

# Farmshed Economics

## Mixed blessings

November 2018




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November has been a busy month for rural and financial market developments. It's also been a mixture of good and bad news over the month. Similarly, the weather has been a mixed blessing, with rain setting growing conditions up well for summer, but also causing flooding in parts of the South.

Looking at dairy markets, strong NZ production is proving too much for global markets to absorb. Fortunately, production is relatively soft in the EU, the US and in Australia. Nonetheless, given NZ's large share of global dairy exports, the mini glut in production is leading prices lower. As a result, this month we trimmed our 2018/19 milk price forecast by 25 cents to \$6.00/kg.

Meanwhile, lamb prices have remained extremely high so far over November. And while prices have come off the boil, we expect prices to remain at very healthy levels over the remainder of the season.

For the beef sector, supply and demand factors remain delicately balanced. Over the next six months or so, we anticipate that strong US production will lead farmgate prices lower.

In comparison, the kiwifruit sector continues to charge ahead. After cracking \$2 billion in annual values for the first time last month, export values have pushed on to reach circa \$2.2 billion in the 12 months to October. Indeed, we expect there's more growth to come.

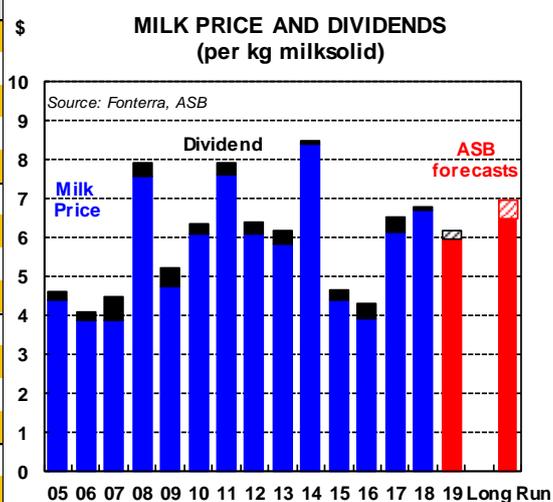
Meanwhile, benchmark interest rates have lifted to date over November. Nonetheless, with the next OCR move still a long way off, we expect that benchmark interest rates are likely to remain low for an extended period of time, before drifting higher.

Lastly, the NZD has lifted to date over November. This move higher removes some of the support that farmgate prices have been receiving over the last three months or so. Looking over a longer period, though, the NZD remains at levels which are still supportive of farmgate prices.

#### Key Rural Data:

#### Chart of the Month:

As at 23 November 2018	Current	5 wks ago	Year ago	Outlook*
<b>Rural Commodity Prices:</b>				
ASB Dairy Price Index (USD)	75.0	79.7	88.3	→
Lamb Price Index (NZD)	134.2	134.5	121.9	↘
Beef Price Index (NZD)	108.4	109.5	116.0	↘
Kiwifruit Export Values (\$bn)**	2.2	2.0	1.7	↗
<b>Interest Rates:</b>				
90-day bank bills	2.00	1.89	1.91	→
2-year swap	2.13	2.01	2.15	→
5-year swap	2.50	2.32	2.60	↗
<b>Exchange Rates:</b>				
NZD/USD	0.6781	0.6512	0.6817	→
NZD/CNY	4.71	4.52	4.52	→
NZD/GBP	0.5292	0.5074	0.5159	↗
Milk solids production (ytd % chg)**	6.0	5.6	1.1	↘
Fonterra Shareholders' Fund	4.77	4.83	6.33	→



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



### Rural Fact or Fiction?

Turkeys are descendants of the *T. Rex* and *Velociraptor*.

Answer on page 3

## Rural Commodities Outlook

### Dairy – Too much of a good thing

Dairy Index (USD), 23 Nov: 75.0 ↓ -6.0% (mpc)

It's true. You can have too much of a good thing. The dairy sector is case in point, with record dairy production ("a good thing") leading to cuts in the farmgate milk price ("a bad thing").

Indeed, the 2018/19 production season is already one for the record books. October production has set a new record high for any month. This record level of production has built on earlier strength, taking production to date this season a whopping 6% ahead of the same period last season.

Moreover, milk continues to roll in. We have lifted our 2018/19 production growth forecast to 5%, from 4% previously, which will see the 2018/19 season set a new production record high. Current growing conditions plus recent rain suggest further production strength in December, if not into the new year.

The NZ production strength is proving too much for global markets to absorb. Fortunately, production is relatively soft in the EU, the US and in Australia. Nonetheless, given NZ's large share of global dairy exports, the mini glut in production is leading prices lower. For example, overall auction prices have fallen more than 20% since May.

As a result, this month we trimmed our 2018/19 milk price forecast by 25 cents to \$6.00/kg.

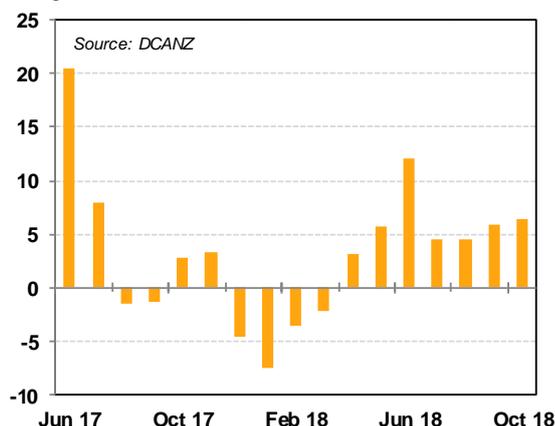
#### Season End Milk Price\* Forecasts:

	2018/19		Long Run
	Fonterra	ASB	ASB
Milk Price*	\$6.25-50	\$6.00	\$6.50-\$7.00

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

ann  
% chg

#### MILK SOLIDS PRODUCTION



### Lamb – Sideways

Lamb Index (NZD), 23 Nov: 134.2 ↓ -0.2% (mpc)

Farmgate lamb prices have largely tracked sideways over November so far. Over the month, prices have stayed within a tight range of \$7.93/kg and \$7.98/kg.

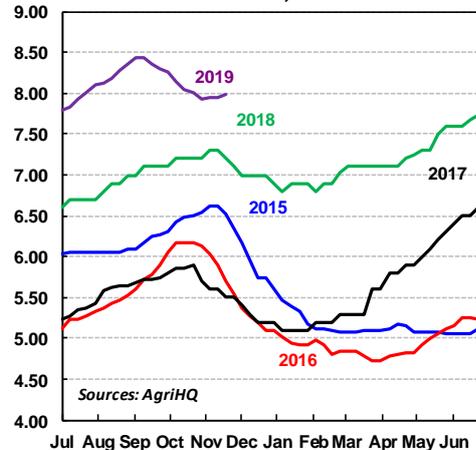
In other words, prices remain extremely high. November prices averaged 10% above November 2017. Moreover, November prices were 27% higher than the average over the previous five November months.

For now, global demand remains firm. In particular, US demand is solid with October export prices 44% above October 2017 prices.

Meanwhile, tight supply is also supporting prices. In particular with feed plentiful, farmers are holding on to stock in order to add weight. As a result, processors are bidding prices higher in order to attract sufficient volume to maintain processing capacity.

With the above in mind, the remainder of the 2018/19 season is shaping up as a healthy one for farmers.

#### LAMB PRICES, June Years



### Beef – Could be worse

Beef Index (NZD), 23 Nov: 108.4 ↓ -1.0% (mpc)

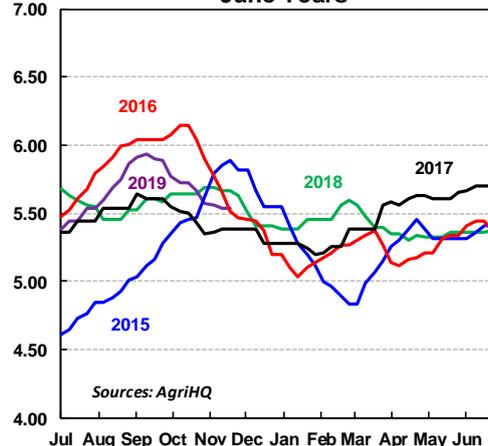
Since the last edition of Farmshed Economics, beef prices have drifted modestly lower. P2 steer prices, for example, have dipped 2.3% from \$5.67/kg to \$5.54/kg as at 23 November. In other words, the price fall could have been worse.

Meanwhile, supply and demand factors remain delicately balanced. The US market remains soft on the back of firm US production. On the other hand, Chinese demand appears firm with the boost from Chinese New Year around the corner and reports that African swine flu may be also aiding beef demand.

Another development putting pressure on farmgate prices is the recent lift in the NZD/USD. It has lifted around 5% in the first four weeks of November, and as we go to print it has lifted another 1%. In total, the NZD has gained nearly four cents against the USD.

All up, we main cautious on the outlook for beef prices for the remainder of the season.

#### BEEF PRICES (NZ P2 STEER) June Years



## Rural Commodities Outlook (continued)

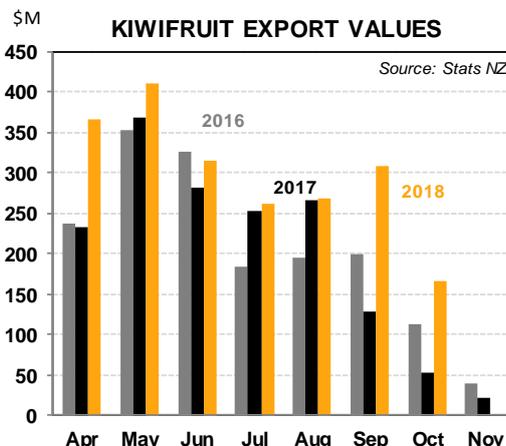
### Kiwifruit – Rollin', rollin', rollin', rawhide

Export values, Oct year: **\$2.2bn ↑ 29.7% (apc)**

Kiwifruit export values continue to roll on. After cracking \$2 billion in annual values for the first time last month, export values have pushed on to reach circa \$2.2 billion in the 12 months to October.

Export volumes surged over September and October. In total, volumes are up 17% for the season to date, with green and gold volumes recording 14% and 21% growth, respectively. Meanwhile, October was another good month for kiwifruit prices. Gold export prices averaged \$5.91/kg over the month (up 12% on October 2017 prices), while green export prices for the season to date are 10% higher than for the same period last season.

The sector's ability to maintain healthy prices while growing export volumes has been key to this remarkable story. This success owes to the opening up of new markets such as China alongside the ongoing popularity and volume growth of the premium-fetching gold variety. This year the weaker NZ dollar has also contributed to the higher export earnings.



## Financial Markets Outlook

### Interest Rates – OCR cut off the radar for now

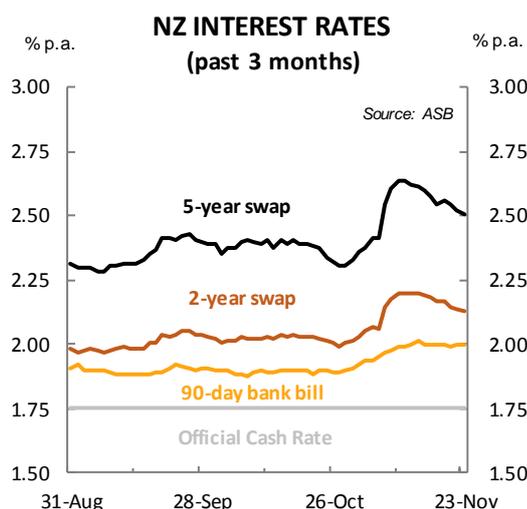
90-day bank bills, 23 Nov: **2.00% ↑ +0.11 (mc)**

Benchmark interest rates have lifted to date over November. Indeed, since the last edition of Farmshed Economics, the lift in rates across the different terms has been between 8 and 18 basis points.

The lift in rates follows some better news on the NZ economy and a more positive economic outlook from the Reserve Bank (RBNZ). In the case of the RBNZ, the chance of an Official Cash Rate (OCR) cut has reduced. Meanwhile, the unemployment rate fell to a 10-year low, which added to the case that the next OCR move will be up not down.

Nonetheless, we anticipate that the next OCR move is still a long way off. In our updated view, we expect the RBNZ to hike the OCR in August 2020.

On that basis, benchmark interest rates are likely to remain low for an extended period before drifting higher. And while we do eventually expect higher rates, benchmark rates are likely to remain very low by historical standards over the next two to three years.



### NZ Dollar – Removing support

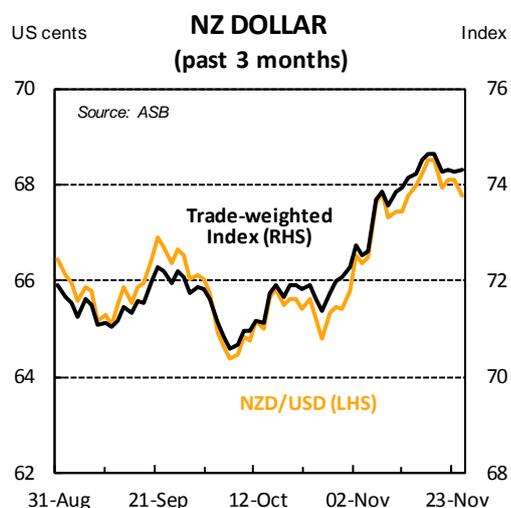
NZD/USD, 23 Nov: **0.6781 ↑ +0.0269 (mc)**

The NZD has lifted to date over November. It has lifted around 5% since the last edition of Farmshed Economics, and as we go to print it has lifted another 1% or so. In total, the NZD has gained nearly four cents or around 6% against the USD since the last month's Farmshed Economics.

Firstly, strong NZ economic data over November helped push the NZD higher. Also, as mentioned in the interest rate section above, NZ interest rates have lifted and this has also supported the NZD.

Meanwhile, the USD has weakened generally, particularly over the last week or so. The US Federal Reserve has hinted that it may not hike its interest rates as aggressively as it had previously signalled. The USD dropped on this news.

All up, these moves remove some of the support that farmgate prices have been receiving over the last three months or so. Looking over a longer period, though, the NZD remains at levels which are still supportive of farmgate prices.



### Rural Fact or Fiction?

**Answer: Fact.** Researchers have found that the wishbone (the one you and your sister pull from opposite ends to see who gets the middle nodule) dates back 150 million years to a group dinosaurs, including *T. Rex* and *Velociraptor*.

**ASB Economics & Research**

Chief Economist  
 Senior Rural Economist  
 Senior Economist  
 Senior Economist  
 Senior Economist, Wealth  
 Economist  
 Data & Publication Manager

Nick Tuffley  
 Nathan Penny  
 Mark Smith  
 Jane Turner  
 Chris Tennent-Brown  
 Kim Mundy  
 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  
 kim.mundy@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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