

# Farmshed Economics

## 2018: the year of the dog

January 2018

ASB

Inside this edition:	Pg.
<b>Rural Commodities</b>	
<b>Dairy</b>	2
<ul style="list-style-type: none"> <li>Weather's mixed blessings</li> </ul>	
<b>Lamb</b>	2
<ul style="list-style-type: none"> <li>17/18 season shaping as one to remember</li> </ul>	
<b>Beef</b>	2
<ul style="list-style-type: none"> <li>Rinse and repeat</li> </ul>	
<b>Forestry</b>	3
<ul style="list-style-type: none"> <li>Back a touch</li> </ul>	
<b>Financial Markets</b>	
<b>Interest Rates</b>	3
<ul style="list-style-type: none"> <li>Divergence</li> </ul>	
<b>NZ Dollar</b>	3
<ul style="list-style-type: none"> <li>Kiwi makes flying start to 2018 against USD</li> </ul>	

**Weather aside, 2018 has gotten underway with most rural sectors in good spirits. Looking ahead, the team at Farmshed Economics expects the rural picture to remain healthy at least over the first half of the year. Of course though, there will be twists and turns to come over 2018: the year of the dog.**

The wild weather is continuing to throw a spanner in the works for NZ dairy production. While wild weather is hard work for farmers, stalling production has supported NZ dairy prices. Overall dairy auction prices lifted over January, helping us to reaffirm our 2017/18 milk price forecast of \$6.50/kg.

Meanwhile, 2018 has started where 2017 left off for lamb prices. From here, we expect a modest seasonal decline through late summer and autumn, with prices remaining strong for this time of the year. With this in mind, we expect lamb prices to remain over \$6.00/kg for the remainder of the season.

Beef prices have also started 2018 on a very healthy note. In fact, January per kg prices for P2 steers, for example, have been the highest on record for a January month. Looking ahead, we expect prices to remain healthy over the remainder of the first half of 2018. In many ways, we are expecting a rinse and repeat of 2017 over 2018.

Forestry had a banner year over 2017, with record high prices in NZD terms for much of the year. While prices have set fresh highs in January, we expect few more headwinds for forestry prices over 2018 and for prices to ease as a result.

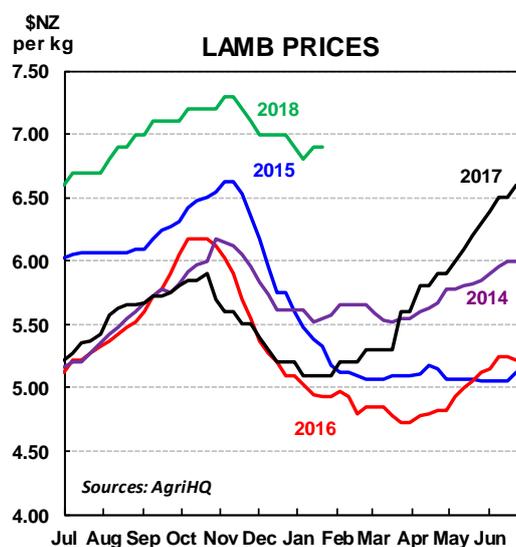
Turning to financial markets, we expect short-term interest rates to remain largely unchanged over the next few months given that we expect no change from the Reserve Bank this year. However, we continue to expect longer-term rates to drift higher following lifting offshore rates.

Finally, the Kiwi dollar has made a flying start to 2018. So far over the month, the NZD has lifted around 3.5% against the USD. That said, the NZD has been weaker against other currencies. Indeed, it has posted modest falls against the euro, Australian dollar, yen and the Pound.

### Key Rural Data:

As at 26 January 2018	Current	4 wks ago	Year ago	Outlook*
<b>Rural Commodity Prices:</b>				
ASB Dairy Price Index (USD)	93.0	90.5	89.5	↘
Lamb Price Index (NZD)	114.4	117.7	85.8	↘
Beef Price Index (NZD)	108.6	110.9	104.7	→
Forestry Price Index (USD)	174.6	174.6	161.9	↘
<b>Interest Rates:</b>				
90-day bank bills	1.88	1.88	1.98	→
2-year swap	2.18	2.21	2.47	↗
5-year swap	2.70	2.68	3.09	↗
<b>Exchange Rates:</b>				
NZD/USD	0.7356	0.7087	0.7264	→
NZD/CNY	4.65	4.61	5.00	↗
NZD/GBP	0.5191	0.5244	0.5786	↗
Milk solids production (ytd % chg)**	0.4	1.8	-3.6	→
Fonterra Shareholders' Fund	6.43	6.41	6.24	↘

### Chart of the Month:



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



### Rural Fact or Fiction?

Dogs can smell your feelings.

Answer on page 3

## Rural Commodities Outlook

### Dairy – Weather’s mixed blessings

2017/18’s wild weather is continuing to throw a spanner in the works for NZ dairy production. Early in the 2017/18 season, wet weather hampered production, although better weather in late spring saw production rebound.

More recently, it has been the turn of dry weather to hamper production. Indeed the NZ Government declared a drought for parts of the North Island in December. More generally large parts of the country have been dry. Accordingly, December nationwide milk production was 4.5% below December 2016 levels.

As a result, we have cut our nationwide (i.e. for all processors) 2017/18 production growth forecast to 1%, from 3% previously. Fonterra has also cut its forecast aggressively to -3%, from flat previously.

While wild weather is hard work for farmers, stalling production has supported NZ dairy prices. Overall dairy auction prices lifted 7.2% over January, while whole milk powder prices surged close to 10%.

All up, the price strength over January reinforces our more optimistic 2017/18 milk price forecast of \$6.50/kg – recall that Fonterra’s forecasts \$6.40/kg.

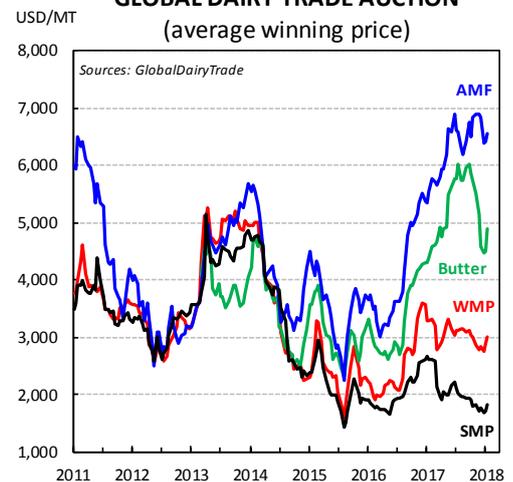
Dairy Index (USD), 26 Jan: 93.0 ↑2.7% (mpc)

#### 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 – 17/18 season shaping as one to remember

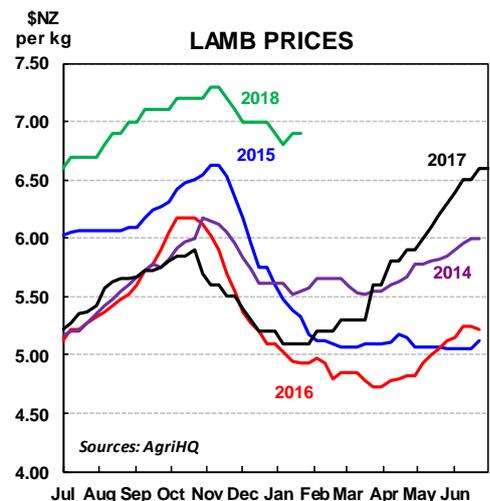
2018 has started where 2017 left off for lamb prices. In fact, average prices over January 2018 prices were only bettered by January 2012.

From here, we expect a modest seasonal decline through late summer and autumn, with prices remaining strong for this time of the year. Indeed, per kg lamb prices only fell 10c/kg over January 2018 compared to 20c/kg average fall in the same period over the past five years.

With this in mind, we expect lamb prices to remain over \$6.00/kg for the remainder of the season. Moreover, the majority of factors underpinning prices are likely to remain in play. Also, we are unlikely to see a major pick up in supply either side of the Tasman.

There remains a risk that drought could see slaughter levels spike, initially pushing prices down. However recent rain has reduced this risk, with the exception of the southern parts of the South Island. All up, the 2017/18 season is shaping up as one to remember.

Lamb Index (NZD), 26 Jan: 114.4 ↓-2.9 (mpc)



### Beef – Rinse and repeat

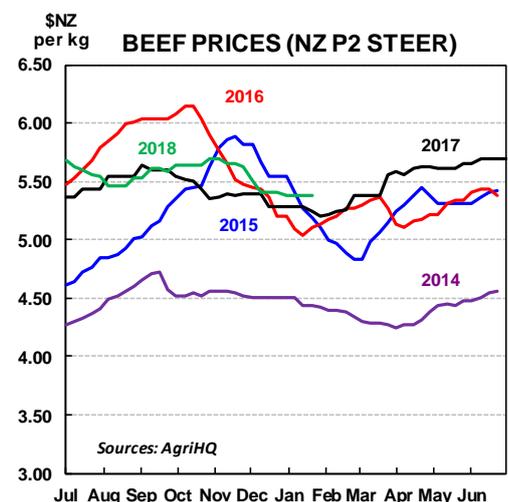
Beef prices have also started 2018 on a very healthy note. In fact, January per kg prices for P2 steers, for example, have been the highest on record.

Moreover, the seasonal dip in prices has been modest to date. After peaking near \$5.70/kg back in November, P2 steer prices have fallen 31 cents per kg through to the end of January. This fall compares favourably to the 44 cent per kg dip over a similar period last season.

With that in mind, we expect prices to remain healthy over the remainder of the first half of 2018. Indeed, we expect P2 steer prices to hold above \$5.00/kg through June. In many ways, we are expecting a rinse and repeat of 2017 over 2018.

As it stands, the main risk to beef prices is a stronger NZD/USD. This strength has the potential to push beef prices in NZD terms from very good to merely good. For now though, beef prices are very healthy despite the recent move higher in the NZD/USD.

Beef Index (NZD), 26 Jan: 108.6 ↓-2.0 (mpc)



## Rural Commodities Outlook (continued)

### Forestry – Back a touch

Log & Pulp Index (USD), 26 Jan: 174.6 (No change)

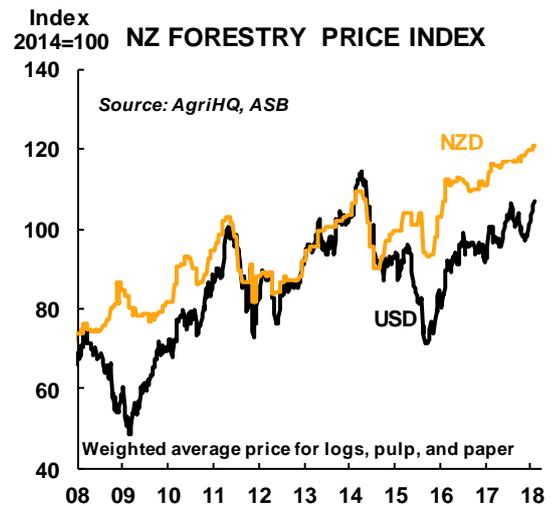
Forestry had a banner year over 2017. In NZD terms, forestry prices as measured by the AgriHQ log index were at record highs for much of the year.

2018 has started off in the same way. Indeed, the AgriHQ log index set a fresh record high in NZD terms over the second half of January.

However, we expect few more headwinds for forestry prices over 2018 and for prices to ease as a result. First up, the NZD/USD has already risen so far this year and we expect it may rise further. From around 0.73 currently, we expect the NZD to rise to US\$0.75 by the end of the year.

Second, with oil prices rising, shipping costs are also likely to increase. Also, we expect lower Chinese economic growth to translate into less demand for logs from our key export market.

But that said, local demand is likely to remain firm. As a result, prices are likely to remain high by historical standards, but back a touch from 2017.



## Financial Markets Outlook

### Interest Rates – Divergence

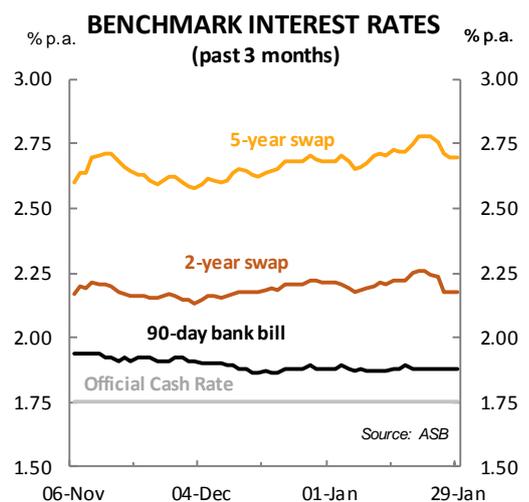
90-day bank bills, 26 Jan: 1.86% ↓-0.05 (mc)

NZ benchmark interest rates have mostly fallen over January. 2-year swap rates, for example, have fallen circa 7 basis points since late December.

These interest rate falls follow very weak NZ inflation data, which have decreased the probability that the Reserve Bank (RBNZ) will hike the Official Cash Rate this year. In our view, the Reserve Bank is likely to wait at least until early 2019 before it starts lifting interest rates.

Meanwhile, offshore interest rates have lifted so far this year. These lifts have been supported by the positive global backdrop, pending US Federal Reserve interest rate hikes and the potential for increases by other central banks too.

Bringing these factors together, we expect short-term NZ interest rates to remain largely unchanged over the next few months given we expect no change from the RBNZ this year. However, we continue to expect longer-term NZ interest rates to drift higher following lifting offshore rates.



### NZ Dollar – Kiwi makes flying start against USD

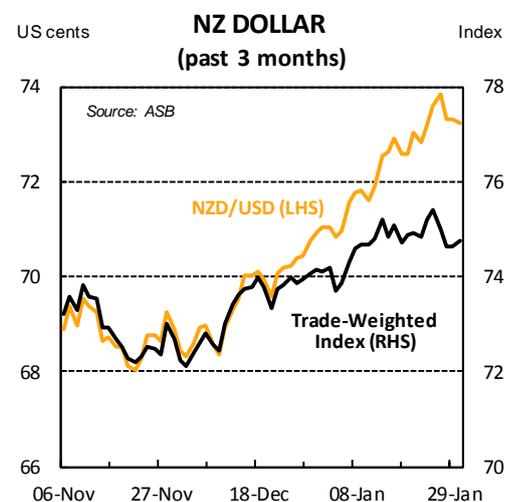
NZD/USD, 26 Jan: 0.6990 ↑ 0.0173 (mc)

The Kiwi dollar has made a flying start to 2018. So far over the month, the NZD has lifted around 3.5% against the USD.

However, the NZD has been weaker against other currencies. Indeed, it has posted modest falls against the euro, Australian dollar, yen and the Pound.

It follows then, that much of the strength in the NZD/USD is in fact due to USD weakness rather than NZD strength. For example, over the last week or so the USD index has hovered around three-year lows.

That said, there are some key factors underpinning the improvement in the NZD since early December 2017. These factors include the improved global growth outlook, improved investor risk appetites and high NZ export commodity prices. As these factors are likely to persist, we expect the NZD to remain firm over coming months. In turn, this may cap commodity price gains in NZD terms over the same period.



### Rural Fact or Fiction?

? **Answer: Fact!** Dogs can pick up on subtle changes in your scent, helping them figure out how you are feeling — such as by smelling your perspiration when you become nervous or fearful.

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