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Happy Holidays!

From all the team at Farmshed Economics

Auspiciously, 2019 was the 'Year of the Pig'. As it turns out though, African Swine Fever meant that pigs were few and far between this year. For NZ farmers, this meant that 2019 quickly turned into the 'Year of the Sheep', with sheepmeat prices reaching unprecedented levels. Beef prices also set fresh record highs, while fruit prices also boomed. With the milk price joining the party in the second half of the year, 2019 has generally been a stellar year for farmers on the commodity price front.

At the start of the year, it was a stretch to imagine lamb prices topping the record highs of spring 2018. But top them they did! In fact, spurred on by African Swine Fever, lamb prices hit as high as \$9.00/kg this year. Beef prices weren't far behind as they also surpassed the previous record highs.

Meanwhile, 2019 has been another banner year for fruit exports. After cracking \$3 billion in exports for the first time over 2018, fruit exports are set for another leg up to around \$3.4 billion over 2019. The kiwifruit sector or more precisely gold kiwifruit exports have been doing much of the fruit industry's heavy lifting.

On the whole, 2019 has been a good year for the milk price. While the 2018/19 season delivered a modest \$6.35/kg milk price, the second half of 2019 saw the milk price hit the ground running. Indeed, we end the year with a bullish \$7.50/kg forecast for 2019/20 in place.

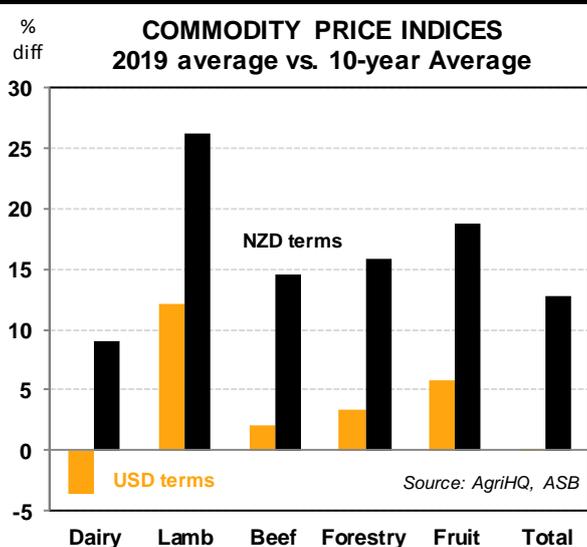
Turning to financial markets, 2019 has seen interest rates tumble to record lows. However, while we expect benchmark rates to remain very low, we may be past the absolute lows in lending or customer rates.

The NZ dollar has also been a 'star' over 2019. As seen in the chart below, the relatively weak NZ dollar has helped boost farmgate prices in NZD terms.

Key Rural Data:

Chart of the Month:

As at 13 December 2019	Current	3 mths ago	Year ago	Outlook*
Rural Commodity Prices:				
ASB Dairy Price Index (USD)	104.7	97.7	86.2	→
Lamb Price Index (NZD)	138.6	133.9	123.1	↘
Beef Price Index (NZD)	112.1	105.9	93.3	↘
Fruit Price Index (NZD)	128.1	112.1	106.1	→
Interest Rates:				
90-day bank bills	1.20	1.14	1.98	↘
2-year swap	1.24	1.02	2.08	↘
5-year swap	1.43	1.09	2.36	↘
Exchange Rates:				
NZD/USD	0.6599	0.6377	0.6868	→
NZD/CNY	4.61	4.51	4.72	→
NZD/GBP	0.4952	0.5101	0.5396	→
Milk solids production (ytd % chg]**	0.5	8.5	6.0	↘
Fonterra Shareholders' Fund	4.04	3.18	4.64	→



*Direction of change over the next 6 months. **As at October 2019.



Rural Fact or Fiction?

According to the Classic Kiwi Christmas 2019 Survey, ham was voted the meat of choice for Kiwis this Christmas.

Answer on page 3

Rural Commodities Outlook

Dairy – A year of two halves

On the whole, 2019 has been a good year for the milk price. While the 2018/19 season delivered a modest \$6.35/kg milk price, the second half of 2019 saw the milk price hit the ground running. Indeed, we end the year with a bullish \$7.50/kg forecast for 2019/20 in place.

Global dairy prices have lifted over the year. A dry NZ summer and autumn boosted prices in early 2019. Meanwhile, tight global supply has also underpinned prices throughout the year. In the EU and the US, annual production growth has been under 1%, while Australian production has continued to head backwards at a rate of knots. Locally, we anticipate that production will be tight this season as well – we forecast flat i.e. 0% production growth this season.

The NZ dollar has also boosted this season's milk price and will boost next season's further. Looking to next season, we have pencilled in a \$7.50/kg milk price forecast on the basis of still relatively tight global dairy markets and the already-mentioned NZ dollar boost.

Almost as important as our bullish milk price view, our recent observation has been that milk price volatility has fallen. Indeed, we believe that the fall in milk price volatility is structural in nature. In that sense, the farmgate milk price is moving to a higher plateau over coming seasons.

Lamb – Double delight

Boom! Boom! 2019 has gone one better than 2018. Indeed, after celebrating passing the \$8.00/kg last year, 2019 has upped the ante, surpassing the \$9.00/kg mark for the first time.

Prices peaked in November at a whopping \$9.00/kg flat. Since then prices have declined a little, but still remain at record levels for a December month. Moreover, current prices are 1.13/kg or 14.8% above year-ago levels.

Heading into 2019, we expect prices to remain very healthy, if not near record highs. Demand from China remains very strong as the recovery from African Swine Fever will take years rather than months. Lamb supply remains tight and supportive of prices. Moreover, we don't anticipate that dynamic to change locally or over the Tasman.

Nonetheless, we still anticipate that prices will decline largely in line with the normal seasonal pattern. All up, the lamb price outlook remains positive and farmers can look forward to healthy returns over 2020.

Beef – Filling the protein hole

Boom! Like lamb, beef prices have also come to the party over 2019, breaking record highs. P2 steer prices, for example, peaked at \$6.24/kg in November, surpassing the previous record highs set back in October 2015.

Similar to the pattern in lamb prices, prices have declined a little since then, with current prices easing to \$6.14/kg. However, prices remain at a record high for a December month.

The protein hole that African Swine Fever has created is the key driver for these record prices. Moreover and as mentioned above, we anticipate that the pork industry will take several years to recover. However, the global beef industry is more responsive to high prices, particularly in places like the US and Brazil. We suspect that this is the key reason that beef prices, while at record levels, are not way out of line with prices recorded over recent years.

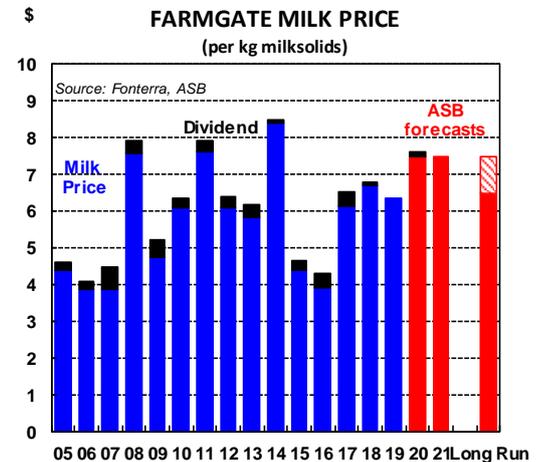
That all said, the sizeable global protein gap means we anticipate that beef prices will remain very healthy over most of 2020.

Dairy Index (USD), 13 Dec: 104.7.1 ↑7.1 (qpc)

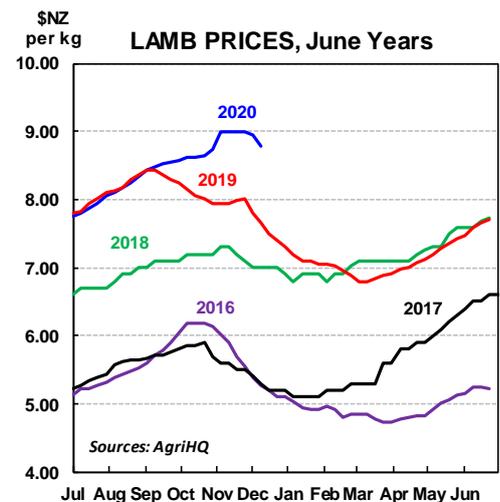
Season End Milk Price* Forecasts:

	2019/20		2020/21	Long Run
	Fonterra	ASB	ASB	ASB
Milk Price*	\$7.00-\$7.60	\$7.50	\$7.50	\$6.50-\$7.50

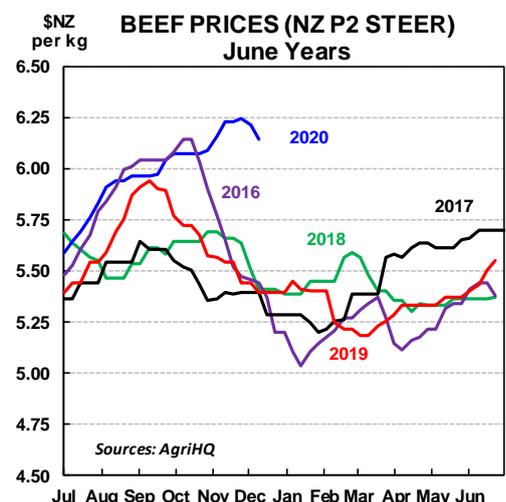
* per kg of milk solids (excluding dividend)



Lamb Index (NZD), 13 Dec: 138.6 ↑3.5 (qpc)



Beef Index (NZD), 13 Dec: 112.1 ↑5.8 (qpc)



Rural Commodities Outlook (continued)

Fruit – Sweet as

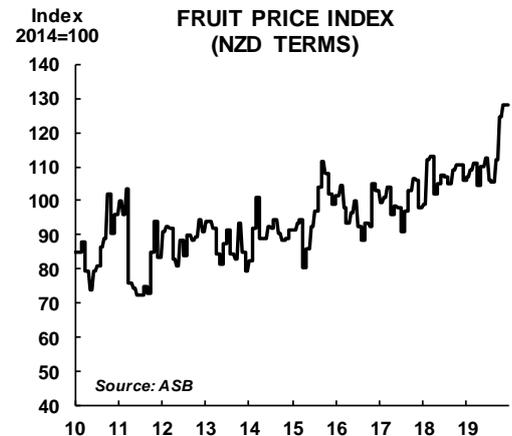
Fruit Index (NZD), 13 Dec: 128.1 ↑14.3 (qpc)

2019 has been another banner year for fruit exports. After cracking \$3 billion in exports for the first time over 2018, fruit exports are set for another leg up to around \$3.4 billion over 2019.

The kiwifruit sector is leading the way. Or more specifically, gold kiwifruit is leading the way. This season marked the first time that gold volumes passed green. And with orchard-gate prices remaining very healthy, we anticipate that total kiwifruit export values will top \$2.2 billion this season.

2019 has also been a stellar year for the apple industry. Apple export values are on track for a record year, tracking around 13% up on 2018 in the year to date. All up, we anticipate that export values will top \$860 million for the year.

Looking to 2020, we expect the fruit industry can build further. Importantly, orchard-gate prices have remained firm during a time of expansion and this bodes well for sustainable growth over coming years.



Financial Markets Outlook

Interest Rates – Rates tumble

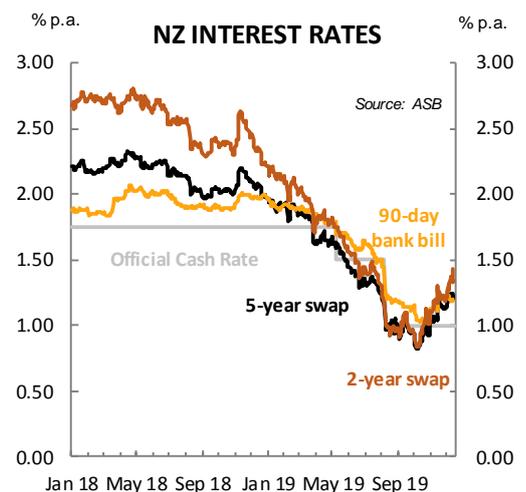
90-day bank bills, 13 Dec: 1.20% ↑0.06 (qc)

Benchmark interest rates have tumbled over 2019. In fact, all benchmark rates hit record lows in October, with many rates dipping below 1%.

The magnitude of the falls this year was also large. Indeed, most rates fell around 100 basis points from the end of 2018 through to the October lows. Some of the longer-term rates even fell close to 150 basis points.

Looking ahead, we expect interest rates to remain low over 2020. Notably, we expect that the Reserve Bank to cut Official Cash Rate once to a fresh record low of 0.75%.

However, while we expect benchmark rates to remain very low, we may be past the lows in lending or customer rates. An increase in banks' capital requirements is likely to put modest upward pressure on lending rates over coming years. With that in mind, it is tempting to take the rates currently on offer sooner rather than later.



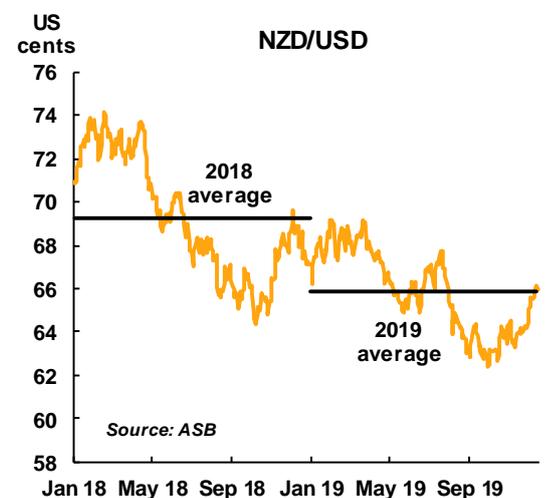
NZ Dollar – Farmgate booster

NZD/USD, 13 Dec: 0.6599 ↑0.0222 (qc)

The NZ dollar has been relatively weak over 2018. For example, the 2019 average NZD/USD level of US\$0.6590 was around 4.7% below the 2018 average level of US\$0.6920. In October, the NZD/USD also reached its lowest level (US\$0.6250) since May 2009.

As a result, the weaker NZ dollar has boosted farmgate prices over 2018. For example, the 2019 average beef, lamb, wool, forestry and fruit prices (priced in USD) were all actually lower than the 2018 average. However, the weak NZD/USD more than offset that difference so that the 2019 average price was above the 2018 average.

We believe that at its current levels the NZ dollar is close to its fair value. Accordingly and as we look to 2020, we expect the NZ dollar to largely trade sideways against the USD from the current level of 0.6580. Similarly, against the pound and euro, we anticipate that current levels will largely hold. The main outlier is the NZD/AUD. We anticipate that the NZD could strengthen against the AUD in the first half of 2020.



Rural Fact or Fiction?

? **Answer: False!** Lamb was the go-to meat of choice for 34% of respondents, with ham only two votes behind in second place with 33%. Beef came third with 13%. Interestingly, only 8% of Kiwis went with turkey as their preferred meat.

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