

Rural Economic Note

Global Dairy Trade Auction

04 July 2018

Trade nerves

- Dairy auction prices dipped to a six-month low overnight.
- The fall likely reflects nervousness around the potential for dairy market fallout from the US-China trade tensions.
- We stick to our positive dairy market view, but note the increasing potential for further dairy market fallout.

Summary

Dairy markets are nervous. And last night's fall in dairy auction prices reflected this nervousness.

The nervousness stems from the increase in trade tensions between the US and China. Indeed, the tensions are now spilling over to actual tariff increases. For example, Chinese tariff increases on US exports, scheduled for 7 July, include dairy and other agricultural products.

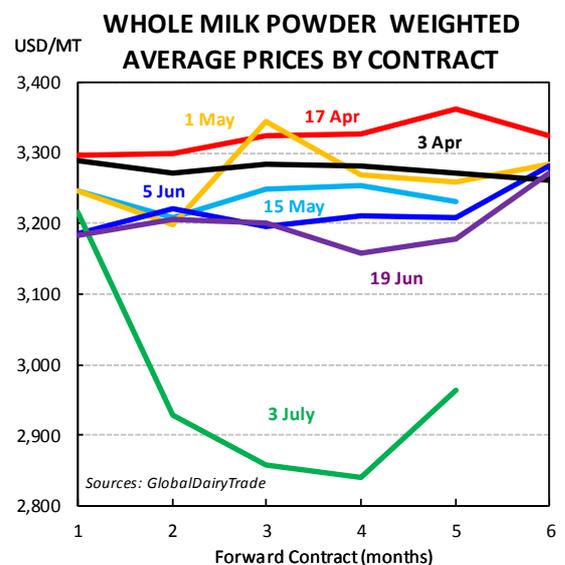
Ironically, **NZ stands to benefit from increased Chinese tariffs on US dairy products.** These tariffs will make NZ dairy products cheap relative to US equivalents. In turn, Chinese are likely to increase their demand for NZ dairy products, boosting NZ dairy prices.

For now though, **dairy buyers are more nervous about the fallout**

from the increasing trade tensions and the potential impact this could have on dairy demand. Already, currencies for key dairy buyers have fallen, with the Chinese yuan down around 3% since the last auction. Meanwhile, Chinese stockmarkets have also taken a hit with the Shanghai Composite Index down nearly 10% over the same period.

It's not all one-way traffic though. The NZD/USD has also fallen around 3% over the past fortnight. Moreover, the 'spot milk price' (using last night's result and the spot NZD/USD) is still sitting at a healthy \$7.00/kg.

Nonetheless, **the risk is that trade tensions increasingly weigh on global growth and significantly dampen global demand for dairy products.** In this scenario, the milk price outlook will change. For now, though, watch this space!



Auction Results, 3 July

Dairy auction prices dipped overnight to a six-month low. Overall prices fell 5.0% to US\$3,232/MT. Whole milk powder (WMP) prices fell 7.3% (to US\$2,905/MT), while skim milk powder prices fell 4.6%. Five out of seven of the

main products we monitor posted falls.

The price fall was also more than we and the market anticipated. We had pencilled in a 1% to 3% fall in WMP prices, while the futures market had priced in a 0.5% fall.

With dairy fundamentals showing little change, we suspect the fall reflects nervousness around the

potential impact of US-China trade tensions. Already, currencies for key dairy buyers have fallen against the USD (recall that dairy auction prices are denominated in USD), with the Chinese yuan down around 3% since the last auction, for example. Meanwhile, Chinese stockmarkets have also taken a hit with the Shanghai Composite Index down nearly 10% over the same period.

Interestingly at this stage, **prices by contract are consistent with temporary uncertainty rather than a fundamental change in demand.** For example, contract 1 prices were at a similar level to previous auctions, whereas the price weakness came in the later-dated contracts. This indicates that buyers have orders to fill in the short-term, but given the market sentiment they are happy to wait and see before committing to further purchases.

Implications

We stick with our 2018/19 milk price forecast of \$6.50/kg. Indeed, despite the auction price fall overnight, the 'spot milk price' remains around \$7.00/kg. However, we maintain a close watching brief on US-China trade developments and the potential for fallout in dairy markets.

Farmgate Milk Price Forecasts

	2017/18	2018/19		Long Run
	Fonterra/ASB	Fonterra	ASB	ASB
Milk Price*	\$6.75	\$7.00	\$6.50	\$6.50-\$7.00

* per kg of milk solids (excluding dividend).

Product	% change in index since last auction	Annual % change in index	Weighted Average Price US\$/MT
Whole Milk Powder	-7.3%	-4.8%	2,905
Skim Milk Powder	-4.6%	-10.1%	1,913
Anhydrous Milk Fat	-1.7%	-9.8%	5,937
Butter	-4.0%	-8.8%	5,390
GDT Price Index	-5.0%	-8.9%	n.a.

ASB Economics & Research

Chief Economist
Senior Rural Economist
Senior Economist
Senior Economist
Senior Economist, Wealth
Economist
Data & Publication Manager

Nick Tuffley nick.tuffley@asb.co.nz
Nathan Penny nathan.penny@asb.co.nz
Jane Turner jane.turner@asb.co.nz
Mark Smith mark.smith4@asb.co.nz
Chris Tennent-Brown chris.tennent-brown@asb.co.nz
Kim Mundy kim.mundy@asb.co.nz
Judith Pinto judith.pinto@asb.co.nz

Phone

(649) 301 5659
(649) 448 8778
(649) 301 5853
(649) 301 5657
(649) 301 5915
(649) 301 5661
(649) 301 5660

www.asb.co.nz/economics

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