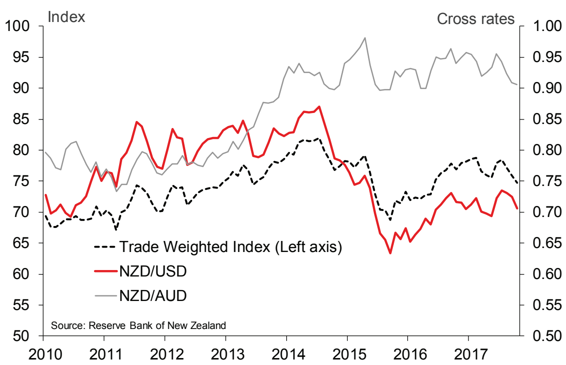
Fortnightly Agri Update

8 November 2017

Turning point for the Kiwi

- Sentiment has been the key driver of the New Zealand dollar recently.
- The NZD/USD has fallen around 7% with election uncertainty driving a majority of the fall.
- With the election uncertainty baked into the exchange rate, the outlook ahead rests on economic performance, inflation and interest rates.

Major trading currencies



It is music to exporters' ears when the NZ dollar weakens against our major trading currencies. In particular, the New Zealand dollar has fallen by 5 cents from its pre-election peak. The drivers of many currencies in the past year have been largely a reflection of political uncertainty.

GlobalDairyTrade Auction Results, 8 November 2017

	Change since last auction	Price index USD/Tonne
Anhydrous Milk Fat (AMF)	0.5%	$6,894
Butter	-3.6%	$5,516
Butter Milk Power (BMP)	7.2%	$1,931
Cheddar	-2.8%	$4,001
Lactose	0.0%	$0
Rennet Casein	-4.0%	$5,465
Skim Milk Powder (SMP)	1.2%	$1,818
Whole Milk Powder (WMP)	-5.5%	$2,852
GDT Price Index	-3.5%	

Farmgate milk price forecasts

	2017/18		2018/19
	Westpac	Fonterra	Westpac
Milk Price	$6.20	$6.75	$6.50

However, going forward we expect the usual drivers such as interest rates and broader economic fundamentals to shape the New Zealand dollar. In this Agri update, we provide some colour around the recent currency movements and outlooks for New Zealand's major trading currencies.

The New Zealand dollar against US dollar has fallen by around 7% between August and November. During this time, little to no economic data had warranted any material uptick in the USD to warrant a decline. Additionally, markets had priced in a status quo outcome for the election, rather than the surprise result of a change of government, which promoted the new Labour Party leader to Prime Minister.

Aside from uncertainty about the new government's policies, the timing of a softer New Zealand dollar being earlier than anticipated, the current exchange rate is within a broader view consistent with our view that the NZD would depreciate against the USD. Moreover, with the RBNZ's Monetary Policy Statement for November due this week, we see the financial markets having already priced in a hold on the Official Cash Rate. As such, we expect the New Zealand dollar to hover around its current levels shy of any material shifts in the domestic market.

NZD/USD outlook

The USD showed signs of life since early September, with the USD weighted index increasing by 5%. Notably, the USD is expected to continue to show strength going into 2018. Although the pace of the rebound has stalled as of late, the exchange rate outlook will primarily be a US dollar story. Relative to the New Zealand dollar we expect that the exchange rate will hover in the mid to high 60's for the better part of 2018.

Factors supporting the US dollar are firming US economic conditions such as rising manufacturing activity and declining unemployment. However, US inflation data has been slow to pick up, leading to concerns around what the Federal Reserve may do with interest rates in the longer term. We anticipate an additional rate hike in December, and two more interest rate hikes in 2018. This will support a stronger USD, which we have built into our expectations for the suite of our export commodities in the 2017/18 season.

NZD/AUD outlook

Australia remains our second largest trading partner, with the exchange rate expected to soften a bit going into 2018. The outlook of the Aussie dollar has been driven by expectations around the Reserve Bank of Australia's interest rate decisions. We continue to expect that the RBA will hold interest rates at 1.50% for quite some time, which would disappoint market expectations. However, to date our call has largely oscillated around key economic fundamentals. Fundamentals such inflation have been too soft, driven largely by weak food prices. Our expectation is that the softer New Zealand dollar going into 2018 will be the driving force of a slightly softer NZD/AUD expected to range in the high 80s.

NZD/EUR outlook

Economic momentum in the European economies continues to improve, supporting a stronger Euro. Similar to the US, the Euro Area faces the challenges of tighter monetary policy in the wake of soft inflation and wage outcomes. This could have implications the around pace of changes to interest rates and by extension, the market's view of the Euro. While political tensions have eased a bit, political cohesion remains a downside risk. However, any resulting softness will be against the USD.

That said, against the NZD, the Euro has sustained strength with an expectation that the NZD/EUR will gravitate towards 0.56 in the near-term. Current economic data also suggests strong growth in the December 2017 quarter, supporting the anticipated pickup in demand for the chilled meat trade. Overall, a stronger economy means stronger demand and along with the stronger Euro good news for our top destination for meats going forward.

NZD/GBP outlook

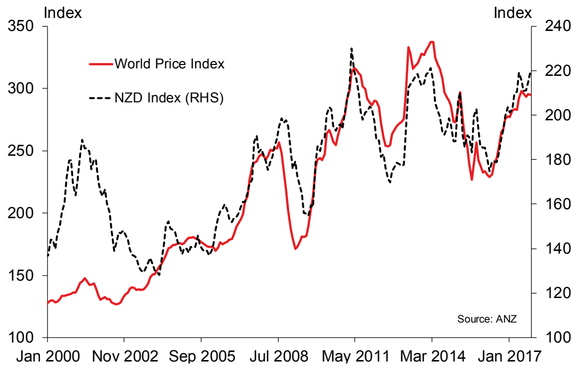
Risks for the Sterling remain to the downside, especially with the concerns of Brexit and the political tensions surrounding the UK's negotiating abilities. However, the long-winded process for Brexit has the markets more interested in the here and now, notably interest rates. November saw the Bank of England's Monetary Policy Committee voting to increase the Bank Rate for the first time in ten years.

The increase still leaves the Bank Rate at the very accommodative level of 0.50% and there was no signal of any further hikes in the pipeline. Against the NZD, the Sterling also weakened, supporting consistent returns for our lamb exports. Looking ahead, we expect the combination of factors driving the Sterling to keep the NZD/GBP relatively stable around its long-term average.

What does this all mean?

The latest read on the ANZ's commodity price index shows a tick up in the NZD index relative to the world price index taking into account the weakening of the exchange rate. This supports the view that a softer New Zealand dollar can be a positive for our export commodity returns. In the medium-term, the lower New Zealand dollar will boost returns and act as a buffer against softer prices that we expect, as detailed in our last few agri updates.

ANZ Commodity Price Index



Shyamal Maharaj
Economist

Beyond the farm gate

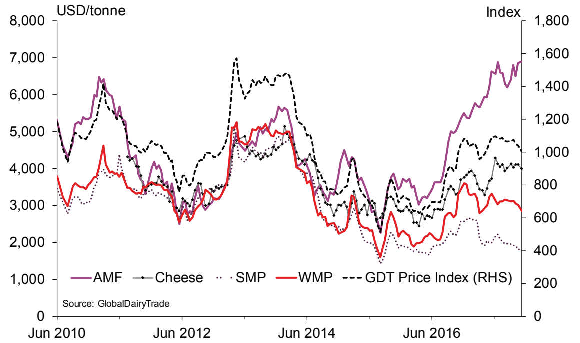
Dairy

	Current price level compared to 10 year average	Next 6 months
Trend	Average	↓

Last night's GlobalDairyTrade auction saw a 3.5% decline in the overall dairy price index. Whole milk powder prices fell by 5.5% to US$2,852/t. Butter prices fell by 3.6% to US$5,516. The decline in milk product prices over recent auctions, despite weaker domestic production, suggests some softening of demand.

We have downgraded our forecast farmgate milk price payout for the 2017/18 season to $6.20/KgMs from $6.50/KgMs. We expect China's growth to slow next year as the government focuses on economic rebalancing, which is likely to crimp demand for a range of commodities.

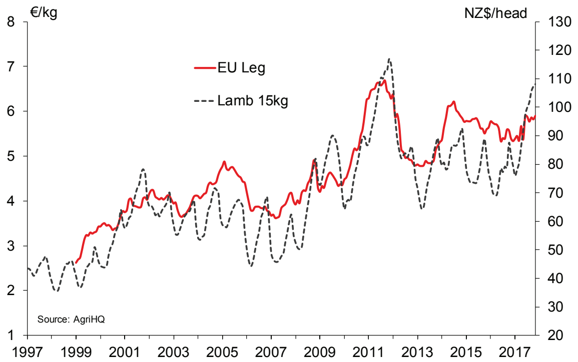
We are also publishing for the first time our milk price forecast for the 2018/19 season. We expect the payout to increase to $6.50/KgMs, on the basis of a revival in the Chinese economy from late 2018 and supported by a lower average exchange rate over the season.



Lamb

	Current price level compared to 10 year average	Next 6 months
Trend	Average	↓

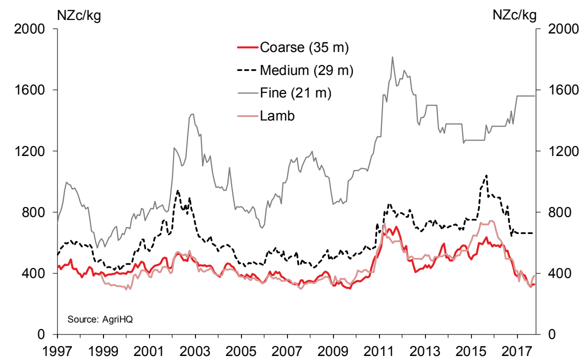
Lamb prices continue to show strength month to month, largely supported by the low slaughter numbers across all farms. Although supply has been teetering, demand has been spectacularly strong, which on balance has been key to the strength we are seeing. US lamb imports from early this year to August rose by 19%. Although the US is not a key destination, average US lamb export returns exceed the returns we get from China and the UK by a considerable margin. But with beef as the main red meat demanded by US consumers, the upside from rising US lamb demand may be slow. Beyond this seasonal uptick in prices, we expect supply to come back on board following the November demand boost, which should lower prices for lamb schedules in early 2018.



Wool

	Current price level compared to 10 year average	Next 6 months
Trend	Low	↘

Wool prices have remained soft this year, though with a small upturn for finer grades in recent weeks. We see some further downside for prices in the near term as China's economic growth slows. The outlook is better for 2019, as a pickup in the Chinese economy boosts demand for raw materials, and higher oil prices lift prices for competing synthetic materials.



Note: Trend arrows indicate direction of change in world prices.

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