

Farmshed Economics

When pigs can't fly

July 2019




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Sometimes one person's loss is another person's gain. And this is the case with the outbreak of African Swine Fever in China and neighbouring countries. The disease has ripped through the Chinese pork industry, with reports of up to 250 million pigs being slaughtered. As a result, Chinese consumers have had to fill the gap by switching to other proteins, including beef and lamb. In other words, Chinese pork producers' loss is a gain for beef and lamb producers like NZ.

The gain for beef and sheep farmers is coming in the form of rising farmgate prices. Beef prices have picked up and P2 steer prices, for example, look poised this spring to test the \$6.00/kg mark. Meanwhile, lamb prices have now caught up with last year's record pace and look set to rise above \$8.00/kg again this spring. Both beef and lamb prices may even test record highs over the spring months.

Meanwhile, the 2018/19 dairy production season was very much a case of a season of two halves i.e. a strong spring, followed by a hot and dry summer. Looking ahead, we expect a similar level of production over 2019/20. On the milk price side, we have pencilled in a bullish milk price forecast of \$7.00/kg.

Turning to horticulture, Zespri estimates that the gold kiwifruit crop has overtaken the green crop for the first time on record. Meanwhile, export sales have started the year strongly and Orchard Gate Returns are shaping up to be similar to last season's healthy levels.

In financial markets, the steady downward march of farmers' borrowing rates over recent years may be coming to an end. And while interest rates for rural loans may drift higher, they are likely to remain low by historical standards.

Finally, the low NZD has been supporting commodity prices in NZD terms. We anticipate that the NZD will remain supportive over the remainder of 2019, however, if recent USD weakness persists, some of the NZD support may wane.

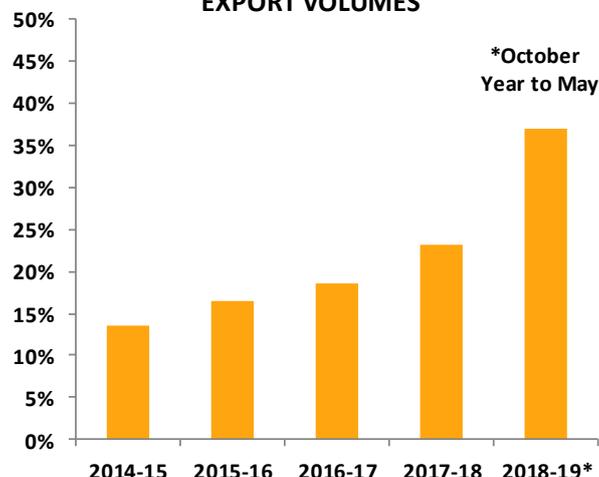
Key Rural Data:

Chart of the Month:

As at 21 June 2019	Current	3 mths ago	Year ago	Outlook*
Rural Commodity Prices:				
ASB Dairy Price Index (USD)	100.4	102.7	102.5	↗
Lamb Price Index (NZD)	120.8	108.1	120.5	↗
Beef Price Index (NZD)	96.3	90.1	96.7	↗
Est. Gold Kiwifruit Crop, m trays, 2019	66.0	N/A	52.0	↗
Interest Rates:				
90-day bank bills	1.58	1.90	2.02	↘
2-year swap	1.29	1.82	2.25	→
5-year swap	1.36	1.92	2.68	→
Exchange Rates:				
NZD/USD	0.6589	0.6877	0.6950	↗
NZD/CNY	4.53	4.62	4.48	↗
NZD/GBP	0.5171	0.5205	0.5231	↗
Milk solids production (ytd % chg]**	2.4	4.9	-0.6	↘
Fonterra Shareholders' Fund	3.91	4.22	5.07	→

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

CHINESE SHARE OF NZ BEEF EXPORT VOLUMES



Rural Fact or Fiction?

Sows (female pigs) may have two dozen or more piglets per year.

Answer on page 3

Rural Commodities Outlook

Dairy – A season of two halves

Dairy production for the 2018/19 season was 2.4% higher than 2017/18. This broke the run of three season-on-season falls from 2014/15 to 2017/18.

The overall lift, however, masked a season of two halves. Production was strong through the spring and early summer. Late last year we had thought that production for the 2018/19 season might be 5% higher.

The hot and dry summer put paid to that. February and March were particularly hot. Production levels swung from being 7.7% ahead of the same month last year in January to being 7.7% behind it in April.

Regionally, the contrast was also stark. Production north of Lake Taupo fell below 2017/18's level. Production south of Lake Taupo fared better, with most regions posting a lift in production compared to the season prior.

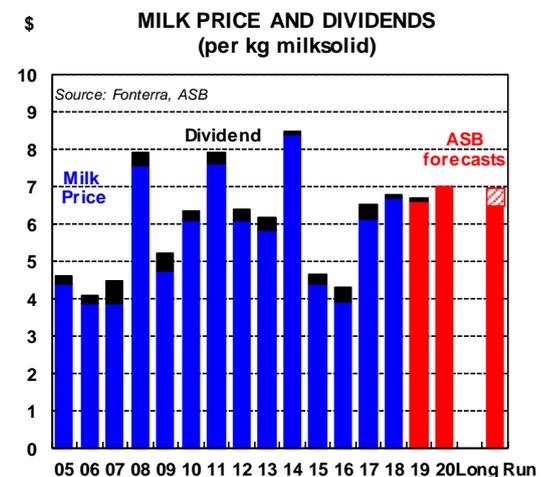
Looking to 2019/20, we expect a similar level of production to 2018/19. On this basis and given production is similarly constrained offshore, we expect healthy global dairy prices over the new season. At this stage, we have pencilled in a \$7.00/kg milk price forecast, but note it's still very early in the season. Fonterra's \$1.00/kg forecast range gives farmers an idea of the wide range of potential outcomes.

Dairy Index (USD), 21 June: 100.4 ↓2.2 (qpc)

Season End Milk Price* Forecasts:

	2018/19		2019/20		Long Run
	Fonterra/ASB	Fonterra	ASB	ASB	ASB
Milk Price*	\$6.30-\$6.40	\$6.25-\$7.25	\$7.00	\$6.50-\$7.00	

* per kg of milk solids (excluding dividend)



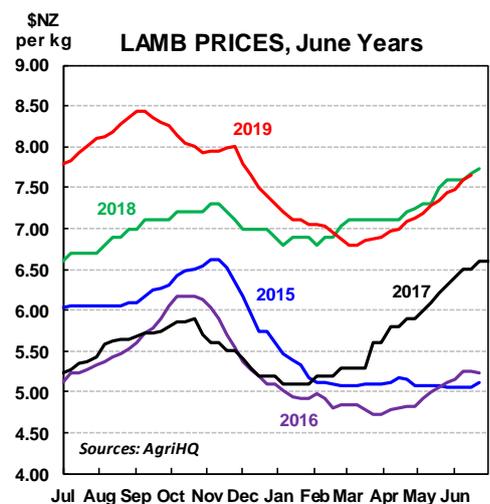
Lamb – \$8/kg on the cards again this spring

Lamb prices are on the move again. Indeed, prices have lifted 85 cents/kg from their March 2019 lows. Moreover, prices look on track to crack \$8.00/kg again in the spring. Prices are at similar level to where they were 12 months ago. Previously we had thought that prices would top out in the high \$7's. Now, we expect prices to top \$8.00/kg over the spring. Recall that prices peaked at \$8.43/kg in spring 2018.

There are a variety of factors driving lamb prices higher. First, on the demand side, African Swine Fever has ripped through the Chinese pork industry, with reports of up 250 million pigs being slaughtered. As a result, Chinese consumers have had to switch to other proteins such as lamb.

Second, lamb supply remains tight, both here and in Australia. The increasing number of conversions of sheep/beef land to forestry will reduce lamb supply over the coming few years. While not necessarily a good thing for the sheep industry, these conversions will nonetheless underpin lamb prices for an extended period.

Lamb Index (NZD), 21 June: 120.8 ↑11.7 (qpc)



Beef – The only way is up

Beef prices are poised to surge over the remainder of 2019. As measured by the Agrifax Beef Index, prices have lifted nearly 7% over the three months since the last edition of Farmshed Economics.

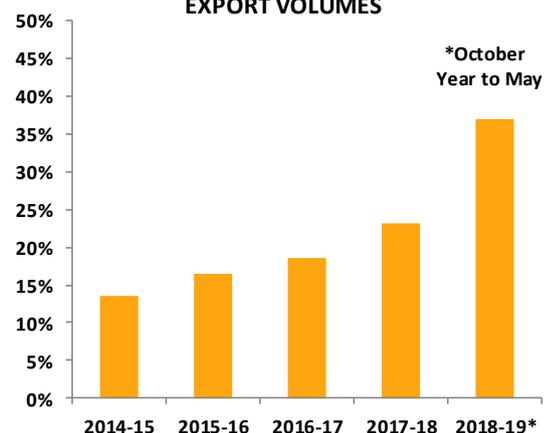
We are more bullish (excuse the pun) on prices than we were three months ago. We anticipate P2 steer prices may challenge the \$6.00/kg mark over the spring, and may even test the record highs set back in 2016.

African Swine Fever has ripped through the Chinese pork industry, with reports of up 250 million pigs being slaughtered. As a result, Chinese consumers have had to switch to other proteins, highlighted by NZ's share of beef exports going to China jumping to 37% so far over 2018/19.

Meanwhile, global beef export supply is modest, at least into the key Chinese market. Australian supply is tight following drought, while US beef exports are being held back by Chinese tariffs. All up, these factors point to prices strengthening over the second half of 2019.

Beef Index (NZD), 21 June: 96.3 ↑6.9 (qpc)

CHINESE SHARE OF NZ BEEF EXPORT VOLUMES



Rural Commodities Outlook (continued)

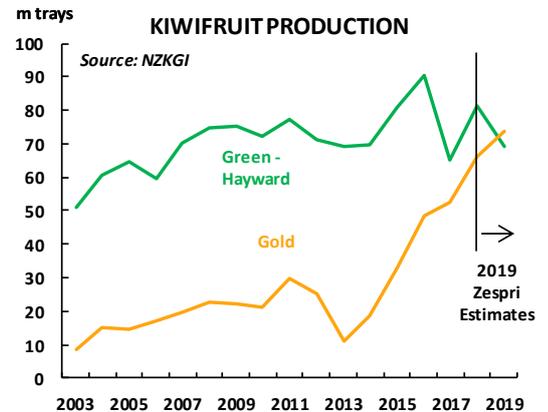
Kiwifruit – Gold crop tops green for first time

Kiwifruit Gold Crop, 2019: 73.7m trays ↑12% (apc)

Zespri estimates production from the gold kiwifruit crop has overtaken that of the green crop for the first time on record. Production for the gold crop rose 12% to 73.7 million trays in 2019, setting another record high. Green crop production was down 15% to 69.4 million trays.

Looking at prices, both gold and green kiwifruit are shaping up for a strong year. Export data show that prices are 4% and 5% ahead at the same stage of last season for gold and green kiwifruit, respectively. On this basis, we anticipate this season's Orchard Gate Returns (OGR, gross after packing costs) will be similar or better than last season's. In terms of Zespri forecasts, we anticipate green OGR in the middle of Zespri's range (\$5.20 to \$6.20), while the gold OGR may be closer to the top end of Zespri's range (\$9.70 to \$10.70).

All up, with the higher share of gold exports and firm overall prices, we anticipate another season of record-high export revenues.



Financial Markets Outlook

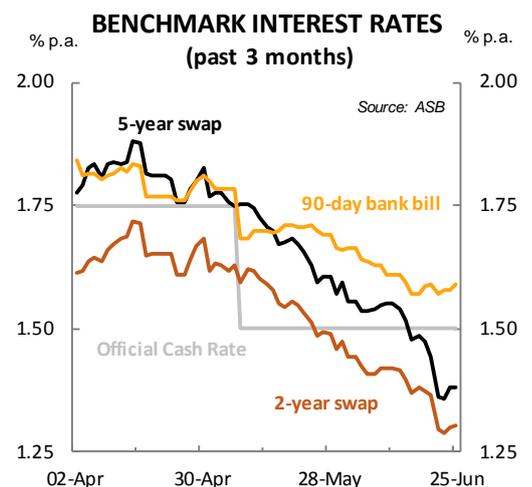
Interest Rates – golden rate run may be ending

90-day bank bills, 21 June: 1.58% ↓-0.32 (qc)

The steady downward march of borrowing rates for farmers over recent years may be coming to an end. And despite falling benchmark interest rates the outlook for borrowing rates has taken a turn upward.

Indeed, for farmers other factors are in play that may offset benchmark interest rate falls. First, banks are currently repricing some commercial loans, including farm loans, to better reflect the higher risk of these loans relative to, say, home mortgages. Second, the Reserve Bank is also proposing to increase banks' capital requirements. These requirements will increase bank funding costs. The combined effect of these changes may offset the impact of falling benchmark interest rates (including the fall in the Official Cash Rate).

For now, interest rates for rural loans are likely to remain low by historical standards. On balance, though, we judge that farmers' borrowing rates are more likely to drift higher over the next few years.



NZ Dollar – Helping hand

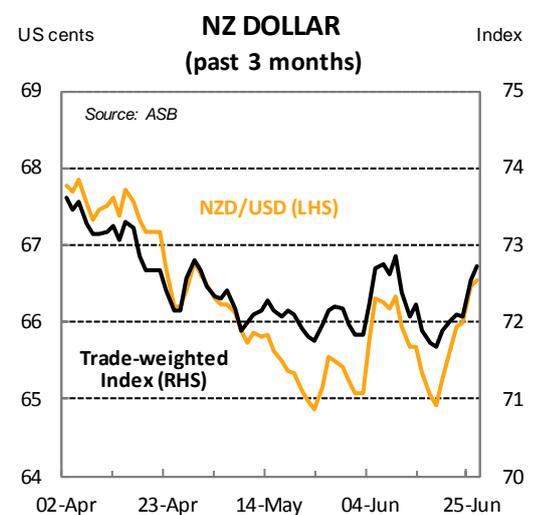
NZD/USD, 21 June: 0.6589 ↓ 0.0288 (qc)

The low NZD is helping boost all NZ commodity prices in NZD terms. Since the last edition of Farmshed Economics, the NZD/USD has fallen by around 1½% (up to the time of writing).

The NZD/USD troughed at around US\$0.6480 in mid-May and mid-June, likely in response to lower NZ interest rates which touched record lows. In May, the Reserve Bank of New Zealand cut the Official Cash Rate (OCR) by 25 basis points to 1.50% and in late June they signalled the OCR could move lower still. We expect another 25 basis point OCR cut in August.

At the time of writing, the NZD is around US\$0.67. NZ wholesale interest rates have edged up, but are still around 40-50bps lower than in late March. Lifting the NZD has been the prospect for lower US interest rates. Indeed, we expect 100 basis points of interest rate cuts by the US Federal Reserve over the next 12 months.

All up, we expect the NZD to average US\$0.66 over the remainder of 2019, with the NZD likely to largely track sideways at current supportive levels.



Rural Fact or Fiction?



Answer: Fact! One of the advantages of farming pigs is their ability to reproduce more often than other livestock species. Sows can produce more than two litters per year and around a dozen piglets per litter.

ASB Economics & Research

Chief Economist

Senior Rural Economist

Senior Economist

Senior Economist

Senior Economist, Wealth

Senior Economist

Data & Publication Manager

Nick Tuffley

Nathan Penny

Mark Smith

Jane Turner

Chris Tennent-Brown

Mike Jones

Judith Pinto

nick.tuffley@asb.co.nz

nathan.penny@asb.co.nz

mark.smith4@asb.co.nz

jane.turner@asb.co.nz

chris.tennent-brown@asb.co.nz

mike.jones@asb.co.nz

judith.pinto@asb.co.nz

Phone

(649) 301 5659

(649) 448 8778

(649) 301 5657

(649) 301 5853

(649) 301 5915

(649) 301 5661

(649) 301 5660

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