

Dairy's mojo returns

- Fonterra has set its opening 2017/18 milk price forecast at \$6.50/kg, close to our own \$6.75/kg.
- At this level, a clear majority of farmers are on track for a season in the black.
- Meanwhile, Fonterra's 2016/17 milk price forecast has also lifted 15 cents to \$6.15/kg.

Summary

Dairy has its mojo back. Fonterra's 2017/18 opening milk price of \$6.50/kg all but confirms that this is the case. Indeed at this level, a clear majority of farmers are setting up for a season in the black.

In the first instance, farmers will look to sure up their businesses.

Debt repayment will be high on priority lists, as well as farm maintenance and animal health.

However, **today's announcement is a shade more bullish than we had expected – and we anticipate this may accelerate other plans, including farm spending and investment.** In particular, farm confidence is likely to see a larger jump than would have otherwise been the case as we enter into the new season.

At the margin, this is likely to add to activity more generally in the sector. **The announcement also gives farmers a firm production signal for the season ahead.** And with that in mind, the recovery in production may be sooner and stronger (weather permitting) than we anticipated previously. In turn, stronger production may cap any upside to our own season-end milk price forecast of \$6.75/kg.

Comments & Implications

Fonterra's first cut at next season's milk price of \$6.50/kg milk solid was close to the informal market consensus of \$6.48/kg and not far off our season-end forecast of \$6.75/kg. **The \$6.50/kg forecast signals that Fonterra sees relatively bullish prospects for the season ahead.**

While the headline milk price forecast was on the bullish side, **Fonterra has balanced that by setting monthly advance payments at a more conservative level.** Specifically, the July through September advances have been set at \$3.70/kg (excluding capacity adjustments). This is 57% of the milk price forecast and compares to 59% at this stage last season.

Meanwhile, **the current season forecast has been lifted by 15 cents to \$6.15/kg, more or less in line with expectations.** At this late juncture, we adopt Fonterra's forecast as generally the milk price moves very little from this point forward to Fonterra's end-of-year results.

Notably, for farmers who took out the Fonterra Support Loan back in 2015, **this move would trigger repayments of the loan.** Around 75% of farmers took up these loans, so for these farmers, the 15-cent lift would effectively be returned straight back to Fonterra. In addition, Fonterra has retained its earnings guidance of 45-55 cents per share and its cash dividend target of 40 cents.

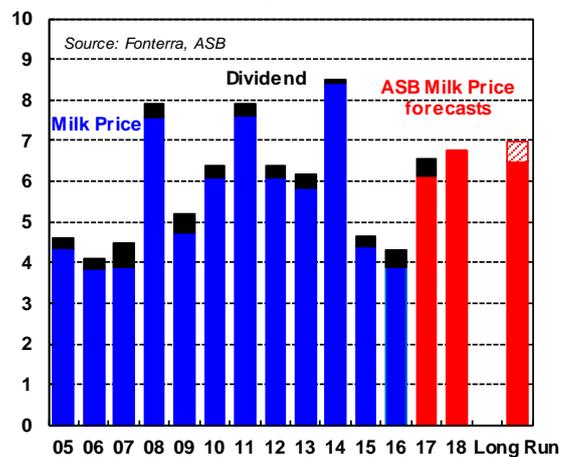
All up and at the margin, this announcement is more bullish than we expected. In particular, the opening season forecast is likely to lead to an increase in farmer confidence and bring forward some farm spending and investment. The strength of that opening forecast consequently reinforces to us that the RBNZ is likely to lift the OCR sooner than its late 2019 view. We continue to expect OCR increases will occur from late 2018.

Opening Price Forecasts, Including Market Sample

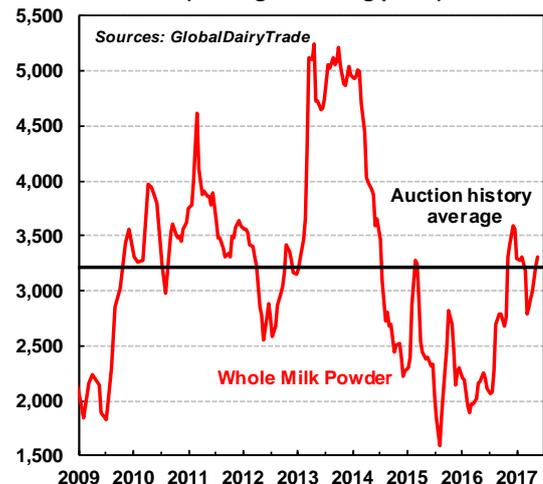
	Farmgate Milk Price*		
	Fonterra	ASB	Informal Market Median
2017/18	\$6.50	\$6.75	\$6.48
2016/17	\$6.15	\$6.15	\$6.14

* per kg of milk solids

MILK PRICE AND DIVIDENDS (per kg milksolid)



GLOBAL DAIRY TRADE AUCTION (average winning price)



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