

Farmshed Economics

March madness

March 2018



ASB

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March has been a very busy month for agricultural and financial market developments. Indeed, we've had a little bit of everything over the month, including, to borrow some American terminology, a little bit of 'March madness'.

For us, lamb prices have been the star over the month. In fact, prices have bucked the normal seasonal pattern, with per kg prices lifting above \$7. Moreover, our records suggest that lamb prices were the highest ever recorded for a March month.

In the opposite camp have been mycoplasma bovis and Donald Trump. In an unprecedented move, MPI announced that over 22,000 animals from 22 infected properties were to be slaughtered. Meanwhile, the Trump administration announced increases to tariffs on selected Chinese exports to the US, prompting fears of a potential trade war.

The dairy sector was also not far from the news. Fonterra lifted its 2017/18 milk price to \$6.55/kg, but at the same time announced a half-year loss driven in a large part a whopping \$405 million writedown in its Beingmate investment. This writedown may have been the last straw for Fonterra, with CEO Theo Spierings set to stand down by the end of the year.

The Reserve Bank was also busy during the month as Adrian Orr started as Governor on the 27th. However, even with the new Governor and a new Policy Targets Agreement with the Government, we expect the Official Cash Rate to remain on hold this year and well into 2019.

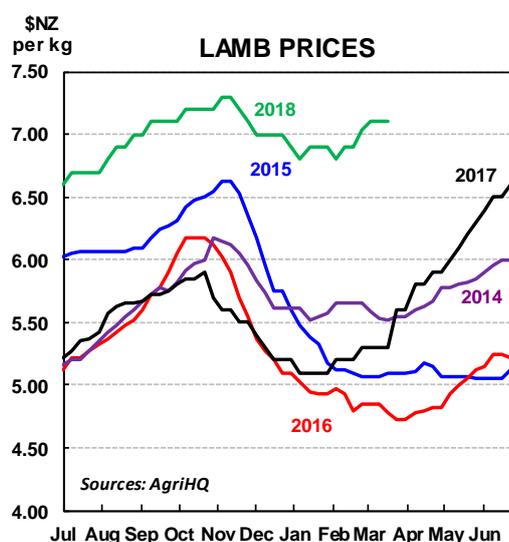
By contrast, the NZD has had a relatively quiet month. Against the US dollar, for example, the NZD has traded within a tight range, reaching as high as US\$0.7340 and as low as US\$7180.

On behalf of everyone at the Farmshed Economics team, we wish you all a very happy Easter. Enjoy the break!

Key Rural Data:

As at 23 March 2018	Current	4 wks ago	Year ago	Outlook*
Rural Commodity Prices:				
ASB Dairy Price Index (USD)	90.0	90.9	84.6	→
Lamb Price Index (NZD)	119.1	116.0	92.5	→
Beef Price Index (NZD)	112.4	112.7	113.8	↘
Feed Wheat Prices (\$NZ/tonne)	374.0	372.0	302.0	↗
Interest Rates:				
90-day bank bills	1.96	1.92	1.98	→
2-year swap	2.23	2.18	2.32	→
5-year swap	2.67	2.72	2.93	↗
Exchange Rates:				
NZD/USD	0.7235	0.7291	0.7029	↗
NZD/CNY	4.57	4.62	4.84	↗
NZD/GBP	0.5119	0.5219	0.5636	↗
Milk solids production (ytd % chg)**	-1.2	-0.9	-2.9	↑
Fonterra Shareholders' Fund	5.85	6.11	6.15	→

Chart of the Month:



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



Rural Fact or Fiction?

The term 'March Madness' refers to traffic jams over Easter.

Answer on page 3

Rural Commodities Outlook

Dairy – Late season flurry

As we anticipated, Fonterra lifted its 2017/18 milk price forecast on 21 March. Although, Fonterra went a step further than we thought it would by lifting its forecast by 15 cents to \$6.55/kg, compared to our forecast of \$6.50/kg.

Following the announcement and given the late stage of the season, we have moved to align our milk price forecast with Fonterra's \$6.55/kg. If anything though, we note that if dairy auction prices hold near current levels, the milk price could edge higher to the vicinity of \$6.60/kg.

Generally global dairy prices, and in particular the prices important to NZ, remain firm. While NZ production is improving, the recovery from weak production earlier in the season is progressing only gradually. With global demand also firm, we expect the global dairy market will remain largely balanced for now and for prices to track sideways as a result.

This trend also bodes well heading into the 2018/19 season. At this early stage, we have pencilled in a similar milk price of \$6.50/kg for next season as well. We should point out, however, that a wide range of possible milk prices are still possible at this juncture. Indeed, the average change milk price from the opening forecast to season end is over \$1.40/kg.

Lamb – Lucky Seven

Lamb prices have bucked the normal seasonal pattern and have lifted over the past four weeks. In fact, per kg prices lifted back above \$7 during the month. Moreover, our records suggest that lamb prices were the highest ever recorded during a March month.

AgriHQ reports that procurement pressures have driven the recent lamb price lift. Indeed, it may have been that recent rains have led to lower slaughter rates, and so to entice farmers back to market processors have had to lift prices.

It follows that underlying demand is also solid. Indeed, all key export markets are paying 15% or more so far this season compared to last season. In particular, Chinese and US markets look robust, delivering not only higher prices but also an increase in NZ lamb export volumes.

We expect lamb prices to remain very strong heading into the start of the new season. However, the growing risk of a global trade war could put a dampner on prices later in 2018.

Beef – Price sacrifice

After a good start to the month, beef prices headed progressively lower. For example, per kg P2 steer prices rose 0.5% in the first week of March, before falling 3.6% over the subsequent three weeks.

In the short-term, tight processor margins may be part of the reason for the fall. AgriHQ reports that margins are well back from average levels, so as processors look to rebuild margins prices will be under pressure.

In the longer term, increasing supply may add to the downward pressure on prices. In the US, drought has led to increased slaughter and thus supply. Moreover, NZ supply is also set to increase as dairy farmers begin their autumn cull.

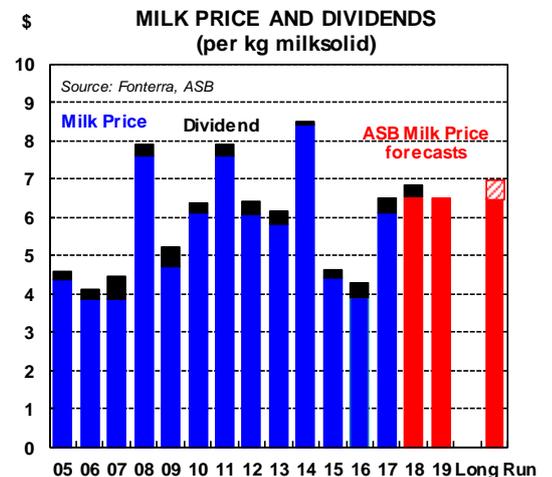
Meanwhile, demand remains solid in our key markets. However, we don't expect the extra supply to be absorbed without sacrificing something on price. As a result, we expect beef prices to drop below season ago levels over coming months.

Dairy Index (USD), 23 Mar: 90.0 ↓-1.0% (mpc)

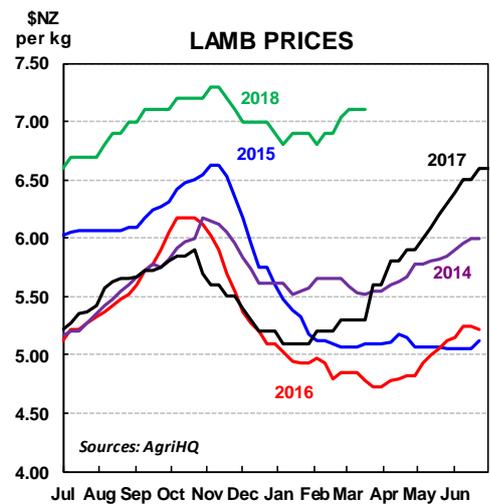
Season End Milk Price Forecasts:

	2017/18		2018/19	Long Run
	Fonterra	ASB	ASB	ASB
Milk Price*	\$6.55	\$6.55	\$6.50	\$6.50-\$7.00

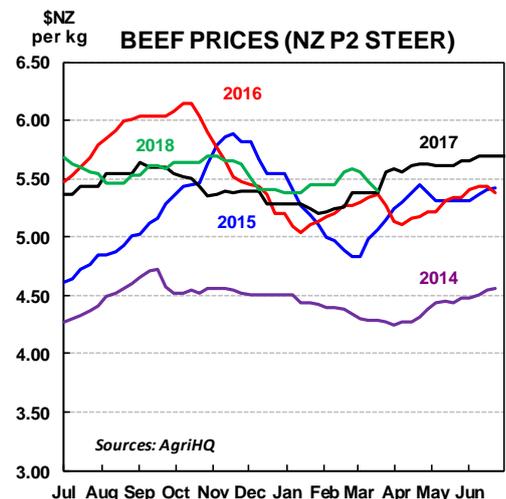
* per kg of milk solids (excluding dividend).



Lamb Index (NZD), 23 Mar: 119.1 ↑2.6% (mpc)



Beef Index (NZD), 23 Mar: 112.4 ↓-0.2% (mpc)



Rural Commodities Outlook (continued)

Feed Grains – Weather woes

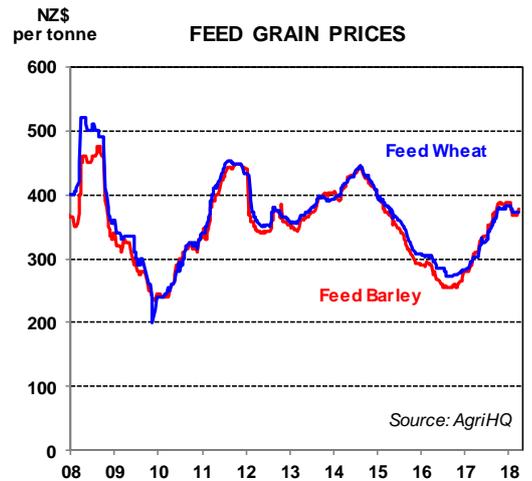
Feed Wheat, 23 Mar: \$374/tonne ↑0.5% (mpc)

It's been a difficult season for grain growers, with weather having an impact on yields. AgriHQ reports that the season started well, but gradually got worse. Hardest hit have been growers in Southland and Otago. There, growers had to contend with first drought and then wet conditions over harvest time.

Growers have fared better in price terms, however. For example, feed wheat prices since July have averaged 6% higher than the 10-year average.

From here, we expect the feed grain prices to remain well-supported. On top of tight supply, the lift in the milk price forecast should give a late season boost to demand. But more importantly, we expect the 2018/19 milk price forecast to start on a healthy note. We have pencilled in \$6.50/kg at this stage.

With the above in mind, we expect feed grain prices to track sideways, if not drift higher, over the remainder of the year.



Financial Markets Outlook

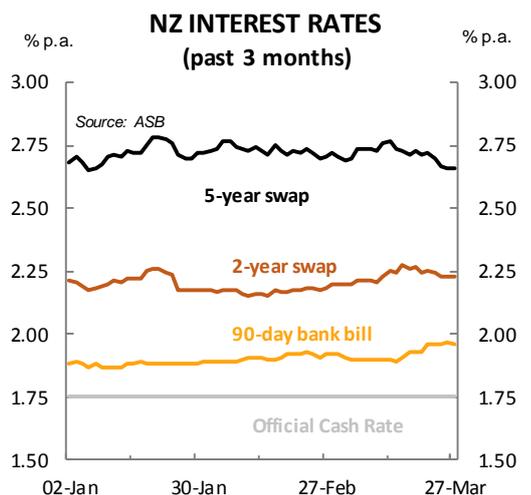
Interest Rates – New era, same OCR

90-day bank bills, 23 Mar: 1.96% ↑ 0.04 (mc)

This month, Adrian Orr officially started as the new Reserve Bank (RBNZ) Governor. However, even with a new Governor, we expect the RBNZ's message on interest rates to remain the same for now. Recall that, earlier in March, the RBNZ kept the Official Cash Rate (OCR) unchanged at 1.75% and stated that it was likely remain there "for a considerable period."

In other words, OCR hikes remain a long way off. For our part, we don't expect RBNZ to begin hiking the OCR until August 2019.

In terms of interest rates, the RBNZ's stance should help keep NZ short-term interest rates near current low levels for most of 2018. In contrast, long-term interest rates may drift higher in line with rising global rates. In fact, we expect two more US Federal Reserve interest rate hikes this year on top of the hike earlier this month. All up and more broadly, we expect interest rates to continue to remain low by historical standards over the next six months.



NZ Dollar – Drifting

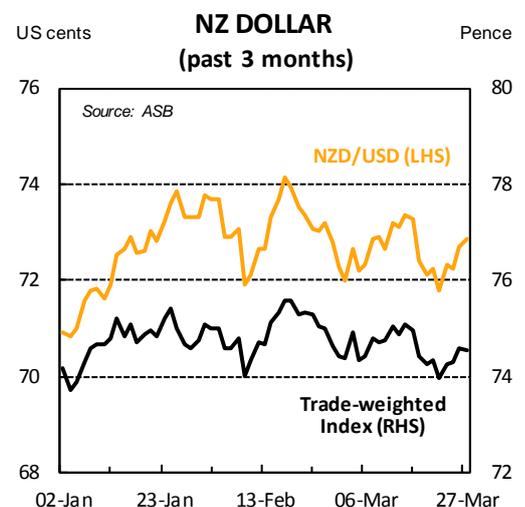
NZD/USD, 23 Mar: 0.7235 ↓ -0.0056 (mc)

The NZD has drifted lower over March. This fall was mainly a consequence of weak investor sentiment, particularly following the announcement of US tariff increases and the subsequent potential for trade wars. Since the last edition of Farmshed Economics, the NZD/USD has fallen nearly 1%.

Against most other currencies, the NZD also fell over March. In particular, NZD fell 3.0% and 2.2% against the yen and the pound, respectively. The AUD was only exception; against which the NZD gained 0.4%.

However on balance, we expect the NZD to drift higher against most of the major currencies over the next six months. In particular, the NZD remains underpinned by the solid NZ economic outlook and strong NZ commodity prices.

With that in mind, a stronger NZD has the potential to cap further any gains in farmgate prices (i.e. commodity prices in NZD terms) over the next six months.



Rural Fact or Fiction?

? **Answer: Fiction!** 'March Madness' is knock-out basketball tournament played between top US college teams. 68 teams compete over seven rounds and 67 games for the US national college championship. Strangely though, while the first 6 rounds are scheduled for March, this year's final is scheduled for April.

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