. However, we expect long-term interest rates to drift modestly higher in line with rising global rates. That said, we expect interest rates to remain low by historical standards over 2019.

BENCHMARK INTEREST RATE FORECASTS



NZ Dollar – 2018: helping hand

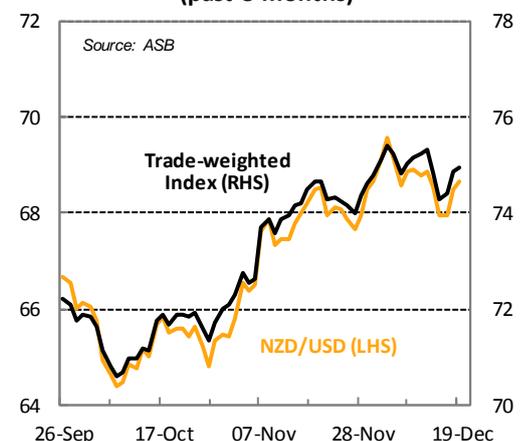
NZD/USD, 14 Dec: 0.6797 ↓0.0081 (mc)

The NZD has been relatively weak over 2018. For example, the 2018 average level of US\$0.6930 was around 2.5% below the 2017 average level of US\$0.7100. The NZD has also been more volatile over 2018. In February, it reached as high as 0.74 against the USD; while in October it dipped as low as 0.68.

The weaker NZD has boosted farmgate prices over 2018. For example, 2018 average dairy auction prices (priced in USD) were actually lower than the 2017 average. However, the weak NZD/USD more than offset that difference so that the 2018 average price was above the 2017 average.

Looking to 2019, we expect the NZD to trade sideways against the USD from the current level of 0.6780. Similarly, against the pound and euro currencies we anticipate that current levels will largely hold. The main outlier is the NZD/AUD. From its current AU\$0.9520, we anticipate cross rate will fall to around AU\$0.9100 by mid-2019.

NZ DOLLAR (past 3 months)



Rural Fact or Fiction?

? Answer: Fact! La Corunna, a coastal city in northwest Spain, has a very large Pohutukawa. Locals believe is nearly 500 years old! What's more is locals have embraced the Pohutukawa, making it the city's floral emblem.

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