

# Farmshed Economics

## Singing in the rain

May 2017



**ASB**

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Autumn has been very wet, and for some, much too wet. And while some farmers have come to loathe weather forecasts, rural sector outlooks provide a welcome contrast. Indeed, there is strength right across the rural sector. All up, this strength bodes well for the upcoming season.

First up, dairy has its mojo back. Fonterra's 2017/18 opening milk price of \$6.50/kg all but confirms that this is the case. Indeed at this level, a clear majority of farmers are setting up for a season in the black.

Similarly, the sheep meat sector has a skip in its step. After notching up the \$6.00/kg mark earlier in the month, lamb prices have lifted further. Moreover, prices over May were their second-highest on record for the month, behind only May 2011.

Likewise, beef prices are very healthy and remain on track to surpass \$6.00/kg in the early spring. While 'merely' tracking sideways over the last month, prices have sat at record highs over the May month as they did over April.

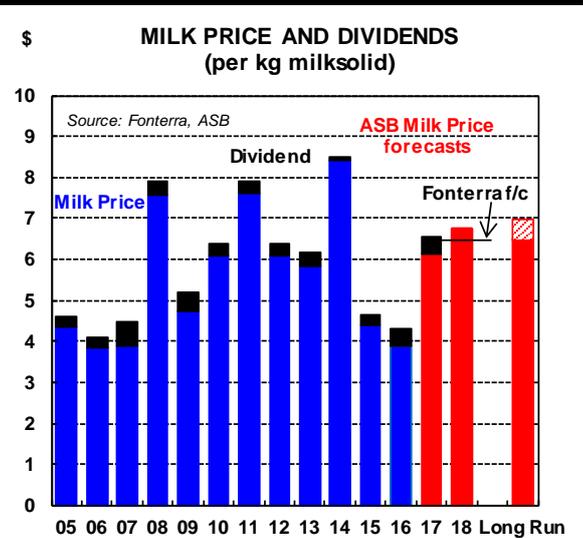
Meanwhile, after the stellar 2016 year, the year ahead is shaping a little more mixed for the kiwifruit sector. Firstly, gold production is set for another step up, while on the flipside green production is falling. In terms of price, we are bullish on green prices, but more circumspect on gold prices. Lastly, the recent wet weather may also lower the quality of both crops and increase packing costs, and as a result, lower the OGR (Orchard Gate Return) for both varieties. All up though, we remain very positive on the outlook for the sector.

Turning to interest rates, the RBNZ's stance should help anchor NZ short-term interest rates around current low levels. Longer-term rates, though, may still drift higher, following global moves such as the pending lifts in US benchmark interest rates.

Lastly, the strong rural sector outlook isn't going unnoticed in currency markets. Indeed, the NZD has tracked higher over the last month. In fact, the NZ dollar might hit the high 90's against the AUD at some stage this year.

**Key Rural Data:** **Chart of the Month:**

As at 26 May 2017	Current	4 wks ago	Year ago	Outlook*
<b>Rural Commodity Prices:</b>				
ASB Dairy Price Index (USD)	199.8	190.4	131.9	→
Lamb Price Index (NZD)	196.8	189.9	164.0	→
Beef Price Index (NZD)	259.8	259.2	256.3	↗
Est. Gold Kiwifruit Crop, m trays, 2017	56.0	N/A	48.5	↑
<b>Interest Rates:</b>				
90-day bank bills	1.97	1.98	2.39	→
2 year swap	2.26	2.35	2.31	→
5 year swap	2.76	2.93	2.52	↗
<b>Exchange Rates:</b>				
NZD/USD	0.7062	0.6868	0.6771	↗
NZD/CNY	4.84	4.73	4.43	→
NZD/GBP	0.5515	0.5304	0.4669	→
Milk solids production (ytd % chg)**	-0.7	-1.3	-1.6	↗
Fonterra Shareholders' Fund	6.03	5.98	5.71	→



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

**? Rural Fact or Fiction?**  
 This April was the wettest on record for many parts of the country.  
Answer on page 3

## Rural Commodities Outlook

### Dairy – Dairy has its mojo back

ASB Dairy Index (USD), 26 May: 199.8 ↑4.9% (mpc)

Dairy has its mojo back. Fonterra's 2017/18 opening milk price of \$6.50/kg all but confirms that this is the case. Indeed at this level, a clear majority of farmers are setting up for a season in the black.

In the first instance, we expect farmers will look to shore up their businesses. Debt repayment will be high on priority lists, as well as farm maintenance and animal health.

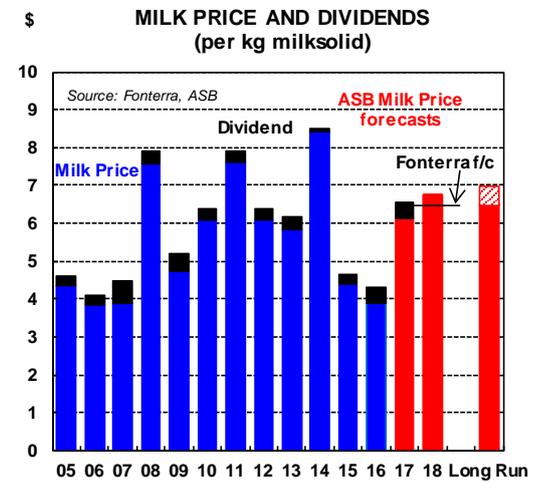
However, last week's Fonterra opening season announcement was a shade more bullish than we had expected – and we anticipate this may accelerate other plans, including farm spending and investment. In particular, farm confidence is likely to see a larger jump than would have otherwise been the case as we enter into the new season.

At the margin, this is likely to add to activity more generally in the sector. The announcement also gives farmers a firm production signal for the season ahead. And with that in mind, the recovery in production may be sooner and stronger (weather permitting) than we anticipated previously. In turn, stronger production may cap any upside to our own season-end milk price forecast of \$6.75/kg. That said, with both the milk price and production outlooks positive, the dairy sector has plenty to look forward to.

#### Season End Milk Price Forecasts:

	2016/17		2017/18		Long Run
	Fonterra/ASB	Fonterra	ASB	ASB	
Milk Price*	\$6.15	\$6.50	\$6.75	\$6.50-\$7.00	

\* per kg of milk solids (excluding dividend).



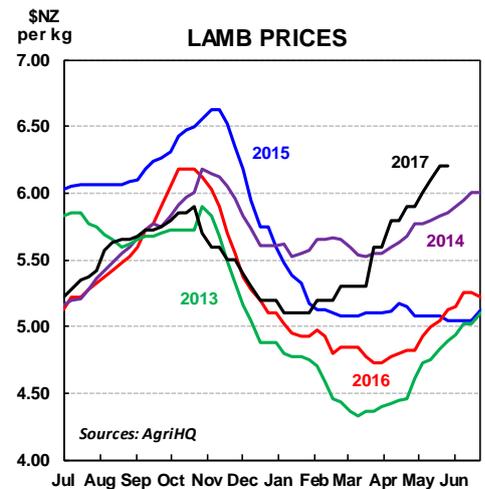
### Lamb – Demand coming to the party

Lamb Index (NZD), 26 May: 196.8 ↑3.6% (mpc)

Lamb prices are kicking on. After notching up the \$6.00/kg mark earlier in the month, prices have lifted further. Currently, prices stand at \$6.20/kg, representing a 5.1% lift over the last month. Moreover, prices over May were their second-highest on record for the month, behind only May 2011.

Previously we have talked about low slaughter rates lifting prices, but now demand is coming to the party as well. European demand, in particular, looks to have firmed. For example, AgriHQ reports that leg prices in the UK market are at their highest since 2011.

Firming demand bodes well for prices heading into the 2017/18 season. This fact is important because as we have mentioned in previous editions, the support for prices from low slaughter rates will fade over time. However, we are now more confident that improved demand can pick up some this slack, keeping prices at relatively healthy levels over the new season.



### Beef – Let the good times roll

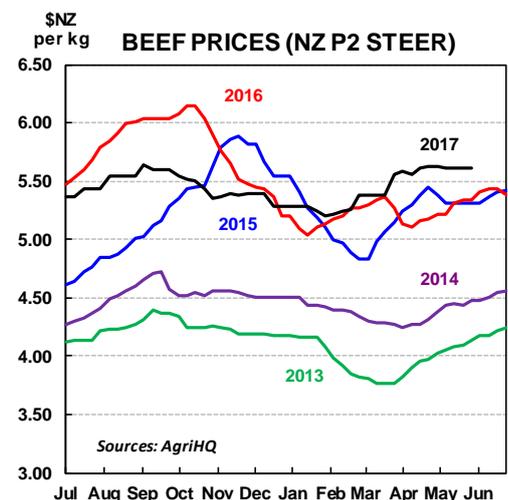
Beef Index (NZD), 26 May: 259.8 ↑0.2% (mpc)

Beef prices are remain on track to surpass \$6.00/kg in the early spring. While 'merely' tracking sideways over the last month, prices have sat at record highs over the May month as they did over April.

As discussed previously, the market fundamentals for beef are still strong. US demand continues to be firm, with US domestic supply relatively tight. Similarly, local (NZ) and Australian beef production remain constrained, underpinning prices further.

Also, India's recent effective ban cattle slaughter may further tighten global beef supply and put more upward pressure on prices. India exports around US\$5 billion worth of beef exports (including buffalo meat), accounting for around 20% of global beef exports (India is also the second-largest exporter). Indeed, this ban will open up further market opportunities for NZ exporters.

All up, we expect the good times to roll on for the beef sector over the new season.



## Rural Commodities Outlook (continued)

### Kiwifruit – Up and down

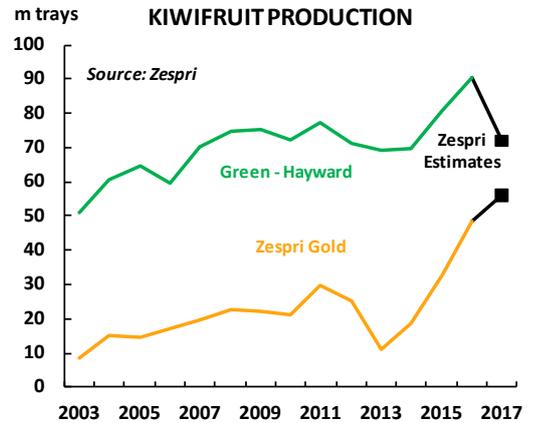
Est. Gold Crop, 2017: 56m trays ↑16% (apc)

After the stellar 2016 year, the year ahead is shaping a little more mixed.

Firstly, gold production is set for another step up. Zespri expects 2017 production to lift to 60 million trays from 48.5 million in 2016 (up 15%). The flipside is lower green production: Zespri anticipates 75 million trays, down from 90.7 million in 2016 (down 19%).

In terms of price, we are bullish on green prices, but more circumspect on gold prices. For green (Hayward) and given the drop in supply, we anticipate an Orchard Gate Return (OGR, gross after packing costs) towards the top half of Zespri's forecast range of \$5.15 to \$6.15. In contrast, with gold supply lifting further we expect a gold OGR closer to the bottom of Zespri's forecast range of \$8.75 to \$9.75. Lastly, the recent wet weather may also lower the quality of both crops and increase packing costs, and as a result, lower the OGR for both varieties.

All up though, we remain very positive on the outlook for the sector.



## Financial Markets Outlook

### Interest Rates – Reserve Bank happily on hold

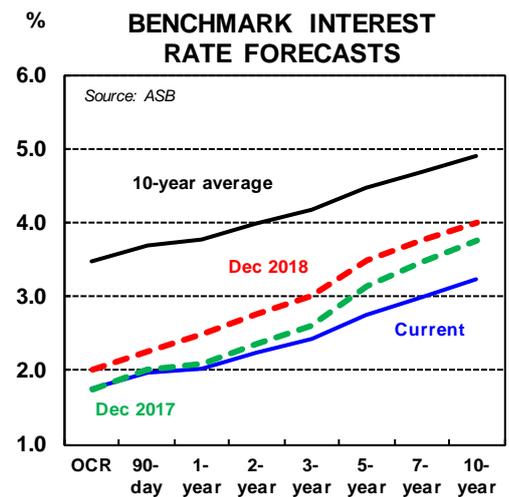
90-day bank bills, 26 May: 1.97% ↓ 0.01 (mc)

The Reserve Bank's (RBNZ) May Official Cash Rate (OCR) announcement surprised financial markets. The surprise came as the RBNZ signalled that it expects to keep the OCR lower for longer than markets had expected.

Moreover, the RBNZ's neutral bias surprised markets. In other words, the RBNZ expects that there is roughly an equal chance of the next interest rate move being up or down. Markets, on the hand, had expected that the next move to clearly be up, and for it to come as soon as next year.

For our part, we still expect that the RBNZ will eventually start lifting the OCR at the end of 2018. In particular, we expect stronger inflation in 2018 than the RBNZ forecasts. But the end of 2018 is still a "considerable" time away, and later than that indicated by market pricing.

In terms of interest rates, the RBNZ's stance should help anchor NZ short-term interest rates around current low levels. Longer-term rates, though, may still drift higher, following global moves such as the pending lifts in US benchmark interest rates.



### NZ Dollar – Firm and perhaps firmer

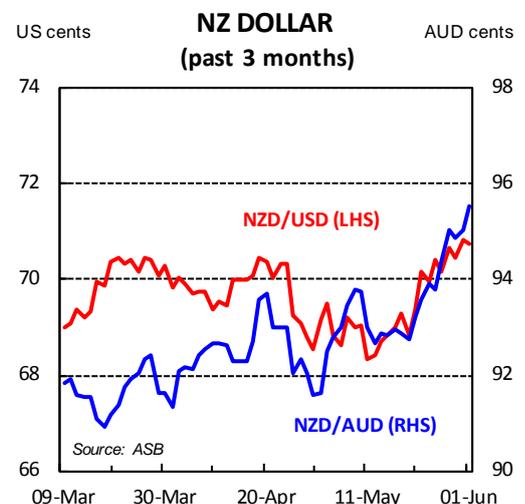
NZD/USD, 26 May: 0.7062 ↑0.0194 (mc)

In the last edition of Farmshed Economics, we indicated that the relatively low NZD may prove short-lived. This indeed has proven to be the case. The NZD is now trading back above the 70 US cents. In terms of change, the lift is nearly 2 cents or 2.8% over the last month.

Moreover, the NZD is strong against the AUD. As at the time of writing, the NZD is trading at around 0.9570. If it lifts further, it is likely that talk of reaching parity against the AUD will again become prevalent.

The NZD rise against the AUD reflects the broad strength of NZ export prices, particularly compared to Australia's. Indeed, NZ's Terms of Trade (the ratio of export prices to import prices) have recorded a 44-year high over the March quarter.

We are confident that the NZ's Terms of Trade will set a new record high this year. And while we expect the NZD can thus go higher, we would be surprised if NZD did go all the way to parity against the AUD.



### Rural Fact or Fiction?

? **Answer: Fact!** Warkworth, Whangaparoa, Te Puke, Taupo, Lower Retaruke, Martinborough, Hawera, Ohakune and Waiouru all recorded their highest April rainfall on record.

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