

# Farmshed Economics

## Trump, earthquakes and \$6

November 2016



Inside this edition:	Pg.
<b>Rural Commodities</b>	
<a href="#">Dairy</a>	2
• Dairy is back	
<a href="#">Lamb</a>	2
• Light at the end of the tunnel	
<a href="#">Beef</a>	2
• Ditto	
<a href="#">Wool</a>	3
• NZD a drag	
<b>Financial Markets</b>	
<a href="#">Interest Rates</a>	3
• Past the bottom	
<a href="#">NZD</a>	4
• Trump wins; NZD weaker	

The Farmshed Economics team would like to send out our thoughts to the farming communities impacted by the North Canterbury/Kaikoura earthquake. Be safe and kia kaha! Meanwhile, rural and financial market developments have been coming thick and fast over the past month.

First up, Donald Trump's US Presidential victory surprised many. Similar to Brexit, the underdog stormed to victory. Foreign exchange markets were initially surprised by Trump's victory (of course), but then Trump surprised markets in his rather moderate victory speech. Indeed, the speech had the effect of calming markets, allowing the USD to surge. As a result, since the election the NZD has lost around 3% against USD.

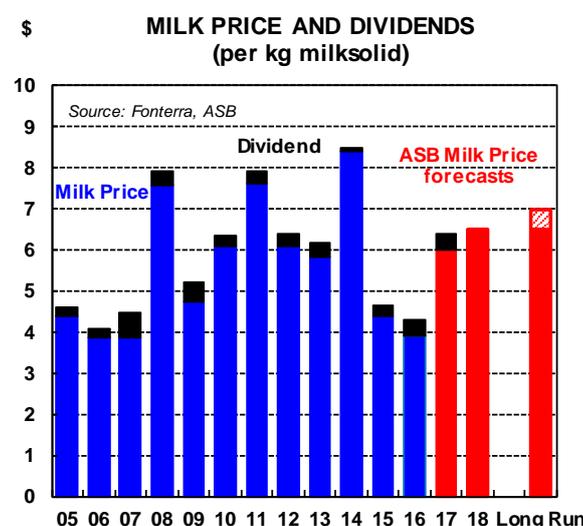
Closer to home and as we have long predicted it would, Fonterra lifted its 2016/17 milk price to \$6.00/kg on 18 November. The revision reflects the rapid about-turn that has occurred in global dairy supply. For us, this supply correction and subsequent price lift came as no surprise – with farmgate milk prices very low, farmers had to respond and change behaviour. Looking ahead, the very wet recent weather has the potential to send the milk price higher yet.

Looking at meat markets, there is some light at the end of the tunnel for lamb prices. Demand for lamb in most markets is improving (the UK being the exception). As for beef prices, not much has changed over recent months – prices remain healthy. Moreover, we expect that picture to largely remain in place heading into 2017. Meanwhile, wool prices have sunk over spring, after a relatively buoyant period through the first half of the year.

Lastly, interest rates may be past their bottom. In particular, benchmark rates have lifted since October. The general rise comes despite an OCR cut by the Reserve Bank. But higher wholesale funding costs have meant little, if any, of this cut was passed on to retail rates. Meanwhile, offshore rates have headed higher, taking NZ medium and long term rates with them. All up though, interest rates are likely to remain low compared to historical averages.

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

As at 25 November 2016	Current	4 wks ago	Year ago	Outlook*
<b>Rural Commodity Prices:</b>				
ASB Dairy Price Index (USD)	195.3	174.3	140.5	➔
Lamb Price Index (NZD)	178.0	191.0	181.8	➡
Beef Price Index (NZD)	248.6	256.3	252.7	➔
Wool Price Index (NZD)	92.6	109.0	137.8	➔
<b>Interest Rates:</b>				
90-day bank bills	2.03	2.12	2.86	➔
2 year swap	2.31	2.13	2.74	➔
5 year swap	2.84	2.36	3.08	➔
<b>Exchange Rates:</b>				
NZD/USD	0.7043	0.7168	0.6567	➔
NZD/CNY	4.87	4.85	4.19	➔
NZD/GBP	0.5645	0.5858	0.4323	➔
Milk solids production (ytd % chg]**	-3.1	-0.8	-3.1	➡
Fonterra Shareholders' Fund	5.90	5.90	5.45	➡



\*Direction of change over the next 6 months. \*\*As at September 2016.

**? Rural Fact or Fiction?**  
 Donald Trump's Scottish ancestry saw him working on a sheep farm in rural New York State as a young man.  
Answer on page 3

## Rural Commodities Outlook

### Dairy – Dairy is back

ASB Dairy Index (USD), 25 Nov: 195.3 ↑12.1% (mpc)

As we have long predicted it would, Fonterra lifted its 2016/17 milk price from \$5.25/kg to \$6.00/kg on 18 November. Fonterra opened the season with a forecast of \$4.25/kg.

The revision reflects the rapid about-turn that has occurred in global dairy supply over 2016. Dairy production is now falling heavily in NZ, the EU and Australia, with the US the only notable exception. Although from a global market perspective, US dairy producers remain largely focused on their relatively strong domestic market.

For us, this supply correction and subsequent price lift came as no surprise. With farmgate milk prices very low, farmers had to respond and change behaviour – farm losses could not continue indefinitely. Moreover, the lifting of EU quotas, EU intervention, low oil prices, for example, were all temporary distractions to the overarching story of low milk prices putting farmers under the pump.

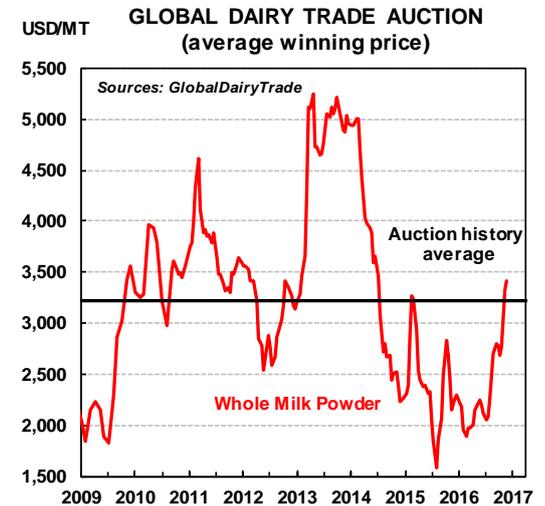
In other words, the dairy commodity cycle trumped all. But the question now turns to how much further has cycle got to run?

On that front, the very wet recent weather has the potential to send the milk price higher yet. For now, though, we sit tight with our \$6.00/kg forecast, and join NZ farmers' in their collective sigh of relief.

#### Season End Milk Price Forecasts:

	2016/17		2017/18	Long Run
	Fonterra	ASB	ASB	ASB
Milk Price*	\$6.00	\$6.00	\$6.50	\$6.50-\$7.00

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



### Lamb – Light at the end of the tunnel

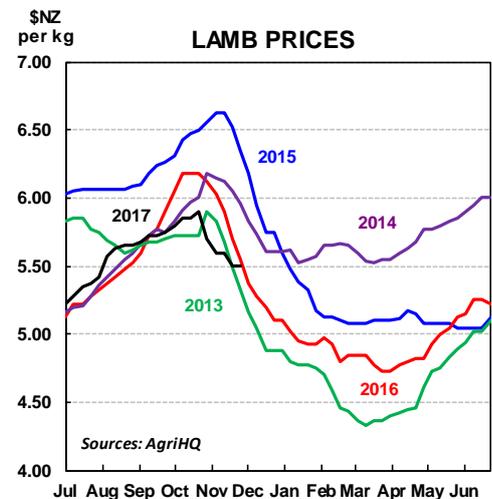
Lamb Index (NZD), 25 Nov: 178.0 ↓-6.8% (mpc)

There is some light at the end of the tunnel for lamb prices (although, as always, we remain wary of false dawns). Nonetheless, demand for lamb in most markets is relatively positive at present; the UK being the exception.

It seems that with local production low, buyers are becoming nervous and are looking to secure supply. In addition, it is a similar story over the ditch, with Australian production also slow for the time of year. The combined supply shortfall should underpin prices in the short term.

China is the shining light for both lamb and mutton markets. Demand there is underpinned by the now not too far away Chinese New Year celebrations, but some reports are indicating that demand may extend beyond this period. For example, lamb flaps prices have lifted around 10% over the past month. We suggest that local Chinese supply may have tightened enough to trigger a long-awaited increase in import demand.

In contrast, the UK market remains weak. Moreover, we expect that to remain the case until some certainty around Brexit plans is found.



### Beef – Ditto

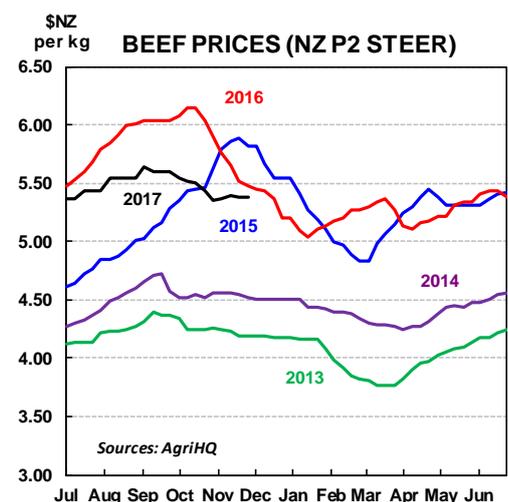
Beef Index (NZD), 25 Nov: 248.6 ↓-3.0% (mpc)

Not much has changed for beef prices over the last month nor since July for that matter – prices remain healthy. Over this period, (P2 steer) prices have sat 14 cents either side of \$5.50/kg. In fact, avid Farmshed Economics readers will probably notice that this month's commentary is pretty much the same as last month's.

This narrow range is despite the general view that prices would decline. In particular, the accepted view was that recovering US beef production would weigh on prices.

However, lack of supply both locally and from Australia is keeping NZ beef prices high. In particular, Australian beef production has slowed as the Australian beef herd slowly rebuilds. That lack of Australian beef continues to keep the door open for NZ exporters, and thus keep prices firm.

All up, it seems that moderating beef prices is a story for the autumn, if not winter, of 2017.



## Rural Commodities Outlook (continued)

### Wool – NZD a drag

Wool Index, 25 Nov: 92.6 ↓ -15.0% (mpc)

Wool prices have sunk over spring, after a relatively buoyant period over the first half of the year. For example, coarse wool (39 micron) prices are down by about a quarter from the end of June. Looking over a longer period, wool prices (as based on a 35 micron fleece, see chart) now sit around 10% below their 10-year average levels.

A major culprit for lower prices has been the lift in the NZD. For example against the Chinese yuan, the NZD has averaged 9% higher since July than it averaged over the first half of the year.

Meanwhile sluggish demand is not helping. In this respect, reportedly high Chinese inventories may delay any price recovery.

From here, though, we expect prices to stabilise. In particular, relatively tight supply should continue to underpin wool prices. Beef+Lamb estimates that the sheep is likely to be 3.0% or 800,000 head lower over the 2016/17 year compared to the year earlier.



## Financial Markets Outlook

### Interest Rates – Past the bottom

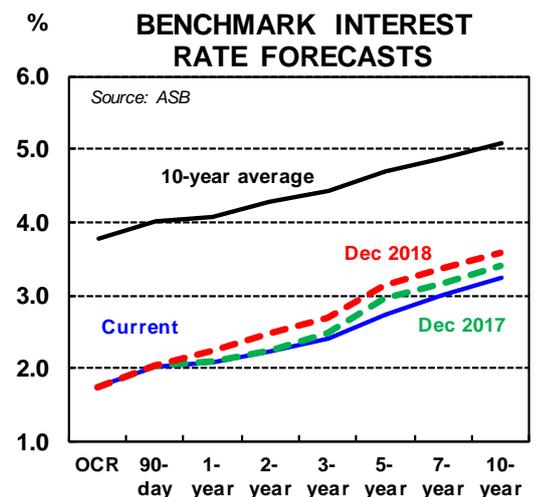
90-day bank bills, 25 Nov: 2.03% ↓ -0.09 (mc)

Interest rates may be past their bottom. In particular, benchmark rates have lifted since around the start of October.

The general rise comes despite an OCR cut by the Reserve Bank. As expected the Reserve Bank trimmed 25 basis points off the OCR on 10 November. But higher wholesale funding costs of late meant little, if any, of this cut was passed on to retail rates.

Meanwhile, offshore rates have headed higher, taking NZ medium and long-term rates with them. For example, the US Federal Reserve is almost certain to lift its policy rate in December as the US economy continues to improve. And Donald Trump has added to the interest rate mix by signalling he is likely to increase spending under his presidency.

All up though, interest rates are likely to remain low compared to historical averages. Moreover, we anticipate that rises over the next couple of years are likely to be modest.



### NZ Dollar – Trump wins; NZD weaker

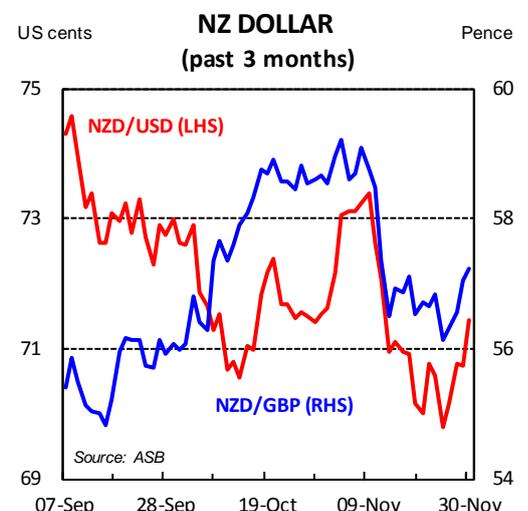
NZD/USD, 25 Nov: 0.7043 ↓ 0.0125 (mc)

Donald Trump's US Presidential victory surprised many. Similar to Brexit, the underdog stormed to victory.

Foreign exchange markets were also surprised by the upset victory in more ways than one. First up, markets were surprised by Trump's victory (of course), but then Trump surprised markets in his rather moderate victory speech.

The speech had the effect of calming markets, allowing the USD to surge. For example, since the election the NZD has lost around 3% against USD. Moreover, there has been a similar effect on the pound, with NZD/GBP down around 4% since the election.

All up, the weaker NZD is supporting farmgate prices. However, both ongoing Brexit uncertainties and Trump's still unknown quantities have the potential to swing currencies back the other way.



### Rural Fact or Fiction?



Answer: False! While Donald Trump has some Scottish ancestry, he has never worked on a sheep farm.

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