Farmshed Economics

Lamb's moment in the sun

November 2017

ASB

It's been a long time between drinks for the lamb sector. As a result, when lamb prices lifted this year, it surprised everyone, the team at Farmshed Economics included. While coarse wool prices are still, unfortunately, lagging behind, at least heading into summer lamb can enjoy its moment in the sun.

In last month's edition of Farmshed Economics, we hinted that lamb prices would top out at $7.20/kg (for a 17.5kg lamb). However, it looks like prices have gone a step further, hitting $7.30/kg during November. At this juncture, we expect lamb prices to remain healthy over the remainder of 2017/18.

For dairy, the wet NZ spring is over and NZ dairy production has lifted as a result. With NZ production much-improved and EU production already firm, we factor in this better global production outlook into our milk price forecast. All up and along with the weak run of recent auction results, we trim our 2017/18 milk price forecast by 25 cents to $6.50/kg.

Meanwhile, beef prices remain healthy. Since the last edition of Farmshed Economics, the Beef Index has lifted 3.2%. All up, we expect the beef sector to continue to roll on over the remainder of 2017/18 season.

Feed grain prices are also on an upward trend. Since we last reported on grain prices back in April, feed barley prices have lifted by a healthy 24%, while feed wheat prices have risen by 26%. With the above in mind, we expect feed grain prices to reach $400/tonne in 2018, before levelling off.

In terms of interest rates, the RBNZ's recent stance will help keep short-term interest rates near current lows. However, we expect long-term interest rates to drift higher in line with rising global rates. That said, we expect interest rates to remain low by historical standards over 2018. Meanwhile, the NZD remains weak and continues to lift all sector boats.

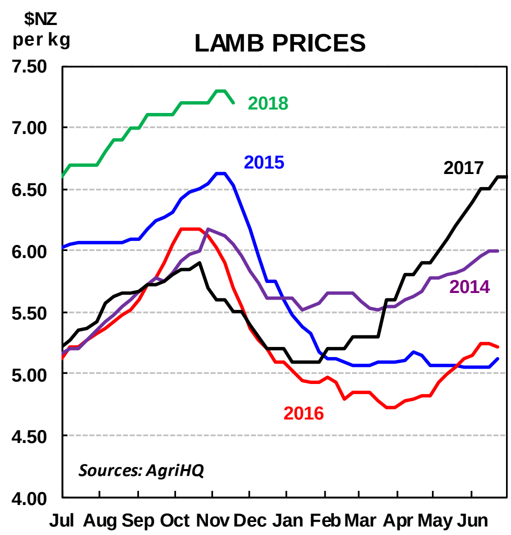
As we head to press, it's been announced that Fonterra has been ordered to pay Danone $183m. We'll get more details in the coming days on how Fonterra plans to respond, but this could briefly dent confidence in the dairy sector.

Key Rural Data:

As at 24 November 2017	Current	4 wks ago	Year ago	Outlook*
Rural Commodity Prices:				
ASB Dairy Price Index (USD)	90.6	92.0	89.1	→
Lamb Price Index (NZD)	122.4	120.8	92.5	↘
Beef Price Index (NZD)	116.0	112.4	106.4	↘
Feed Wheat Prices ($NZ/tonne)	381.0	379.0	278.0	↗
Interest Rates:				
90-day bank bills	1.91	1.95	2.03	→
2-year swap	2.16	2.17	2.27	↗
5-year swap	2.61	2.68	2.80	↑
Exchange Rates:				
NZD/USD	0.6881	0.6881	0.7043	↗
NZD/CNY	4.54	4.58	4.87	↗
NZD/GBP	0.5159	0.5241	0.5645	↗
Milk solids production (ytd % chg]**	1.1	-0.1	-3.1	↗
Fonterra Shareholders' Fund	6.34	6.28	5.90	→

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

Chart of the Month:



Rural Fact or Fiction?

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Studies have found that sheep are actually more intelligent than cattle as well as pigs.

Answer on page 3

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Rural Commodities Outlook

Dairy – Turning on a dime

ASB Dairy Index (USD), 24 Nov: 90.6 ↓-1.6 (mpc)

The wet NZ spring is over. The sun is out and temperatures in key NZ dairy regions have lifted, taking NZ production higher as a result.

Indeed, October was a good month for NZ production. So good, in fact, that NZ production has rebounded sooner than we expected from the very wet weather (we had expected the rebound to come over the summer and autumn). Nationwide production (i.e. for all processors) for October lifted 2.9% compared to October 2016, after August and September had been well behind 2016 levels. It seems that NZ weather and thus production can turn on a dime.

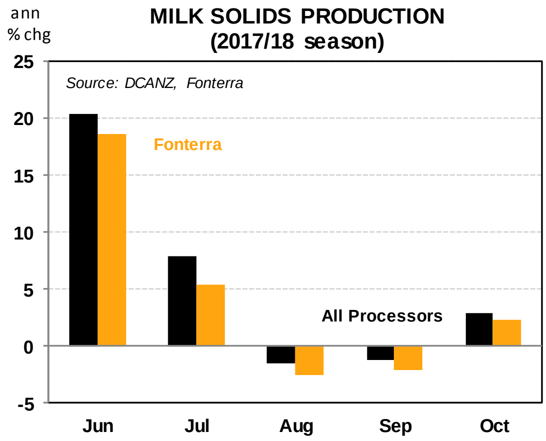
Meanwhile, dairy auction prices have now fallen for four consecutive auctions. Over this period, overall and WMP prices have dipped by around 10%. The NZD is providing some offset to falling auction prices. Over the same four-auction period, the NZD has dipped around 6% against the USD. However, not all of that gain will be captured in this season's milk price calculation.

With NZ production much-improved and EU production already firm, we factor in this better global production outlook into our milk price forecast. All up and along with the weak run of recent auction results, we trim our 2017/18 milk price forecast by 25 cents to $6.50/kg.

Season End Milk Price Forecasts:

	2017/18		Long Run
	Fonterra	ASB	ASB
Milk Price*	$6.75	$6.50	$6.50-$7.00

* per kg of milk solids (excluding dividend).



Lamb – Pinch me

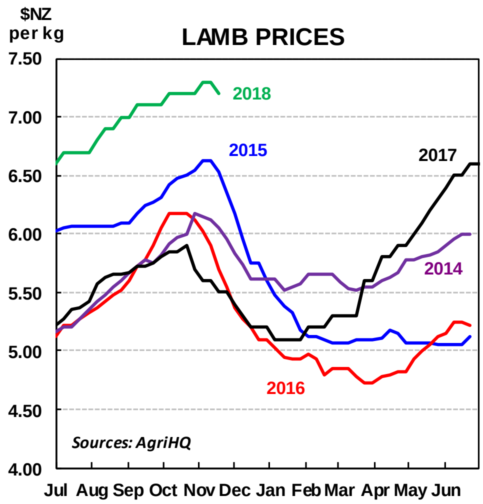
Lamb Index (NZD), 24 Nov: 122.4 ↑1.4% (mpc)

In last month's edition of Farmshed Economics, we hinted that lamb prices would top out at $7.20/kg (for a 17.5kg lamb). However, it looks like prices have gone a step further, hitting $7.30/kg during November.

This is in stark contrast to this time last year! Then prices peaked at $5.90/kg. Indeed, this year's prices have come as a welcome surprise and have exceeded even the wildest of expectations.

From here, we continue to expect a modest seasonal decline. Indeed, in recent seasons the seasonal decline has ranged between $0.60/kg and $1.60/kg, averaging $1.20/kg. Accordingly, we expect the seasonal decline to be towards the lower end of this range. The more conservative assumption of the average decline and starting from the $7.30/kg peak, would see prices reach around $6.10/kg by autumn.

Of course other factors such as the NZD may change this outlook, but at this juncture, we expect lamb prices to remain healthy over 2017/18.



Beef – Catching a chill

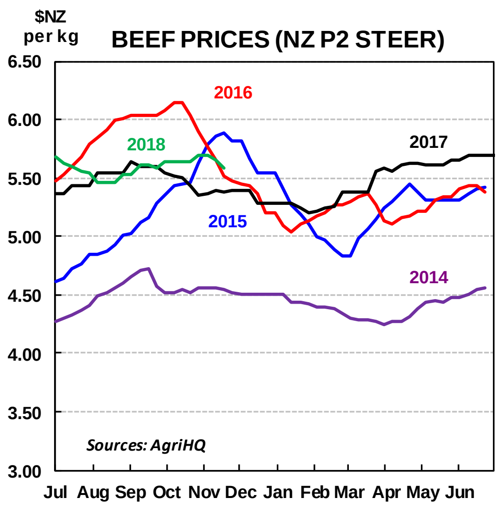
Beef Index (NZD), 24 Nov: 116.0 ↑3.2% (mpc)

Beef prices remain healthy. Since the last edition of Farmshed Economics, the Beef Index has lifted 3.2%. Moreover, prices are comfortably above this time a year ago.

In addition to solid beef market fundamentals, Chinese demand is on the up. In addition, chilled beef sales are proving popular, coming with the added bonus of a premium attached.

That said, the normal seasonal pattern is likely to apply with prices likely to grind lower over the 2018 summer. But we'd expect the seasonal fall to be modest, mirroring the modest fall during the 2017 summer.

Moreover, tight supply continues to underpin prices. Indeed NZ and Australian beef export supply is tight, with supply from the latter tightening following recent rains. All up, we expect the beef sector to continue to roll on over the remainder of 2017/18 season.



Rural Commodities Outlook (continued)

Grains – Grinding higher

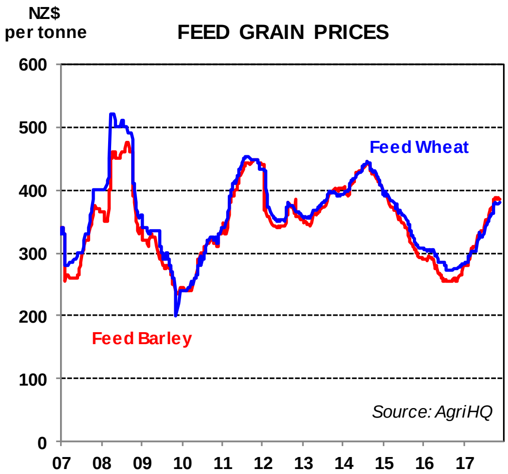
Feed Wheat, 24 Nov:	$381/tonne ↑0.5% (mpc)

Feed grain prices continue to lift. Since we last reported on grain prices back in April, feed barley prices have lifted by a healthy 24%, while feed wheat prices have risen by 26%.

The steady lift very much reflects the ongoing improvement in dairy sector incomes. Indeed, given that the majority of farmers are back in the black, we expect some will be considering supplementing their pastures with grain, particularly as we head into the second half of the season.

From here, we expect grain prices to grind higher. However, the magnitude of gains are likely to be dictated to by the weather and the subsequent demand for feed. Also, the success or otherwise of grain harvests will also play its usual role with regards to prices.

With the above in mind, we expect feed grain prices to reach $400/tonne in 2018, before levelling off.



Financial Markets Outlook

Interest Rates – Stuck in neutral

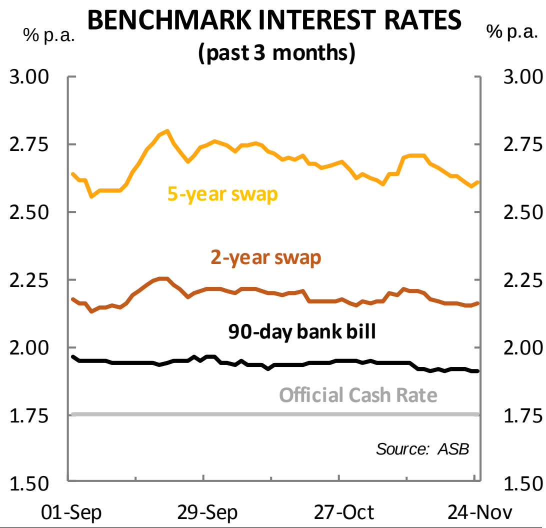
90-day bank bills, 24 Nov:	1.91% ↓-0.04 (mc)

On 9 November, the Reserve Bank (RBNZ) kept the Official Cash Rate (OCR) at 1.75% as widely expected. In addition, the RBNZ kept its neutral bias. In other words, the RBNZ expects that there is roughly an equal chance of the next interest rate move being up or down.

The November announcement was the first under a new government, with the RBNZ incorporating some government policies into its projections. However, extra government spending was largely offset by weak recent economic activity, so that the interest rate outlook was mostly unchanged.

With this in mind, we continue to expect the RBNZ to remain on hold through next year before starting to lift the OCR in early 2019.

In terms of interest rates, the RBNZ's stance will help keep short-term interest rates near current lows. However, we expect long-term interest rates to drift higher in line with rising global rates. In particular, we expect three US Federal Reserve rate hikes by the end of 2018. That said, we expect interest rates to remain low by historical standards over 2018.



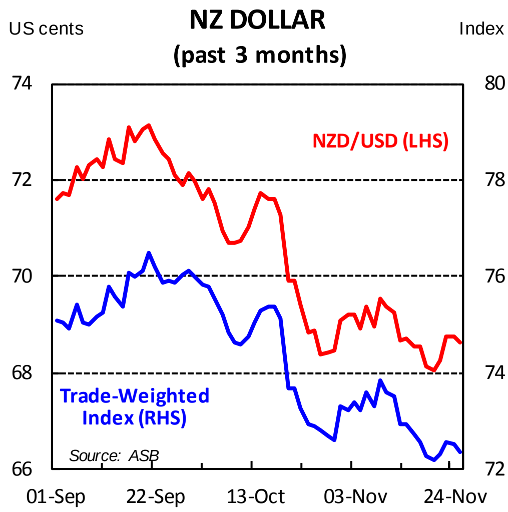
NZ Dollar – Lifting all boats

NZD/USD, 24 November:	0.6881 (No change)

The NZD remains weak. Indeed, since the last edition of Farmshed Economics, the NZD has stayed put at US$0.6881.

Currency markets remain wary of the new Government. And that wariness was reinforced by a plunge in business confidence over November. The November survey was the first since the new Government came into power, with the survey results the weakest since the Global Financial Crisis. Following the survey release, the NZD dipped around half a cent against the USD.

In the short term, we expect the NZD to remain under downward pressure. However heading into 2018 and as the Government's policies and their implications become clearer, the NZD may start to regain some lost ground. Moreover, the NZ economy is generally sound and we expect it to continue to grow at a moderate pace over 2018. As a result, we expect the NZD to climb back to the mid 70s against the USD by the middle of 2018. Accordingly, some of the commodity price gains may not last.



Rural Fact or Fiction?

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Answer: Fiction! Not quite. Although, studies have shown that sheep IQ is on par with cattle IQ, but just below pigs. Indeed, they can learn to recognize human faces, and some will learn to respond to their name, if trained.

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