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Dairy prices continue to slide. Ten of the last 12 dairy auctions have now recorded overall price falls. These falls emphasise how exceptional the season just gone really was for both dairy prices and in turn for dairy production. Now though, for dairy farmers it's getting quickly back to reality.

The dairy price falls have been more than we and others expected. Factoring in the recent falls, we have revised down our milk price forecast for the 2014/15 season by 80 cents to \$6.20/kg of milk solids.

That said, if current trends continue, our milk price forecast could head lower. As such, the possibility of a sub-\$6.00 milk price for the 2014/15 season is rising.

Dairy's slide contrasts with other agricultural markets, which are mostly on the improve. Meat markets, in particular, are healthy, and the signs are pointing towards improving wool markets too.

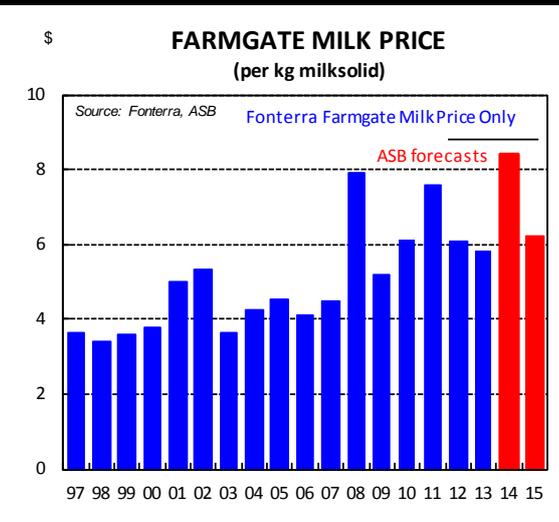
Lamb prices recovered steadily over the season just gone, rising some 9% for the season as a whole. While lamb markets are quiet for now, we expect lamb price increases kick back into gear as we get closer to Christmas. Most of the factors supporting prices remain in play.

Beef prices also remain rock solid. And similarly, factors supporting beef prices are set to stay in place for the rest of the year and well into 2015. Meanwhile, wool prices are creeping higher, with improving Australian and US housing markets generating demand for carpets and thus for coarse wool.

Turning to financial markets, interest rates are moving higher following the RBNZ's June Official Cash Rate increase. Moreover, we expect another 25bp rise is on the way later this month. But in our view, fewer, in total, will be needed over 2014 and 2015 than the RBNZ currently projects. At the same time, the NZD has set fresh records, despite the hefty falls in dairy auction prices.

Key Rural Data: Chart of the Month:

As at 11 July 2014	Current	4 wks ago	Year ago	Outlook*
Rural Commodity Prices:				
ASB Dairy Price Index (USD)	220.3	228.4	250.4	↑
Lamb Price Index (NZD)	192.0	191.8	166.4	↑
Beef Price Index (NZD)	220.3	219.2	210.3	→
Wool Price Index (NZD)	124.2	127.6	115	↑
Interest Rates:				
90-day bank bills	3.67	3.53	2.65	↑
2 year swap	4.23	4.22	3.23	↑
5 year swap	4.65	4.61	4.02	↑
Exchange Rates:				
NZD/USD	0.8814	0.8664	0.7708	→
CNY/NZD	5.47	5.38	4.73	↑
NZD/GBP	0.5148	0.5107	0.5177	↓
Milk solids production (ytd % chg)**	9.6	8.1	-0.4	↑
Fonterra Shareholders' Fund	5.80	5.91	7.31	↑



*Outlook indicates direction of change over the next six months. **Current data is April.

? Rural Fact or Fiction?
Apples are the world's number one fruit crop.

Answer on page 3

Rural Commodities Outlook

Dairy – On guard

ASB Dairy Index, 11 July: 220.3 ↓ 3.5% (mpc)

Dairy prices continue to slide. In the 15 July GlobalDairyTrade auction, overall dairy prices recorded a further 8.9% fall. All up, compared to the same time a year ago, prices are down by around a third.

This downward pressure on prices firstly came from the stellar NZ production season where production has lifted by around 10% from the season prior. Production has also lifted strongly in Europe and to a lesser extent in the US and China. In addition, Chinese dairy stocks are high and are taking time to clear.

These price falls are more than we had factored in previously. Recently, we have noted that we expected dairy prices to stabilise through the middle of 2014 before recovering. We would thus expect to have seen clearer signs that prices were stabilising at this juncture. But these signs have yet to emerge.

With this in mind, we have revised down our milk price forecast for the 2014/15 season by 80 cents. We now forecast a milk price of \$6.20/kg of milk solids, compared to our \$7.00/kg forecast from back in May.

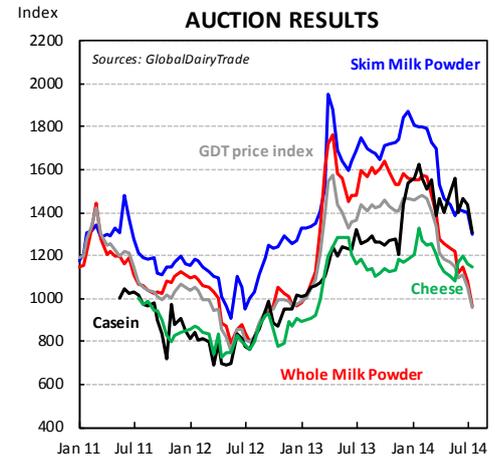
That said, if current trends continue, our milk price forecast could head lower. As such, the possibility of a sub-\$6.00 milk price for the 2014/15 season is rising.

Milk Price Forecast:

	2013/14		2014/15	
	Fonterra	ASB	Fonterra	ASB
Milk Price*	\$8.40	\$8.40	\$7.00	\$6.20

*per kg of milk solids

GLOBAL DAIRY TRADE AUCTION RESULTS



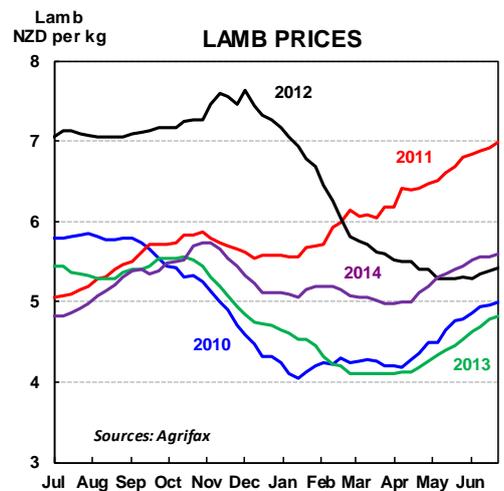
Lamb – Quiet on the home front

ASB Lamb Index, 11 July: 192.0 ↑ 0.1% (mpc)

Currently lamb markets are quiet as the UK and European summer gets into full swing. With demand lower over the next few months, we can expect lamb price increases to slow temporarily, if not tread water.

Looking back over the June 2014 year, the ASB Lamb Price Index averaged 9% higher than over the June 2013 year. While lamb prices started the season behind the level of the season prior, by around November lamb prices overtook the season-prior levels and continued to widen their lead over the remainder of the season. And by June this year, the ASB Lamb Index was averaging 15% higher than in June 2013.

Once through the quiet period, we expect lamb price increases kick back into gear as we get closer to Christmas. The same factors we have discussed recently (tight supply from NZ and Australia) coupled with improving and growing demand (from the UK and China respectively) are still in play. All up, we expect lamb prices to build further on last season's gains over the new season.



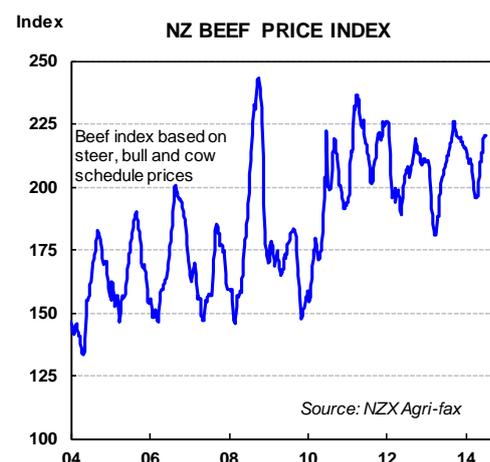
Beef – Filling the gap

ASB Beef Index, 11 July: 220.3 ↑ 0.5% (mpc)

Beef prices remain rock solid. Average beef prices over the last four weeks (based on the beef price index) are 5% higher than the average level for the same period in 2013.

The US beef market continues to look to imports to fill the gap being left by tight domestic beef supply. In its latest forecast, the US Department of Agriculture expects the import proportion of total beef supply to rise from 7.9% in 2013 to over 9% in both 2014 and 2015.

This dynamic will continue to present opportunities for NZ beef exporters. And while this opportunity continues in what is NZ's largest export market, beef prices are likely to remain well-supported over the remainder of 2014 and into 2015. At this juncture, with the outlook beef export prices strong, beef export incomes are only tempered by the stubbornly high NZD against the USD.



Rural Commodities Outlook (continued)

Wool – Creeping higher

ASB Wool Index, 11 July: 124.2 ↓ 2.7% (mpc)

After a weak start to 2014, wool prices have recovered some of their lost ground. The prices for coarse wool (35 micron) over the last 3 months averaged around 11% higher than the 3 months earlier. Similarly, prices over the last four weeks are 10% higher than the same period a year ago.

We expect coarse wool prices to creep higher over the coming months. For coarse wool prices the housing markets, particularly in the US and Australia, are key drivers. Over in Australia, strong population growth means a shortage of housing. This along with low interest rates should see housing construction continue to pick up and with it demand for carpets. Over in the US, the housing market continues to recover which should be supportive of coarse wool prices as well.

Turning to fine wool, the outlook is more mixed. Demand for fine wool largely depends on Northern Hemisphere consumer demand for wool apparel. In this respect, generally the pick-up in demand is more cautious.



Financial Markets Outlook

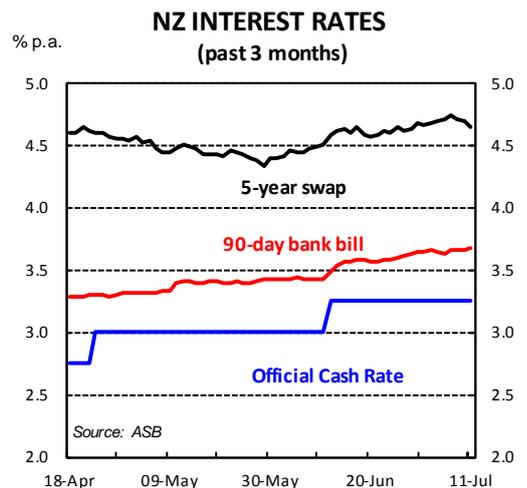
Interest Rates – One more hike, then a pause?

90-day bank bills, 11 July 3.67% ↑ 0.14bps (mc)

Short-term interest rates continued to move higher since June as the Reserve Bank lifted the Official Cash Rate (OCR) a further 25bps to 3.25% on 12 June. The Reserve Bank also reiterated its intention to continue lifting interest rates steadily over 2014, 2015 and into 2016. As a result, forecasters and money market participants upped the likelihood of another hike in July. That saw a sharp move higher in short-term interest rates.

We also now expect another 25bps hike in July. Although from there, we expect the Reserve Bank to pause, before hiking again until December. Ultimately, we see the OCR peaking at 4.5% by late 2015.

Meanwhile, longer-term interest rates rose modestly over the last month. These rates tend to be driven by the US Treasury market, where yields recovered somewhat following a dip in late May. NZ rates also rose by a little more than those in the US as local markets factored in the higher likelihood of further lifts in the OCR by the Reserve Bank.



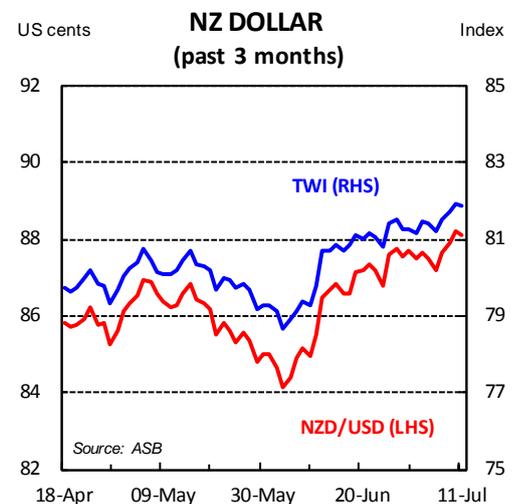
NZ Dollar – Records tumble

NZD/USD, 11 July 0.8814 ↑ 0.0150 (mc)

With NZ's economic and interest rate outlook continuing to look appealing to international capital, the NZD remained under upward pressure over the past four weeks. The NZD TWI hit fresh post-float highs, with the latest high of 82.01 recorded on 14 July. At the same time, the NZD also approached to within touching distance of the 88.43 record high against the USD set back in 2011.

This NZD strength came despite weakening overall export prices, in particular for dairy, over the same period. In this sense, the currency isn't acting in its usual capacity as a buffer for the export sector at the moment.

With this in mind, it appears that the support for the NZD from NZ's relatively rosy economic and interest rate outlook is dominating any NZD weakness from falling export prices. With the Reserve Bank likely to hike the OCR again later this month (and little sign of offshore Central Banks raising their own rates), for now, we expect the NZD support to remain largely in place.



Rural Fact or Fiction?

Answer: Fiction! While more than 6,000 apple varieties are grown around the world, the number one fruit crop is, in fact, bananas, and not apples.

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