

# Commodities Weekly

For the week ending Friday 17<sup>th</sup> May



## Two steps back, one forecast forward

- Fonterra has effectively cut its 2018/19 milk price forecast by 10 cents.
- At the same time, Fonterra’s business performance continues to disappoint, with a cut to its 2018/19 earnings forecast also announced.
- Looking ahead, Fonterra has set its 2019/20 season opening forecast at a relatively healthy level.

### Farmgate Milk Price Forecasts

	2018/19	2019/20		Long Run
	Fonterra/ASB	Fonterra	ASB	ASB
Milk Price*	\$6.30-\$6.40	\$6.25-\$7.25	\$7.00	\$6.50-\$7.00

\* per kg of milk solids (excluding dividend).

### Two steps back...

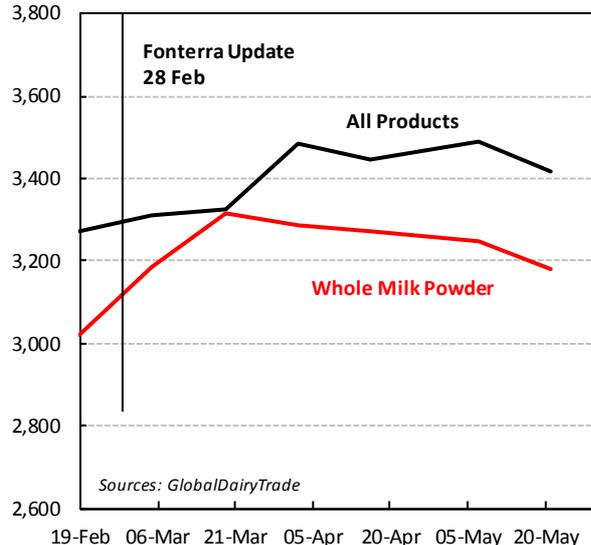
Using the forecast range midpoints, **Fonterra has effectively cut its 2018/19 milk price forecast range by 10 cents.** The new \$6.35/kg midpoint of the updated range (\$6.30/kg to \$6.40/kg) compares to the \$6.45/kg midpoint of the previous range (\$6.30/kg to \$6.60/kg).

**The downward revision came as a surprise as it contradicts the lift in dairy auction recorded over the past three months.**

Overall dairy auction prices, including whole milk powder prices, have lifted around 5% since Fonterra’s last update back in February, while the NZD/USD has fallen by a similar amount. Indeed, on that basis we had pencilled in a \$6.60/kg milk price forecast. However, Fonterra stated that prices had been “slightly weaker than expected”, implying that Fonterra’s previous forecast had factored in larger price increases than achieved. Note, given the late stage of the season and since Fonterra also has most of the necessary pricing information, we move to adopt Fonterra’s forecast.

Weighted Average US/MT  
3,800

### GLOBAL DAIRY TRADE AUCTION RESULTS SINCE FEBRUARY UPDATE



In addition, **Fonterra’s corporate performance over the year continues to disappoint.** Fonterra has revised down its 2018/19 forecast earnings per share by 7.5 cents to 10 to 15 cents per share (change based on range midpoints). Recall that Fonterra cut its earnings forecast by 10 cents back in February. Using Fonterra’s policy of paying 70% of earnings as dividends and the midpoint of the new range, the final dividend is likely to be around 9 cents per share.

While the result is disappointing, **Fonterra maintains that it is making progress on a new business strategy and its implementation.** Fonterra said that “good progress is being made on the strategy review and reiterated that the benefits from those changes will take time to flow through into the Co-op’s financial performance.” In this sense, the jury will remain out on these changes and Fonterra’s subsequent performance for a number of years.

### ...with the forecast changes lowering expected farm incomes

All up, **these forecast changes reduce forecast aggregate Fonterra farmer incomes for 2018/19 season by around \$225m.** Adding non-Fonterra farmers into the mix sees forecast nationwide farm incomes reduce by around to \$260m. For the average Fonterra farmer, forecast net milk price and dividend income reduces by around \$24,000 (or \$16,000 for non-Fonterra farmer; note these farmers are not impacted by the forecast dividend changes).

### Looking to 2019/20, the milk price is starting on the front foot

For 2019/20, Fonterra has set its opening season milk price forecast range at a relatively healthy \$6.25/kg to \$7.25/kg.

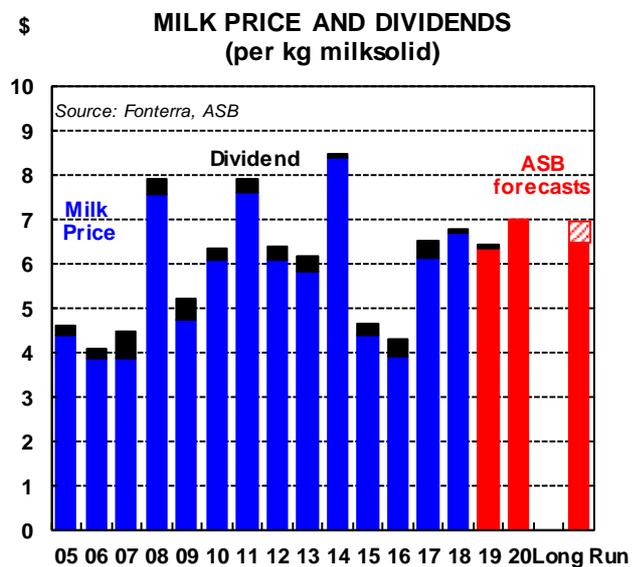
Again using the midpoints, this forecast, if realised, represents a 40 cent/kg gain on 2018/19.

Fonterra points to “strong [demand] across key trading partners” as supporting this healthy opening forecast.

Meanwhile, Fonterra expects very modest milk collections growth of 0.6%, which would also underpin the new season’s milk price forecast.

While we agree with the sentiment, **we are more bullish on the outlook for global dairy prices than Fonterra.** The current ‘spot milk price’ is a shade under \$8.00/kg. Global production growth is soft and unlikely to match growth in global demand over the remainder of 2019. Moreover this week, the NZD/USD has fallen below 0.65 i.e. to a very supportive level. On this basis, we have pencilled in a \$7.00/kg milk price forecast for 2019/20, and we see upside potential to that number. Indeed, if we were to use a similar \$1.00/kg forecast range, ours would be roughly \$6.70/kg to \$7.70/kg.

On a different note, **we applaud Fonterra for introducing a wider range to its milk price forecasts.** The new \$1.00/kg range reflects the wide range of outcomes that are possible at this stage of the season. This range is new information for farmers and markets and as such will require ongoing explanation. But, for now, and from us, well done Fonterra.



### ASB Commodity Price Index, Week ending 17 May

A weaker NZD led the ASB Commodity Price Index 0.8% higher in NZD terms during the week ending 17 May. That said, the Index was down a touch in USD terms over the week.

All components slipped in USD terms. Forestry and fruit led the price falls, both posting declines of 1% or more. Meanwhile, **dairy and sheep/beef prices were down a touch (0.1% and 0.3%, respectively) over the week.**

The NZD/USD fell 1.2% last week, as NZ interest rates fell and US-China trade tensions rose. The NZD/USD has since dropped further this week, **trading at around US\$0.6500 as at the time of writing.**

### ASB New Zealand Commodity Price Indices As at Friday 17<sup>th</sup> May 2019

	Index*	Week %	Year %**
Total NZD	109.6	0.8%	4.9%
Total SDR	102.1	0.2%	1.9%
Total USD	101.4	-0.4%	-1.8%
Dairy USD	105.7	-0.1%	3.1%
Sheep/beef USD	95.2	-0.3%	-6.9%
Forestry USD	98.4	-1.0%	-4.4%
Fruit USD	101.5	-1.2%	-1.3%
NZD/USD	0.6521	-1.2%	-6.4%

\* For all indices 2014 average = 100

\*\* Percentage change since same week last year

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