



Rural Economic Note

Fonterra Milk Price Revision

10 October 2018

Fonterra reduces 2018/19 milk price forecast

- Fonterra shifts its 2018/19 milk price forecast to a \$6.25-6.50/kg range from \$6.75/kg.
- Strong global (and NZ) production cited as a reason for the forecast drop.
- Our 2018/19 milk price forecast of \$6.50/kg continues to carry some downside risk.

Summary

Fonterra Co-operative Group has bitten the bullet and revised down its 2018/19 milk price forecast to a \$6.25-6.50/kg range from \$6.75/kg. Fonterra's previous forecasts for this season had looked on the high side, and a downward revision was anticipated. The forecast range is now set at a more realistic level. Furthermore, the shift to using a range rather than a point estimate is an acknowledgement of the uncertainties to the outlook. Higher global milk production was the key reason for the forecast cut.

For the time being we will stick to our \$6.50/kg forecast, but note it continues to carry risk of being trimmed. Production is flush, although NZD/USD weakness is welcome in providing some buffer to the drift down in USD prices in the recent run of GlobalDairyTrade auctions.

Ample supply, demand lagging for now

The price forecast revision was triggered by higher production, rather than softer demand. Fonterra cited strong production coming from Europe, the US and Argentina as catalysts for the downward forecast. Global demand had not kept pace.

Local production has also been stronger than Fonterra previously expected. Fonterra has revised its forecast milk collections for the year up 1.3% to 1,550 million kgMS – from 1,525 million kgMS.

Our back-of-the-envelope estimates suggest that a downward revision of the milk price from \$6.75 per kgMS to \$6.25-\$6.50 per kgMS would lower farm incomes by \$380m-\$760m in the 2018/19 season. **But factoring in Fonterra's higher volume forecast, the net hit to farm incomes will be in a \$220m to \$620m range, according to our estimates.**

Fonterra cautions that it is early in the season, and there is the potential for considerably volatility ahead. As such some caution is required when setting farm budgets.

Despite today's announcement, the medium-term outlook for the sector remains favourable, with strong demand from Chinese and South East Asian consumers.

In the short-term, we expect more downward pressure on dairy prices. NZ is at its seasonal peak in production in October and in line with this peak auction volumes are also at their highest level for the year.

Implications

For now we continue with our 2018/19 milk price forecast of \$6.50/kg, but with clear downside risks given our expectations that dairy auction prices will come under further pressure over the peak of the production season. Fonterra’s second revision to its forecast does, however, put its signal to farmers in a more realistic space.

Farmgate Milk Price Forecasts

	2018/19		Long Run
	Fonterra	ASB	ASB
Milk Price*	\$6.25-50	\$6.50	\$6.50-\$7.00

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