

Rural Economic Note

Fonterra 2018/19 Opening Season Farmgate Milk Price Forecast

23 May 2018

Fonterra opens with bullish salvo

- Fonterra has set its opening 2018/19 milk price forecast at a bullish \$7.00/kg.
- This is higher than our forecast of \$6.50/kg and an informal market expectation of \$6.60/kg.
- Meanwhile, Fonterra's 2017/18 milk price forecast has lifted 20 cents to \$6.75/kg, but the dividend range has been cut 10 cents to 15-20 cents per share.

Key Announcements

Farmgate Milk Price*			
	Fonterra	ASB	Informal Market Median
2018/19	\$7.00	\$6.50	\$6.58
2017/18	\$6.75	\$6.75	\$6.60

* per kg of milk solids

Implications

This announcement is more bullish than we expected. For now though, this bullishness is being tempered by mycoplasma bovis concerns. As a result, farmers are unlikely to act on the strong milk price outlook and their spending and investment plans are likely to subdued until mycoplasma bovis concerns recede.

Details

Fonterra's first cut at next season's milk price of \$7.00/kg milk solids was higher than both the informal market consensus of \$6.60/kg and our forecast of \$6.50/kg. The \$7.00/kg forecast signals that Fonterra sees bullish prospects for the season ahead, particularly given that traditionally Fonterra has set opening forecasts at a somewhat conservative level.

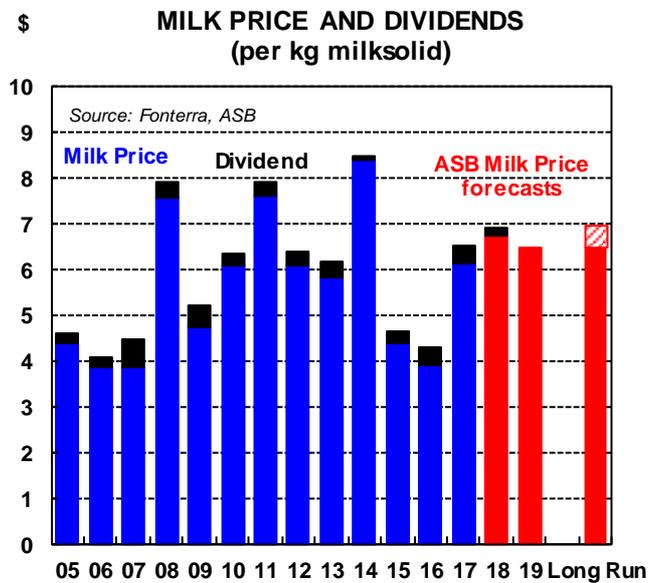
In the short term (over the next three months), we share Fonterra's bullishness. On the dairy price side of the equation, weak NZ production and the acute global butter shortage are supporting NZ dairy commodity prices. In addition, the recent weakening in the NZ dollar is giving the milk price forecast a boost.

However, we are more circumspect over the remainder of the new season. Indeed, we anticipate a rebound in NZ production over the 2018/19 season after three consecutive season falls. In particular, a return to more normal weather alone (after poor weather the last two seasons) should boost production and thus put downward pressure on dairy prices from the NZ spring. In addition, we anticipate some NZ dollar strength to return over the remainder of 2018.

Moreover, it remains early days in the season.

Historically, the average movement from opening forecast to final milk price is plus or minus \$1.50/kg. Nonetheless, we acknowledge the upside risks to our 2018/19 milk price forecast of \$6.50/kg. As a result, we continue to keep this forecast “under review”.

Meanwhile, Fonterra has lifted the 2017/18 season milk price forecast by 20 cents to \$6.75/kg, also by more than expected. We had anticipated an increase of up to 10 cents. However, a 10-cent decrease in dividend forecast range has tempered the milk price forecast increase. Thus, the net increase of 10 cents per kg was effectively in line with our expectations. Also, at this late stage of the season we adopt Fonterra’s milk price forecast of \$6.75/kg.



Lastly, Fonterra also revised higher its milk collections forecast. Fonterra now expects 2017/18 season collections to fall 1.7% from 2016/17 collection level. Previously, it had expected a 3% fall. This adjustment brings Fonterra more into line with our production view.

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