

#SixDollarsOnTrack

- Dairy auction prices jumped overnight by more than expected.
- With wet weather slamming the brakes on NZ dairy production.
- This result reconfirms our \$6.00/kg milk price forecast, and also adds some upside risk.

Summary

Dairy markets didn't take that much convincing after all. We had thought that dairy buyers would take their time in bidding prices higher following the very wet North Island weather. Dry weather hurting milk supply was one thing, but wet? That, we thought, may take some convincing.

For our part, we were already convinced. And the lift in prices on the basis of rapidly falling NZ production was just a matter of time.

Indeed, the 'big wet' is a game-changer for this season's production. For example, on the back of the wet weather, Fonterra lowered its milk collections forecast to 7% below last season (from a 3% fall previously). This is in line with our forecast drop of 5% across all suppliers (note Fonterra has been losing market share).

The 'big wet' has also sped up the dairy price correction, **meaning we are ahead of where we thought prices would be at this stage of the season.** In fact, prices have both lifted earlier and higher than we anticipated. As a result, if NZ production is indeed as weak as we anticipate, then prices are likely to stabilise at current levels, if not lift further. **In this respect, we see an increasing probability that this season's milk price lifts above our current \$6.00/kg forecast.**

Auction comments

Dairy prices jumped overnight. Key WMP prices surged 19.8% (the sixth largest rise in auction history). Other price rises were more modest, with SMP and butter, for example, lifting 6.5% and 4.0%, respectively.

The price surge follows a rapid decline in NZ production on the back of very wet weather. Fonterra has reported that late October milk volumes in the key Waikato region have been down around 14% vs. the same time last season. Fonterra also followed that announcement by lowering its milk collections forecast to 7% below last season (from a 3% fall previously). This is in line with our forecast drop of 5% nationwide across all suppliers (note Fonterra continues to lose milk supply share).

At this juncture, we point out that prices have lifted earlier and higher than we anticipated. As a result, **if NZ production is indeed as weak as we now anticipate, then prices are likely to stabilise at current levels, if not lift further.** In this respect, we see an increasing probability that this season's milk price lifts above our current \$6.00/kg forecast.

Implications

This result reinforces our 2016/17 milk price forecast of \$6.00/kg. At the same time, we note the growing risk that the milk price surpasses our already bullish forecast this season.

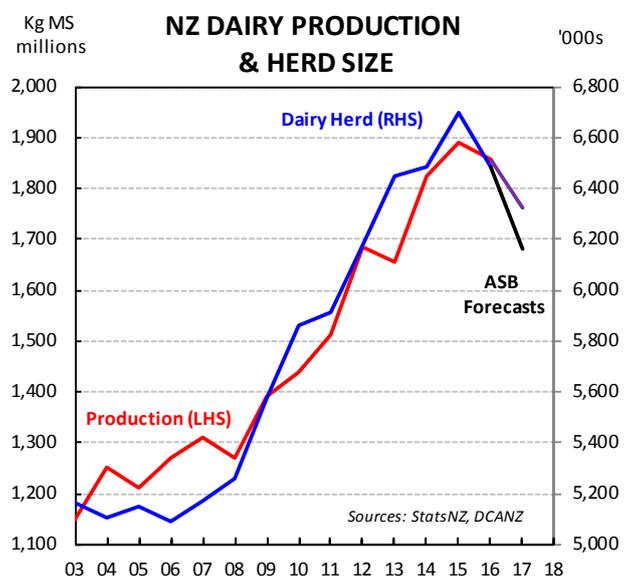
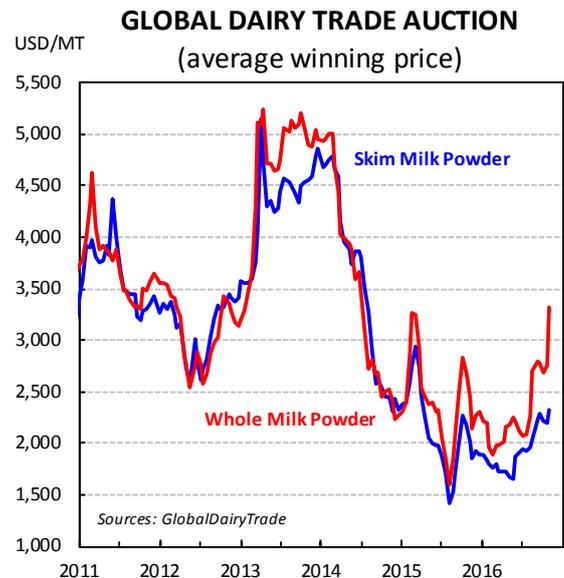
Season-end Forecasts

	2016/17		2017/18	Long Run
	Fonterra	ASB	ASB	ASB
Farmgate Milk Price*	\$5.25	\$6.00	\$6.50	\$6.50-\$7.00

* per kg of milk solids (excluding dividend).

Auction Results

Product	% change in index since last auction	Annual % change in index	Weighted Average Price US\$/MT
Whole Milk Powder (WMP)	19.8%	40.0%	3,317
Skim Milk Powder (SMP)	6.5%	17.0%	2,329
Anhydrous Milk Fat (AMF)	2.6%	41.7%	5,146
Butter	4.0%	59.7%	4,146
GDT Price Index	11.4%	33.2%	n.a.



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