

Pit stop

- Overall dairy prices dipped at the auction overnight.
- In particular, butter prices took a breather following their recent record-setting run.
- However, we anticipate that butter prices may surge again over coming months.

Summary

Butter prices have taken a breather. After setting a whopping seven auction record highs this year, butter prices dipped nearly 5% overnight.

In the context of this year's price surge, a modest retracement does not come as a surprise. After all, and despite last night's price fall, butter prices have still surged over 35% to date in 2017 and have doubled over the past year.

The question then becomes where to next for butter. Are prices going to consolidate around this new level or is there something left in butter's tank?

In our view, butter's fall overnight is akin to a motor racing pit stop. Pull over, refuel, change tyres and then go again. In other words, **we think that butter and milk fat prices can go higher yet.**

If we are right, **a further surge in butter prices is likely to lift all dairy prices more generally.** In turn, such a general price lift would also lift our milk price forecast above \$6.75/kg. Of course time will tell, but in our view butter's race higher is still worth watching.

Auction Results

Overall dairy auction prices dipped 1.6% overnight. Milk fat prices led the fall, with butter and AMF both falling 4.9%. SMP also fell 3%. All up, five out of the six main products we monitor posted declines.

Meanwhile, WMP prices (up 1.3%) rose against the grain; however this lift was less than expected. Futures prices prior to the auction had pointed to a lift in the 4% to 6% range.

Taking a step back, it's not altogether surprising that milk fat prices took a breather, given the price explosion over recent months. Butter prices, for example, have surged over 35% this year, while AMF prices have lifted a more modest, but still robust, 18%. Moreover, both butter and AMF have set multiple auction record highs over 2017.

However, we suspect that the slowdown in milk fat prices may be temporary. Demand continues to surge and inventories are now very tight. Indeed as supply struggles to keep up, we expect that any further lift in milk fat prices will lift dairy prices more generally. Accordingly, such a lift would break WMP prices out of their holding pattern of recent months (see chart).

Implications

This result is consistent with our 2017/18 milk price forecast of \$6.75/kg. However, with a strong price outlook, particularly for milk fats, we currently see upside risk to this forecast.

Season-end Forecasts

	2016/17	2017/18		Long Run
	Fonterra/ASB	Fonterra	ASB	ASB
Milk Price*	\$6.15	\$6.75	\$6.75	\$6.50-\$7.00

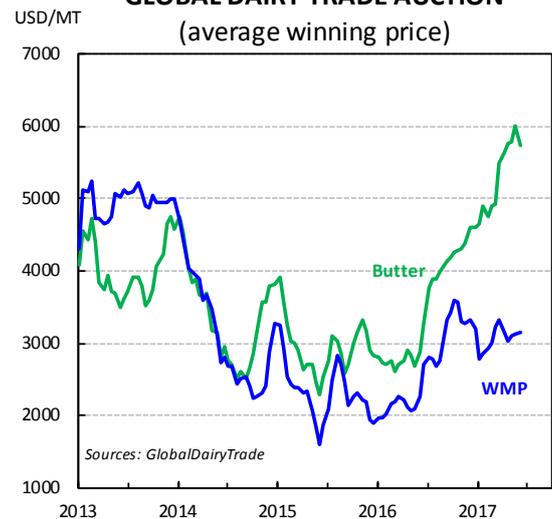
* per kg of milk solids (excluding dividend).

Key Auction Results

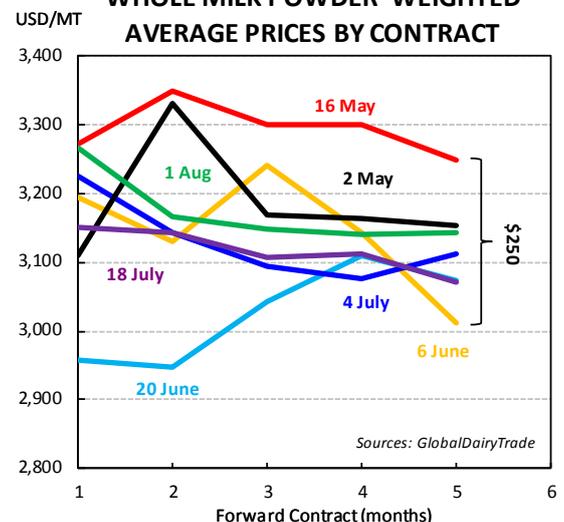
Product	% change in index since last auction	Annual % change in index	Weighted Average Price US\$/MT
Whole Milk Powder (WMP)	1.3%	40.4%	3,155
Skim Milk Powder (SMP)	-3.0%	2.0%	1,966
Anhydrous Milk Fat (AMF)	-4.9%	66.4%	6,289
Butter	-4.9%	101.8%	5,747
GDT Price Index	-1.6%	44.4%	n.a.

GLOBAL DAIRY TRADE AUCTION

(average winning price)



WHOLE MILK POWDER WEIGHTED AVERAGE PRICES BY CONTRACT



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