

Farmshed Economics

Weak NZD lifting all boats

October 2017




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The Labour-NZ First coalition has been welcomed, albeit cautiously, by the farming sector. The removal of the water tax policy at least has started relations off on the right foot. The full impact of the Government's new policies, however, will take time to play out. In the meantime though, the materially weaker NZ dollar since the election is lifting all agri sector boats.

Indeed, the NZD is lower across the board, falling 1.5 cents against the USD on the day of the announcement and then falling by roughly that amount again since. These falls are boosting commodity prices in NZD terms. For example, the lower NZD has trumped the dip in dairy prices since the election.

At the same time, wet weather has officially stalled spring dairy production. September nationwide production fell 1.3% compared to September 2016. Moreover, on a season-to-date basis, production is now effectively level with last season.

Production is also constrained in the lamb sector, with this year's lamb crop likely to be smaller than last year's. Specifically, Beef+Lamb NZ forecasts a 1.9% fall. If this new estimate is close to the mark, we expect lamb prices this season to remain elevated, allowing for the normal seasonal price pattern.

Turning to the beef sector, prices there have largely tracked sideways over October. All up, we expect the beef sector to continue to roll on over the remainder of 2017/18 season.

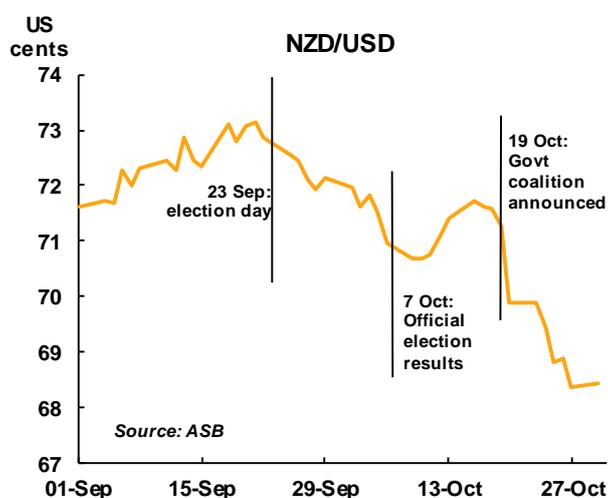
Meanwhile, the worst appears to be over for wool prices, with 39 micron wool prices, for example, lifting off their record lows. Looking ahead, we expect prices to rise, although we anticipate that prices are likely to remain below their long run averages.

Lastly, while the sinking NZD has grabbed the headlines in the wake of a new government, in contrast, NZ interest rates have been relatively stable. It seems that in the case of NZ interest rates, the more things change, the more they stay low.

Key Rural Data:

Chart of the Month:

As at 27 October 2017	Current	4 wks ago	Year ago	Outlook*
Rural Commodity Prices:				
ASB Dairy Price Index (USD)	88.9	91.3	83.3	↗
Lamb Price Index (NZD)	120.8	118.6	99.6	↘
Beef Price Index (NZD)	112.4	112.4	107.0	→
Wool Price Index (NZD)	62.5	64.5	85.8	→
Interest Rates:				
90-day bank bills	1.95	1.96	2.12	→
2-year swap	2.17	2.21	2.15	↗
5-year swap	2.68	2.75	2.44	↗
Exchange Rates:				
NZD/USD	0.6881	0.7207	0.7163	↗
NZD/CNY	4.58	4.80	4.86	↗
NZD/GBP	0.5241	0.5379	0.5879	→
Milk solids production (ytd % chg]**	-0.1	1.7	-0.8	↗
Fonterra Shareholders' Fund	6.28	6.24	5.90	→



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



Rural Fact or Fiction?

New PM Jacinda Ardern, at 37 years old, is the world's youngest leader.

Answer on page 3

Rural Commodities Outlook

Dairy – Production stall

ASB Dairy Index (USD), 27 Oct: 88.5 ↓-2.7 (mpc)

Wet weather has officially stalled spring dairy production. September nationwide (i.e. for all processors) production fell 1.3% compared to September 2016. This fall was the second month in a row which monthly production has fallen on an annual basis. Moreover, on a season-to-date basis, production is now effectively level with last season.

Indeed, the weak production numbers come at the start of the spring flush – the time of the season where production is highest. September is usually the fourth-highest month for milk production, while October is the usually the highest.

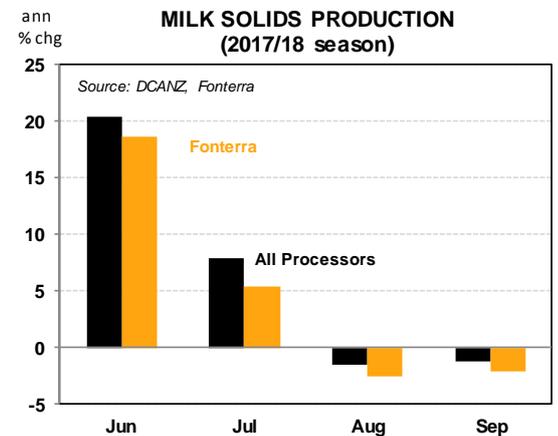
With this weakness anticipated early in the month, we cut our milk production growth forecast to 3%, from 4% previously. However, even this lower forecast may prove optimistic as production needs to rebound strongly over the remaining 8 months of the season.

It follows that we have been surprised at the recent dairy price softness. Other analysts have pointed to EU and US production strength. However, with NZ still the leading dairy exporter and production weak at the part of the season where it should be strongest, we'd be surprised if prices stayed soft for long. With this in mind, plus the circa five cent drop in the NZD against the USD, we stick with our 2017/18 milk price forecast at \$6.75/kg.

Season End Milk Price Forecasts:

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

* per kg of milk solids (excluding dividend).



Lamb – Smaller lamb crop to underpin prices

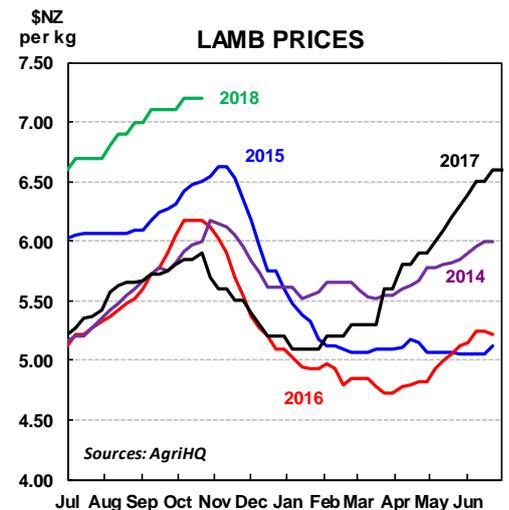
Lamb Index (NZD), 27 Oct: 120.8 ↑1.8% (mpc)

This year's lamb crop is likely to be smaller than last year's. In its New Season Outlook, Beef+Lamb NZ forecasts a 1.9% fall. This forecast contrasts with its previous estimate of a modest rise of 1.1%.

If this new estimate is close to the mark, we expect lamb prices this season to remain elevated, allowing for the normal seasonal price pattern. For a start, the per kg price for 17.5kg lambs looks to be peaking at \$7.20.

From there and with the smaller lamb crop, we only expect a modest seasonal decline. Indeed, in recent seasons the seasonal decline has ranged between \$0.60/kg and \$1.60/kg, and averaged \$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 \$7.20/kg peak, would see prices reach around \$6.00/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 – Sideways

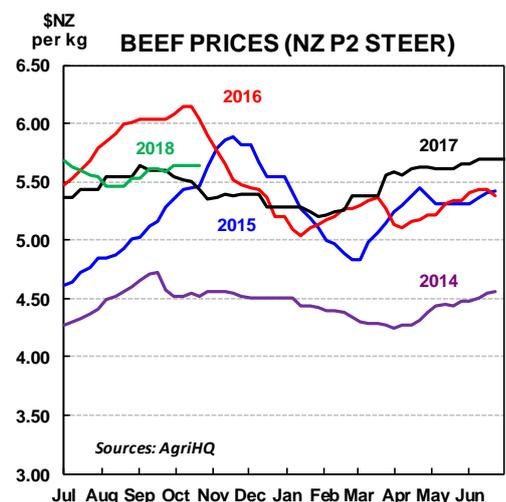
Beef Index (NZD), 27 Oct: 112.4 → no change

Beef prices have largely tracked sideways over October. For example, since the last edition of Farmshed Economics, the AgriHQ beef index was unchanged, while the per kg price of P2 steers lifted a modest 1.1%.

As we have mentioned in recent editions, beef market fundamentals remain firm. With that in mind and while we expect prices to continue to wax and wane, we expect the general price trend to be sideways over the remainder of 2017 and heading into 2018.

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 and for it to mirror the fall during the 2017 summer.

In particular, 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)

Wool – Past the bottom

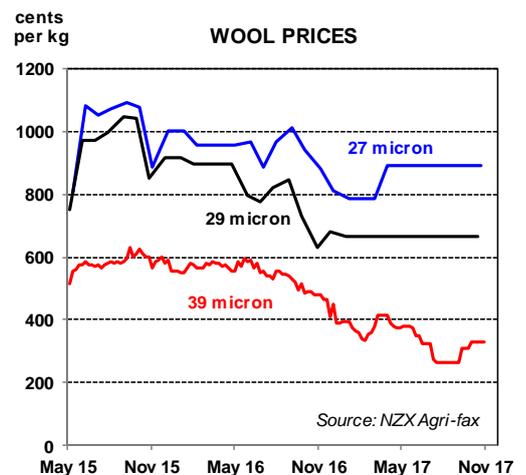
Wool Index (NZD), 27 Oct: 62.5 ↓ -3.0% (mpc)

The worst appears to be over for wool prices. For example, 39 micron wool prices have lifted by 25% from the record low level, set back in July 2017.

However, prices are still very low and the wool industry is still not out of the woods yet. Indeed, despite the lift 39 micron prices remain 28% below the 10-year average level.

Meanwhile, mid-micron prices have been stable over recent months. Mid-micron wool prices bottomed earlier than coarse types (towards the start of 2017). However, while that was a blessing, mid-micron prices have not lifted in tandem with coarse wool prices over recent weeks.

Looking ahead, we expect prices to rise generally as global growth and demand improves and wool supply remains low. Notably though, while we are optimistic that prices will improve over the next six months or so, we anticipate that prices are likely to remain below their long run averages.



Financial Markets Outlook

Interest Rates – More things change, more they stay the same

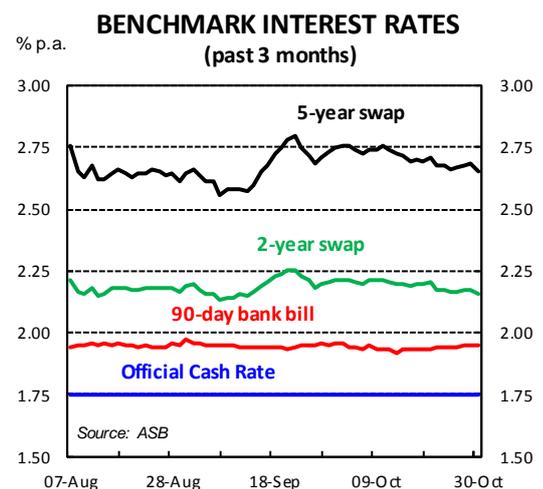
90-day bank bills, 27 Oct: 1.95% ↓ -0.01 (mc)

While the sinking NZD has grabbed the headlines in the wake of a new government, in contrast, NZ interest rates have been relatively stable. Indeed, if anything, some rates have drifted lower. For example, benchmark 2-year swap rates have fallen by about 5 basis points since the coalition announcement.

In a way, the more things change, the more they stay the same. For example, despite the change in government, at this juncture we still expect the RBNZ to start lifting the OCR at the start of 2019.

At the same time, some changes may be afoot. For example, the new Minister of Finance has expressed a desire to review and reform the Reserve Bank Act. In addition, a new Reserve Bank Governor will take the helm in March next year.

However, all these changes take time. In the meantime, for NZ interest rates, it's a case of the more things change, the more they stay low.



NZ Dollar – Silver lining

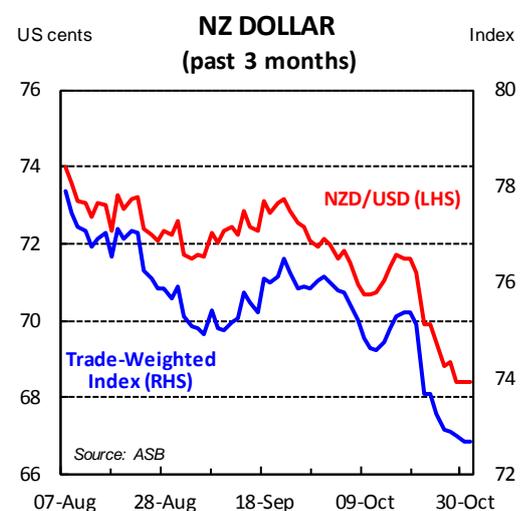
NZD/USD, 27 Oct: 0.6881 ↓ -0.0326 (mc)

For farmers, there is at least one silver lining to the new Labour- NZ First Government. That is a lower NZD! Indeed, the NZD is lower across the board, falling 1.5 cents against the USD on the day of the announcement and then falling by roughly that amount again since.

A new PM, a new government, new policies and new Ministers all come with questions and uncertainties for currency markets. Policy details are being released gradually, but until markets get a better understanding, the NZD will remain under pressure.

In the meantime, the weak NZD is providing a boost to commodity prices. The NZD has fallen around 6% since prior to the election against the USD. Indeed, this fall trumps the dip in dairy price since the election.

From here though and as the Government's policies and their implications become clearer, the NZD may regain some lost ground. As a result, some of the commodity price gains may not last.



Rural Fact or Fiction?

? **Answer: Fiction!** Sebastian Kurz, 31, became the world's youngest national leader when he was elected prime minister of Austria in October 2017.

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