

# Rural Economic Note

Fonterra Milk Price Forecast Update

6 December 2018

## Top-heavy

- As expected, Fonterra has trimmed its 2018/19 milk price forecast range to \$6.00-6.30/kg from \$6.25-\$6.50/kg.
- Fonterra cited stronger-than-expected global production as the key reason for the forecast drop.
- We see Fonterra’s forecast as a tad optimistic - our own forecast sits at \$6.00/kg or the bottom of Fonterra’s range.

## Summary

As we expected, Fonterra has trimmed its 2018/19 milk price forecast range to \$6.00-6.30/kg range from \$6.25-\$6.50/kg.

The revision has come as no surprise as dairy prices have dipped since Fonterra’s last update back in October.

Moreover, the NZ dollar has strengthened as well, adding to the downward pressure on the milk price forecast.

However, in our view, Fonterra’s updated forecast remains a tad optimistic. We anticipate more (NZ) production strength than Fonterra appears to have factored into its forecast and as a result we don’t expect dairy prices to lift over coming months as Fonterra does.

With the above in mind, we note the risks to Fonterra’s forecast are clearly tilted to the downside as indicated by our forecast of \$6.00/kg. Indeed, if we were to use a similar 30-cent range, our forecast would be \$5.85-\$6.15/kg.

	2018/19		Long Run
	Fonterra	ASB	ASB
Milk Price*	\$6.00-\$6.30	\$6.00	\$6.50-\$7.00

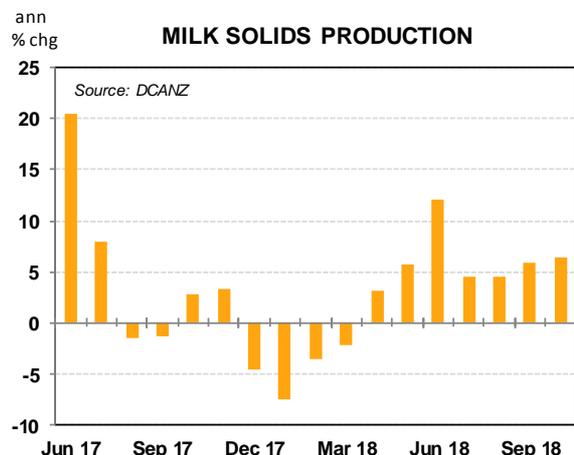
\* per kg of milk solids (excluding dividend).

## Despite the revision, we see the updated forecast as a tad optimistic

This morning’s milk price forecast revision comes as no surprise. Since the October update, USD dairy prices have fallen around 4%. Factoring in the movement in the NZD/USD and the impact on NZD prices has been doubled to or around 8%.

Using the midpoints of the Fonterra’s forecast range, the revision equates to a net income reduction for the industry of over \$400m. For an average farm, that equates to nearly \$34,000.

While we agree with the downward move, we still view Fonterra’s forecast as a tad optimistic. For example, we



suspect Fonterra’s 2018/19 milk collections growth forecast at 3% is too low. When we convert our own nationwide dairy production growth forecast of 5% to a Fonterra only forecast we get 4%.

And if anything, **we are leaning towards upping our production growth forecast.** Recent rain and favourable growing conditions suggest a very low chance of a drought this summer. And with October production setting a new record high, we anticipate that this production momentum can kick on into the new year. This contrasts to Fonterra’s view – from today’s update: “here in New Zealand, we are maintaining our forecast collections at 1,550 million kgMS. NIWA is saying its likely we will see an abnormal El Nino weather pattern over summer and this could impact our farmers’ milk production.”

Moreover, **we anticipate that dairy prices will remain soft over the next 2-3 months.** Again this contrasts with Fonterra’s view: “today’s forecast range assumes dairy prices will firm across the balance of the season.”

## Implications

With the above in mind, we note that the risks to Fonterra’s forecast are clearly tilted to the downside as indicated by our forecast of \$6.00/kg. Indeed, if we were to use a similar 30-cent range, **our forecast would be \$5.85-\$6.15/kg.**

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