

Commodities Weekly

For the week ending Friday 22nd February



Fonterra's give and take

- Fonterra has lifted its 2018/19 milk price forecast range by 30 cents to \$6.30-\$6.60/kg.
- At the same time, Fonterra's business performance continues to disappoint, with a cut to its earnings forecast also announced.
- On a net basis, these changes add around \$225m to our forecast of Fonterra farmer incomes for the season.

Updated Farmgate Milk Price Forecasts

	2018/19		2019/20	Long Run
	Fonterra	ASB	ASB	ASB
Milk Price*	\$6.30-\$6.60	\$6.25	\$7.00	\$6.50-\$7.00

* per kg of milk solids (excluding dividend).

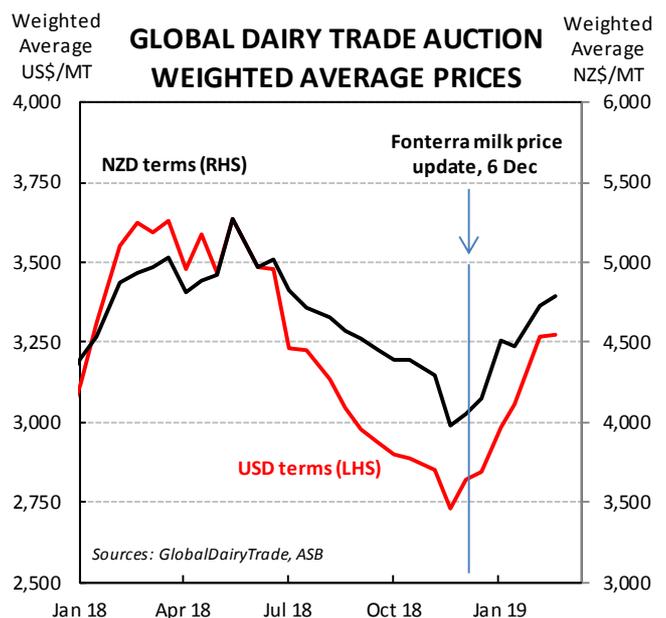
The give...

Fonterra has lifted its 2018/19 milk price forecast range by 30 cents to \$6.30-\$6.60/kg. The revision was at the top end of our expectations. For example, we had revised our own forecast up by a more modest 25 cents earlier this month.

The revision reflects the tightening in dairy markets over the past three months. Dairy auction prices have lifted 17.3% since Fonterra's last update back in early December.

Catalysts for the improvement include tighter global dairy supply and ongoing firmness in demand. **Supply growth is soft the EU and US, with supply outright falling Australia.** Meanwhile, it's likely that recent hot weather means that NZ supply growth is past its peak. Global dairy stocks are also much lower than in previous years. EU intervention stocks had been a buffer against any supply tightness; however, now these stocks have been sold down, making dairy supply vulnerable to shocks.

Indeed, **our view is that the conditions are in place for the start of a new dairy price cycle.** With that in mind along with Fonterra's announcement today, we place our 2018/19 milk price forecast of \$6.25/kg under review.



Importantly, the cycle is priming the 2019/20 season as evidenced by our initial 2019/20 milk price forecast of \$7.00/kg (set last week).

...and the take

Meanwhile, **Fonterra’s corporate performance continues to disappoint**. Fonterra has revised down its 2018/19 forecast earnings per share by 10 cents to 15-25 cents per share. Fonterra also announced that it will not pay an interim dividend this year. Using the midpoint of its forecast and Fonterra’s current 70% dividend policy implies a forecast dividend reduction of 7 cents per share for the year.

Fonterra highlighted several pressure points within its business, including “challenges in our Australian Ingredients and our Foodservice businesses in wider Asia. In addition, the increase in milk price... has put pressure on margins.”

The update also shines light on the ongoing concerns around the strength of its balance sheet. Fonterra has plans to reduce debt by \$800m this year and it seems it has had to, in part, sacrifice the interim dividend to do so.

Lastly, **Fonterra also revised down its forecast growth in milk collections**, citing hot and dry weather this year. Fonterra now expects 2% growth over the season, from 3% previously.

The forecast changes are net positive for farmer incomes

On a net basis, **Fonterra’s changes to its milk price, dividend and milk production forecasts add around \$225m to our forecast of Fonterra farmer incomes**. Adding non-Fonterra farmers into the mix sees our forecast nationwide farm incomes lift around \$345m. For the average Fonterra farmer, the net impact of the forecast changes lifts income by \$27,000 (or \$39,000 for the non-Fonterra farmer; note these farmers are not impacted by the forecast dividend changes).

Week ending 22 February

The ASB Commodity Price Index slid 0.3% in NZD terms to the week ending 22 February. NZD commodity prices were supported by a slight drop in the NZD/USD of 0.3% over the week.

The index was stable in USD terms. Falls in the USD price of sheep/beef (-1.3%), forestry (-0.3%) and fruit (-0.3%) were neutralised by a gain for Dairy (+0.5%). **Dairy prices remain robust as we continue to enter a new price cycle categorised by tighter global supply**.

The NZD/USD was broadly stable over the course of last week, with a slight shift downward. The NZD began the week strong against the USD, but the Greenback rose slightly following the release of the Federal Reserve meeting minutes on Thursday and the Kiwi dipped Friday afternoon on news proposed bank regulations could trigger a cut in interest rates **The NZD/USD continues to trade at US\$0.6845 as at the time of writing**.

ASB New Zealand Commodity Price Indices As at Friday 22nd February 2019

	Index*	Week %	Year %**
Total NZD	110.0	0.3%	1.2%
Total SDR	98.8	-0.4%	-1.8%
Total USD	90.4	0.0%	-6.2%
Dairy USD	85.6	0.5%	-6.3%
Sheep/beef USD	86.7	-1.3%	-9.2%
Forestry USD	104.5	-0.3%	-2.6%
Fruit USD	98.7	-0.3%	-12.4%
NZD/USD	0.6845	-0.3%	-7.4%

* For all indices 2014 average = 100

** Percentage change since same week last year

ASB Economics & Research

Chief Economist
Senior Rural Economist
Senior Economist
Senior Economist
Senior Economist, Wealth
Data & Publication Manager

Nick Tuffley
Nathan Penny
Jane Turner
Mark Smith
Chris Tennent-Brown
Judith Pinto

nick.tuffley@asb.co.nz
nathan.penny@asb.co.nz
jane.turner@asb.co.nz
mark.smith4@asb.co.nz
chris.tennent-brown@asb.co.nz
judith.pinto@asb.co.nz

Phone

(649) 301 5659
(649) 448 8778
(649) 301 5853
(649) 301 5657
(649) 301 5915
(649) 301 5660

www.asb.co.nz/economics

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