

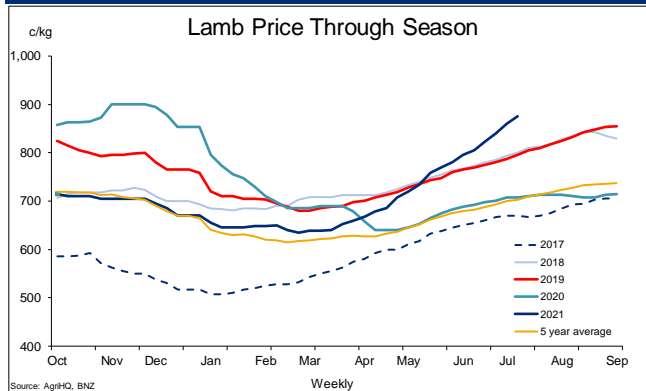
Lamb Prices Leaping

- NZ lamb supply is tight; demand conditions improving
- Australian supply affected by flock rebuilding
- China buying more of NZ sheepmeat exports
- Lamb prices look set for new highs
- But plenty of challenges remain, risks to monitor

Lamb prices have lifted over recent months. Of course, there is nothing unusual in lamb prices rising through autumn and winter given typically lower production at this time of year. But the extent of the price increases this season has been remarkable.

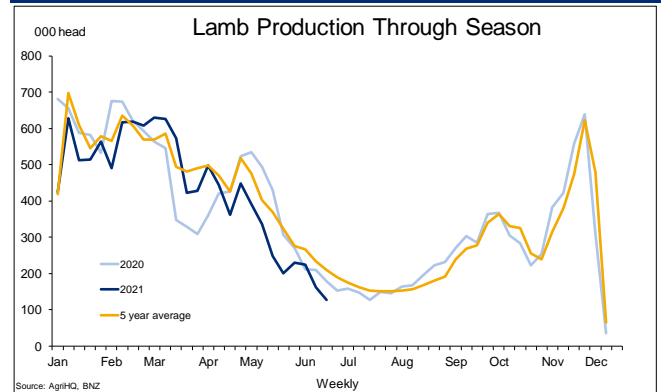
Farmer operating prices have typically shown gains of around 12%, or 75c/kg, from early April through late July over recent season. AgriHQ data show that this year's gains have been 31%, or more the \$2/kg, over the same period – lifting from just under \$6.70/kg to \$8.75/kg on last count. This puts lamb prices more than 24% above their 5-year average for this time of year. We expect further gains ahead before new season lambs come through in volume.

Lamb Prices Lift



Limited supply is one important factor behind the price lift. Beef and Lamb NZ estimate last year's lamb numbers were down more than 1% on the previous season, reflecting fewer breeding ewes. An early kill profile, provoked in part by poor weather, has subsequently seen slaughter numbers over recent months drop below their respective 5-year average. Rain (albeit with way too much in some areas) has generally supported keeping some lambs on farms – intensifying supply tightness. Store prices have been strong.

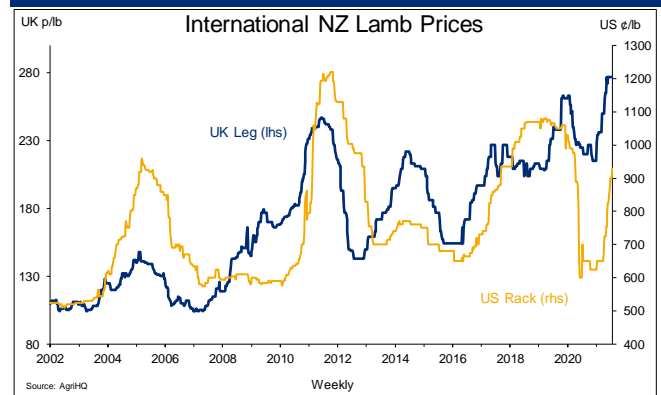
Tracking Well Behind Average



Australian flock rebuilding has added to the tightness in sheepmeat availability in world markets – albeit more so for mutton than lamb recently. It follows from an ongoing run of better weather. The Australian sheep flock is expected to expand more than 6% this year. This is a rapid bounce off last year's all-time low resulting in limited slaughter numbers supporting prices.

Lamb product prices in overseas markets, like legs in the UK and french racks in both the US and EU, are sharply higher over recent months. In addition to supply tightness, such price gains also reflect stronger demand on reopening of economies as higher Covid vaccination rates allow relaxation of previous restrictions.

Offshore Prices Higher

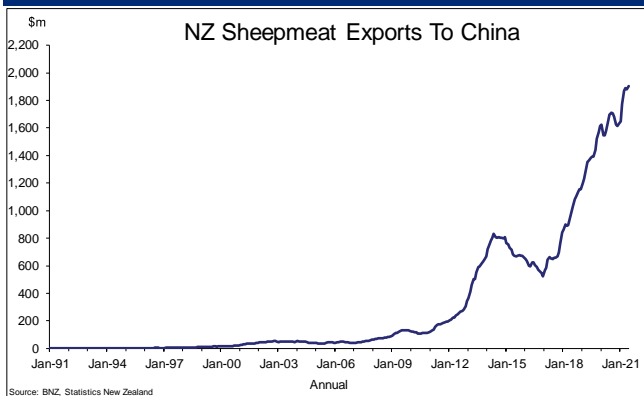


Food service activity has certainly improved, with indicators showing restaurant bookings in the UK above 2019 levels. In the US, the Restaurant Performance Index (RPI) has punched well above average levels over recent

months – driven by strength in the current situation component. However, the expectations component has pulled back from its highs earlier in the year although remains above average. The latter is a reminder that while reopening is occurring and activity improving, concerns around the spread of the Delta variant and what it will mean for activity ahead are circulating.

China’s demand for sheepmeat remains firm. This is reflected in higher NZ exports to China. In the year to June 2021, NZ sheepmeat exports to China pushed through \$1.9 billion for the first time, resuming what has been a very strong multi-year uptrend after something of a pause last year. China now accounts for about half of NZ’s total sheepmeat exports (from around 5%, 10 years ago). Strong Chinese demand has been a support to product prices, including for flaps that are up around 50% on a year ago.

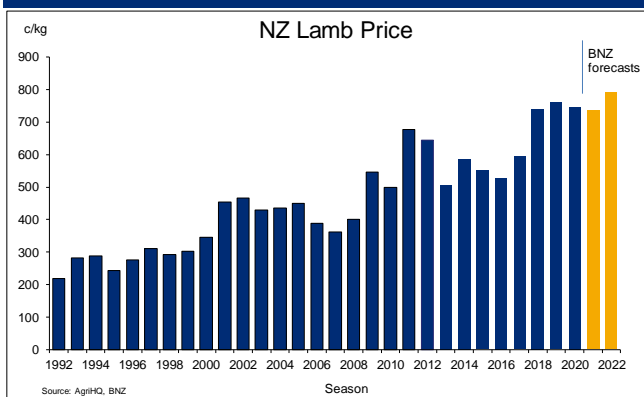
China Buying More NZ Sheepmeat



Higher world lamb product prices and a generally contained NZD is a good mix for prices at the farm gate.

All this presents a strong starting position for the season ahead. Recent developments have supported our prior cautious optimism on lamb prices. It sets up a good chance for average lamb prices in the 2021/22 season to make an all-time high. But if the past 18 months has taught us anything, nothing can be taken for granted.

Positive

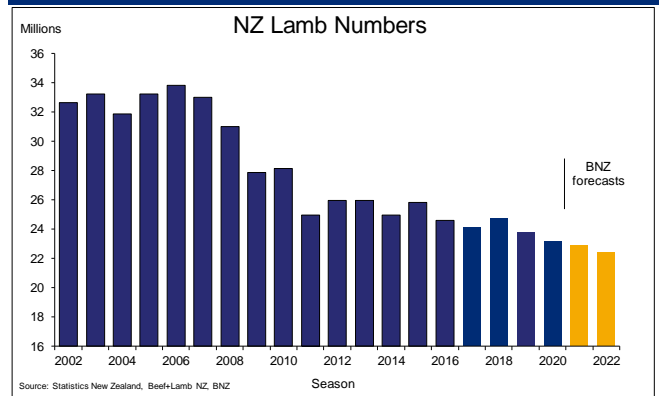


Numerous supply chain challenges and rising costs need navigating.

We are also wary that the flock rebuilding underway in Australia will see more lambs to market at some point down the track. In other words, beware the cycle. For now, with the season looking so good weather-wise across the ditch (and notwithstanding the challenges associated with Covid outbreaks), there may be a temptation to hold more lambs back for expansion.

Eyes will be also on this year’s NZ lambing season. Outside of the seasonal supply lift, we think lamb numbers will remain constrained given the multi-year downtrend in breeding ewe numbers, another year of elevated mutton slaughter, and prior pockets of inclement weather that could dent lambing percentages for some. Tight supply might not be the best way to achieve better prices for producers, but it is very much part of the equation.

Fewer Lambs



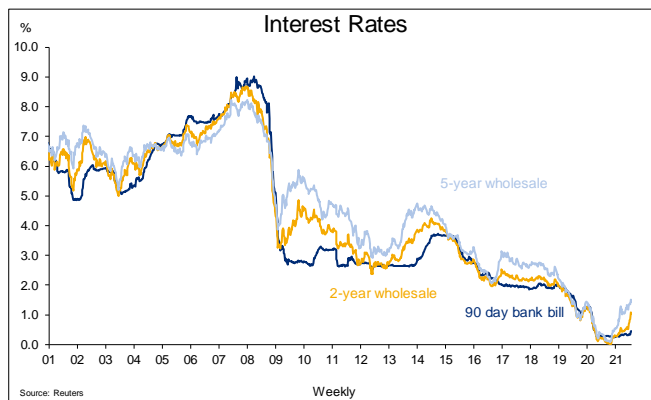
On the demand side, China is obviously important as is the Delta variant and its potential to disrupt the economic reopening in key markets. We continue to watch developments on these fronts closely.

We are also keeping an eye out for NZ-UK free trade announcements, with expectations that an agreement in principle will be reached by the end of August. As always with these things, interest will be in the details of what has been agreed and when any changes will be implemented. This applies to the sheepmeat market as much as any other.

doug_steel@bnz.co.nz

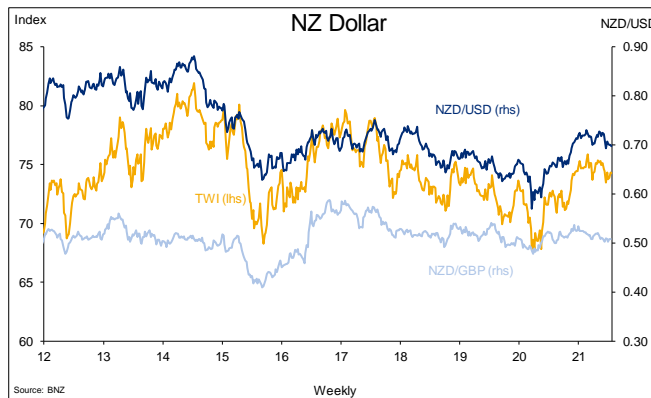
Key Macro Drivers for Commodity Producers

Interest Rates



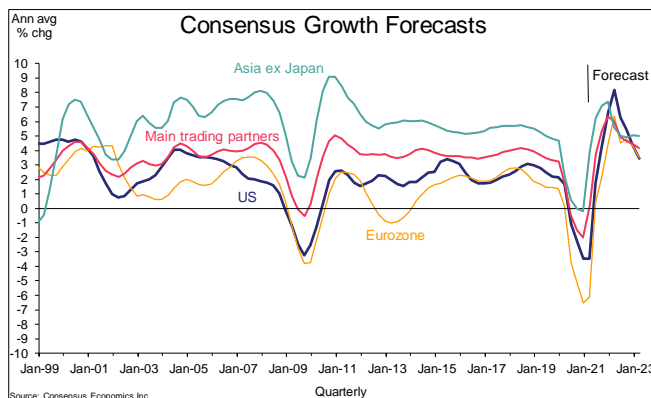
The RBNZ held the Official Cash Rate (OCR) steady at 0.25% at its July Monetary Policy Review. But there was a distinct change of tune more generally, with the Bank headline reading ‘Monetary stimulus reduced’ as it announced it would stop buying bonds. The corollary is that the market is now on notice for OCR hikes from now on. Wholesale interest rates have pushed higher. It all follows from the economy outperforming the Bank’s previous forecasts, many indicators pointing to a tightening labour market (which we expect the official Q2 figures on 4 August to confirm), and inflation rising aggressively. We expect the RBNZ to lift the OCR to 0.50% at its meeting on 18 August. That is not necessarily a done deal. But our broader economic forecasts suggest that the OCR is likely to track higher over the coming 18 months or so – to around 2%. If so, this suggests short-term fixed rates have some further upside. We also expect long-term rates to follow global rates higher over the coming year.

Foreign Exchange



The spread of the Delta variant has checked previously buoyant global market sentiment. This has seen an unexpectedly weaker NZD/USD against the backdrop of supportive domestic factors (which has increased the likelihood of the RBNZ leading the policy tightening cycle ahead of other developed countries). We are hopeful that, as the global vaccination rollout gathers pace, the global recovery can ultimately get back on track. We have slightly lowered our near-term NZD/USD projections, and headwinds are likely to linger until the market senses the threat has passed, while our projected March-2022 peak of 0.76 is left intact. This is largely a softer USD view, with NZD forecasts against the AUD, EUR, and GBP reasonably steady.

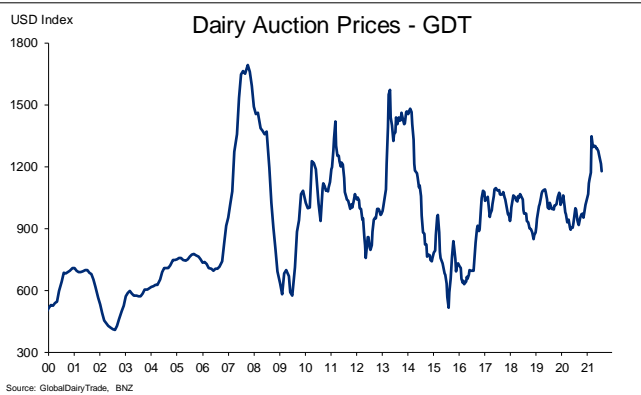
Global Growth



COVID-19 remains the most significant risk to our positive global outlook. Much of the emerging world remains vulnerable to the pandemic due to low vaccination rates and this is unlikely to be resolved before late 2022 at the earliest. There is growing concern that variants are more easily transmitted – potentially requiring higher than previously thought rates of vaccination to achieve herd immunity. This has seen markets reassess risk appetite over recent months. More encouraging is that vaccinations seem to have weakened the link between case numbers and severity of illness or death. Relatively strong global business survey readings are skewed towards the opening-up advanced economies. In contrast, surveys for EMs have softened. Supply chain challenges remain significant.

Key Commodities

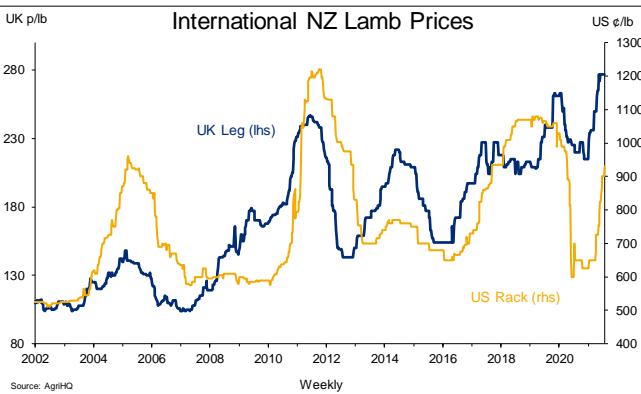
Dairy



Global dairy prices continue to moderate. A big lift in US milk production in addition to strong NZ supplies from the end of last season appears to have taken the edge off pricing. Demand seems solid. The GDT Price Index has declined in seven consecutive events through to July, to be a cumulative 12.5% down from their recent early-March peak. But prices, as they stand, remain relatively strong and are around 19% above a year ago. For 2021/22 milk price calculations, recent GDT price declines have been broadly in line with our expectations so no need to change our \$7.80 forecast. That remains our base case amid a still wide range of potential outcomes by season end.

	Current	Month ago	Year ago	Next 12 months
Whole milk powder (US \$/t)	3850	4050	3250	↓

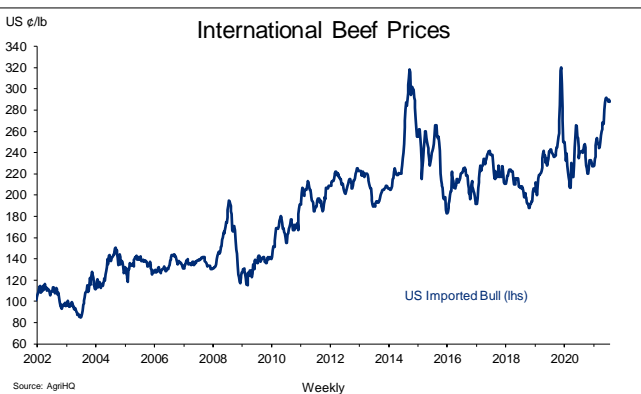
Lamb



NZ lamb prices have lifted strongly through winter, reflecting sharp increases in offshore markets across a range of products. Economic reopening in key markets has been a boon. Meanwhile, NZ supply has been particularly tight over recent months given an early kill profile of an already estimated lower lamb crop. NZ supply is expected to remain on the tight side such that if demand remains robust, as is our base case, it sets up a good chance that average lamb prices in 21/22 will make an all-time high.

	Current	Month ago	Year ago	Next 12 months
Lamb leg (UK p/lb)	277	277	220	→

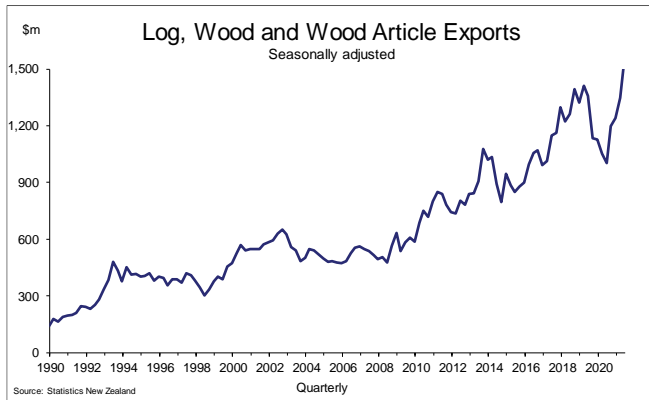
Beef



US beef prices have remained elevated over the past couple of months. Economic reopening has been positive for food service with demand indicators lifting well above average, albeit with a hint of potential tempering after the initial rush. Meanwhile, US supply has increased as drought and poor profitability has seen some herd liquidation. That suggests tighter supply in due course which should support prices ahead. Chinese beef demand appears solid, while rising Covid cases elsewhere in Asia is a threat. On balance, we expect 21/22 beef prices in NZ to average higher than the current season average.

	Current	Month ago	Year ago	Next 12 months
Imported bull (US ¢/lb)	288	290	241	↑

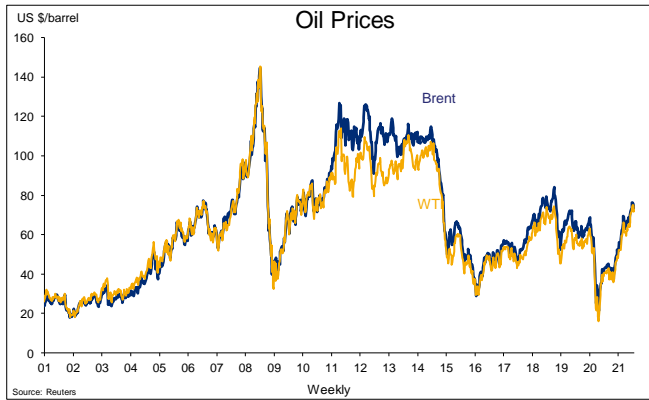
Forestry



Log exports posted another very strong gain in Q2 2021. Very strong offshore pricing, a contained NZD, and a big volume response has seen export values hit record highs. As buoyant as offshore markets have been, AgriHQ data show July export prices easing back from all-time highs on softer Chinese demand. This bears watching, as it appears not all of it can be attributed to the usual seasonal dip. That said, many global supply issues remain even before the upcoming Russian export log ban. Higher shipping costs are a negative. Meanwhile, elevated house construction activity continues to add support a strong domestic log market.

	Current	Month ago	Year ago	Next 12 months
S1/S2 log price (NZ \$/t)	134	134	124	↑

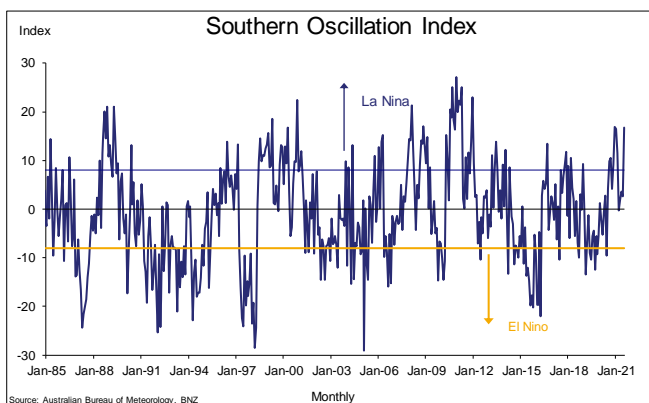
Oil



Crude oil prices continue to trend higher. To be sure, Brent crude prices have been wobbling around the mid-\$US70s over recent weeks as concern lingers around what the Delta variant means for global economic growth. But prices are still around 10% higher than two months earlier and a full 71% up a year ago. To date, economic reopening has underpinned demand. Forecast price gains reflect an expectation of ongoing economic recovery balanced against possible relaxation of curbs on OPEC+ production.

	Current	Month ago	Year ago	Next 12 months
Brent Crude (US \$/b)	74	76	43	↑

Soil Moisture (mm)



Floods in Canterbury, West Coast, and the top of the South Island over recent months cause significant damage leaving huge clean-up jobs and repair bills for some. As an example of the intensity of recent rain, NIWA data shows that flood flows on the Buller River in July were the largest of any river in New Zealand in nearly 100 years. Elsewhere, periodic rain over recent months has generally been more welcome with NIWA maps showing next to no soil moisture deficits across the country. Looking ahead, we note some climate models are indicating the possibility of La Nina conditions in spring, although the majority suggest neutral conditions will remain. This is worth watching as we look forward to the production season ahead. One positive consequence of the recent rainfall is a very welcome topping up of the country's hydroelectric storage lakes. Back in April, their collective water level had fallen below 60% of normal for the time of year. Wholesale electricity prices more than tripled. Now, hydro lake levels are back above normal, seeing power prices reverse and significantly reducing risk to those with exposure to that market.

Quarterly Forecasts

Forecasts as at 30 July 2021

Key Economic Forecasts

Quarterly % change unless otherwise specified

Forecasts

	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22
GDP (production s.a.)	-1.5	-10.8	14.1	-1.0	1.6	0.7	0.6	0.7	0.5	1.1
Retail trade (real s.a.)	-1.3	-14.8	27.7	-2.6	2.5	2.5	0.6	0.5	0.6	0.8
Current account (ytd, % GDP)	-2.8	-1.8	-0.8	-0.8	-2.2	-3.2	-3.8	-4.0	-3.8	-4.1
CPI (q/q)	0.8	-0.5	0.7	0.5	0.8	1.3	1.3	0.5	0.5	0.3
Employment	1.0	-0.2	-0.7	0.6	0.5	0.7	0.3	0.4	0.5	0.7
Unemployment rate %	4.3	4.0	5.2	4.9	4.7	4.4	4.3	4.1	4.0	3.7
Avg hourly earnings (ann %)	3.7	2.9	3.9	4.6	3.0	3.5	2.7	2.9	4.0	4.3
Trading partner GDP (ann %)	-2.4	-5.3	-0.9	0.7	6.3	9.8	5.4	4.6	4.8	4.9
CPI (y/y)	2.5	1.5	1.4	1.4	1.5	3.3	4.0	4.1	3.7	2.7
GDP (production s.a., y/y)	0.0	-11.2	0.4	-0.8	2.4	15.6	2.0	3.7	2.6	2.9

Interest Rates

Historical data - qtr average

Forecast data - end quarter

	Cash	Government Stock			Swaps			US Rates		Spread
		90 Day	5 Year	10 Year	2 Year	5 Year	10 Year	Libor	US 10 yr	NZ-US
		Bank Bills						3 month		Ten year
2019 Dec	1.00	1.15	1.05	1.40	1.10	1.20	1.50	1.95	1.80	-0.40
2020 Mar	0.75	1.05	1.00	1.35	1.00	1.10	1.40	1.55	1.40	-0.03
Jun	0.25	0.30	0.40	0.85	0.25	0.40	0.80	0.60	0.70	0.15
Sep	0.25	0.30	0.25	0.65	0.15	0.25	0.60	0.25	0.65	0.02
Dec	0.25	0.25	0.25	0.70	0.15	0.30	0.75	0.20	0.85	-0.15
2021 Mar	0.25	0.30	0.75	1.40	0.40	0.85	1.50	0.20	1.30	0.09
Jun	0.25	0.35	1.00	1.75	0.55	1.20	1.90	0.15	1.60	0.17
Forecasts										
Sep	0.50	0.70	1.60	1.95	1.35	1.70	2.05	0.15	1.50	0.45
Dec	0.75	0.95	1.95	2.30	1.65	2.05	2.40	0.15	1.80	0.50
2022 Mar	1.00	1.20	2.25	2.60	1.90	2.35	2.70	0.15	2.00	0.60
Jun	1.25	1.45	2.50	2.80	2.15	2.60	2.90	0.15	2.20	0.60
Sep	1.50	1.75	2.70	3.00	2.35	2.80	3.10	0.15	2.35	0.65
Dec	1.75	2.00	2.85	3.15	2.50	2.95	3.25	0.15	2.50	0.65
2023 Mar	2.00	2.15	2.90	3.25	2.50	3.00	3.35	0.15	2.65	0.60

Exchange Rates (End Period)

USD Forecasts

	NZD/USD	AUD/USD	EUR/USD	GBP/USD	USD/JPY
Current	0.70	0.74	1.18	1.38	110
Sep-21	0.72	0.76	1.21	1.41	109
Dec-21	0.75	0.78	1.23	1.43	109
Mar-22	0.76	0.80	1.24	1.46	109
Jun-22	0.75	0.80	1.26	1.48	109
Sep-22	0.75	0.80	1.28	1.52	109
Dec-22	0.74	0.80	1.30	1.54	109
Mar-23	0.73	0.79	1.28	1.52	108
Jun-23	0.72	0.77	1.26	1.50	108
Sep-23	0.71	0.76	1.25	1.47	107
Dec-23	0.69	0.75	1.24	1.47	107

NZD Forecasts

	NZD/USD	NZD/AUD	NZD/EUR	NZD/GBP	NZD/JPY	TWI-17
Current	0.70	0.95	0.59	0.51	77.3	74.4
Sep-21	0.72	0.96	0.60	0.51	78.8	75.2
Dec-21	0.75	0.95	0.61	0.52	81.5	76.6
Mar-22	0.76	0.95	0.61	0.52	82.8	77.3
Jun-22	0.75	0.94	0.60	0.51	82.0	76.4
Sep-22	0.75	0.94	0.59	0.50	82.0	76.3
Dec-22	0.74	0.93	0.57	0.48	80.7	75.1
Mar-23	0.73	0.92	0.57	0.48	78.8	74.5
Jun-23	0.72	0.93	0.57	0.48	77.5	74.0
Sep-23	0.71	0.93	0.57	0.48	76.0	73.6
Dec-23	0.69	0.92	0.56	0.47	73.8	71.8

TWI Weights

13.3% 19.2% 10.5% 4.1% 6.4%

Source for all tables: Statistics NZ, Bloomberg, Reuters, RBNZ, BNZ

Annual Forecasts

Forecasts as at 30 July 2021	March Years					December Years				
	Actuals		Forecasts			Actuals		Forecasts		
	2020	2021	2022	2023	2024	2019	2020	2021	2022	2023
GDP - annual average % change										
Private Consumption	2.9	-0.7	9.6	3.3	2.0	3.6	-1.9	10.7	3.2	2.4
Government Consumption	6.1	6.3	4.5	1.8	1.3	5.4	6.4	5.3	2.2	1.2
Total Investment	1.3	-4.7	13.8	4.2	-0.6	3.2	-7.4	14.6	5.0	0.1
Stocks - pts cont'n to growth	-0.5	-0.2	0.8	-0.1	0.0	-0.7	-0.8	1.6	-0.3	0.0
GNE	2.5	-0.5	10.2	3.1	1.3	3.0	-2.5	11.9	3.1	1.6
Exports	-0.3	-15.9	4.0	11.1	8.1	2.3	-11.8	-4.4	9.9	10.8
Imports	1.2	-16.2	17.9	9.9	5.4	2.2	-16.4	15.1	9.4	7.1
Real Expenditure GDP	2.1	-0.4	5.7	2.8	1.6	3.0	-1.2	5.9	2.8	2.0
GDP (production)	1.7	-2.3	5.6	3.0	1.6	2.4	-2.9	5.6	3.0	1.9
GDP - annual % change (q/q)	0.0	2.4	2.6	2.9	1.6	1.8	-0.8	3.7	3.1	1.3
Output Gap (ann avg, % dev)	1.6	-2.1	0.7	1.4	0.7	2.0	-2.2	0.6	1.2	0.9
Nominal Expenditure GDP - \$bn	322	325	355	371	384	319	322	350	367	380
Prices and Employment -annual % change										
CPI	2.5	1.5	3.7	2.3	2.7	1.9	1.4	4.1	2.1	2.6
Employment	2.6	0.3	1.7	2.0	1.1	1.2	0.8	1.8	2.3	0.9
Unemployment Rate %	4.3	4.7	4.1	3.7	4.4	4.1	4.9	4.2	3.5	4.3
Wages - ahote	3.7	3.0	4.0	4.0	2.8	4.3	2.6	4.6	2.9	4.1
Productivity (ann av %)	-0.3	-2.9	4.2	0.9	0.5	0.5	-4.1	4.6	0.9	0.6
Unit Labour Costs (ann av %)	3.5	5.3	-0.4	2.4	2.3	2.5	6.9	-1.0	2.5	2.3
House Prices	7.8	20.7	9.6	2.3	2.0	4.6	15.5	17.2	2.8	2.0
External Balance										
Current Account - \$bn	-9.1	-7.2	-13.3	-16.4	-14.7	-10.6	-2.4	-14.1	-17.3	-15.3
Current Account - % of GDP	-2.8	-2.2	-3.8	-4.4	-3.8	-3.3	-0.8	-4.0	-4.7	-4.0
Government Accounts - June Yr, % of GDP										
OBEGAL (core operating balance)	-7.3	-2.8	-3.6	-0.9	0.3					
Net Core Crown Debt (excl NZS Fund Assets)	26.3	34.0	43.0	48.0	48.0					
Bond Programme - \$bn (Treasury forecasts)	29.0	45.0	30.0	25.0	25.0					
Bond Programme - % of GDP	9.0	13.8	8.4	6.7	6.5					
Financial Variables ⁽¹⁾										
NZD/USD	0.60	0.71	0.76	0.73	0.69	0.66	0.71	0.75	0.74	0.69
USD/JPY	108	109	109	108	107	109	104	109	109	107
EUR/USD	1.11	1.19	1.24	1.28	1.24	1.11	1.22	1.23	1.30	1.24
NZD/AUD	0.97	0.93	0.95	0.92	0.92	0.96	0.94	0.95	0.93	0.92
NZD/GBP	0.49	0.51	0.52	0.48	0.47	0.50	0.53	0.52	0.48	0.47
NZD/EUR	0.55	0.60	0.61	0.57	0.56	0.59	0.58	0.61	0.57	0.56
NZD/YEN	65.1	77.5	82.8	78.8	73.8	72.0	73.6	81.5	80.7	73.8
TWI	68.9	74.8	77.3	74.5	71.8	72.8	74.3	76.6	75.1	71.8
Overnight Cash Rate (end qtr)	0.25	0.25	1.00	2.00	2.00	1.00	0.25	0.75	1.75	2.00
90-day Bank Bill Rate	0.71	0.33	1.20	2.15	2.15	1.23	0.26	0.95	2.00	2.15
5-year Govt Bond	0.80	1.00	2.25	2.90	2.95	1.25	0.40	1.95	2.85	2.95
10-year Govt Bond	1.15	1.75	2.60	3.25	3.30	1.60	0.90	2.30	3.15	3.30
2-year Swap	0.65	0.50	1.90	2.50	2.50	1.25	0.28	1.65	2.50	2.50
5-year Swap	0.80	1.15	2.35	2.95	3.05	1.40	0.49	2.05	2.95	3.05
US 10-year Bonds	0.90	1.60	2.00	2.65	3.00	1.85	0.90	1.80	2.50	3.00
NZ-US 10-year Spread	0.25	0.15	0.60	0.60	0.30	-0.25	0.00	0.50	0.65	0.30

⁽¹⁾ Average for the last month in the quarter

Source for all tables: Statistics NZ, EcoWin, Bloomberg, Reuters, RBNZ, NZ Treasury, BNZ

Contact Details

BNZ Research

Stephen Topliss
Head of Research
+64 4 474 6905

Craig Ebert
Senior Economist
+64 4 474 6799

Doug Steel
Senior Economist
+64 4 474 6923

Jason Wong
Senior Markets Strategist
+64 4 924 7652

Nick Smyth
Senior Interest Rates Strategist
+64 4 924 7653

BNZ Markets

Blair Wilson
Interest Rate Solutions
+64 6 350 1670

Phil Townsend
Interest Rate Solutions
+64 3 353 2219

Wayne Brill
Interest Rate Solutions
+64 7 928 0871

Jeff Yeakley
Interest Rate Solutions
+64 3 938 5995

BNZ Partners

David Handley
Head of Agribusiness
+64 9 976 5009

National Australia Bank

Dean Pearson
Senior Economist
Industry & Commodities
+61 3 8634 2331

Main Offices

Wellington
Level 4, Spark Central
42-52 Willis Street
Private Bag 39806
Wellington Mail Centre
Lower Hutt 5045
New Zealand
Toll Free: 0800 283 269

Auckland
80 Queen Street
Private Bag 92208
Auckland 1142
New Zealand
Toll Free: 0800 283
269

Christchurch
111 Cashel Street
Christchurch 8011
New Zealand
Toll Free: 0800 854 854

This document has been produced by Bank of New Zealand (BNZ). BNZ is a registered bank in New Zealand and is only authorised to offer products and services to customers in New Zealand.

Analyst Disclaimer: The Information accurately reflects the personal views of the author(s) about the securities, issuers and other subject matters discussed, and is based upon sources reasonably believed to be reliable and accurate. The views of the author(s) do not necessarily reflect the views of the NAB Group. No part of the compensation of the author(s) was, is, or will be, directly or indirectly, related to any specific recommendations or views expressed. Research analysts responsible for this report receive compensation based upon, among other factors, the overall profitability of the Global Markets Division of NAB.

NAB maintains an effective information barrier between the research analysts and its private side operations. Private side functions are physically segregated from the research analysts and have no control over their remuneration or budget. The research functions do not report directly or indirectly to any private side function. The Research analyst might have received help from the issuer subject in the research report.

New Zealand: The information in this publication is provided for general information purposes only, and is a summary based on selective information which may not be complete for your purposes. This publication does not constitute any advice or recommendation with respect to any matter discussed in it, and its contents should not be relied on or used as a basis for entering into any products described in it. Bank of New Zealand recommends recipients seek independent advice prior to acting in relation to any of the matters discussed in this publication.

Any statements as to past performance do not represent future performance, and no statements as to future matters are guaranteed to be accurate or reliable.

Neither Bank of New Zealand nor any person involved in this publication accepts any liability for any loss or damage whatsoever which may directly or indirectly result from any advice, opinion, information, representation or omission, whether negligent or otherwise, contained in this publication.

USA: If this document is distributed in the United States, such distribution is by nabSecurities, LLC. This document is not intended as an offer or solicitation for the purchase or sale of any securities, financial instrument or product or to provide financial services. It is not the intention of nabSecurities to create legal relations on the basis of information provided herein.