

Time to reflect

- Dairy auction prices fell overnight largely in line with expectations.
- As dairy markets take a breather and reflect on August and September's price surge.
- From here, we expect prices to track sideways, before lifting again later in the season.

Summary

Dairy markets have gotten a little ahead of themselves. The auction price correction over August and September was rapid and large. And now, it also seems a touch overdone.

However, for the main part **we expect this price correction will be sustained.** In particular, a change in dairy fundamentals supports the correction – global dairy production has shifted lower, and prices needed to correct higher as a result.

On the production shift, we expect there is more to come (or less as this case may be). That said, it is still relatively early in the NZ season. Thus, dairy markets will want to see further evidence of continued production weakness before pushing prices higher. On that basis, **we look to NZ spring data that supports or challenges our view that global production will weaken further over 2016.**

With that in mind, we expect prices to largely track sideways from current levels, before lifting again later in the season. As a result, **we continue to expect a finalised milk price of \$6.00/kg for 2016/17.**

Auction comments

Dairy prices gave back some of their recent gains overnight. Overall prices fell 3.0%, while WMP and SMP prices dipped 3.8% and 3.9%, respectively.

In view of the recent price surge, it is not surprising dairy markets wanted to catch their breath. WMP prices, for example, had spiked 35% over August and September.

The result was a touch weaker than expectations heading in. Futures market pricing hinted at a WMP fall in the 0% to 2% range prior to the auction.

The price dip was broad-based, with seven out of eight products on offer recording price falls. Only butter milk powder recorded a rise (up 9.3%).

From here, we expect prices to track largely sideways over coming auctions as markets wait for further confirmation of weakening NZ production. In our view, **we expect production to continue to weaken and thus for prices to lift again later in the season.**

On that basis, **we look to NZ spring data that supports or challenges our view that global production will weaken further over 2016.** Data so far are consistent with our view. NZ production for August was 3% lower than August 2015; with production for the season to date 2.4% lower than over the same period last season. Meanwhile, July EU production fell 1.3% compared to July 2015.

Implications

We stick with our 2016/17 milk price forecast of \$6.00/kg.

Season-end Forecasts

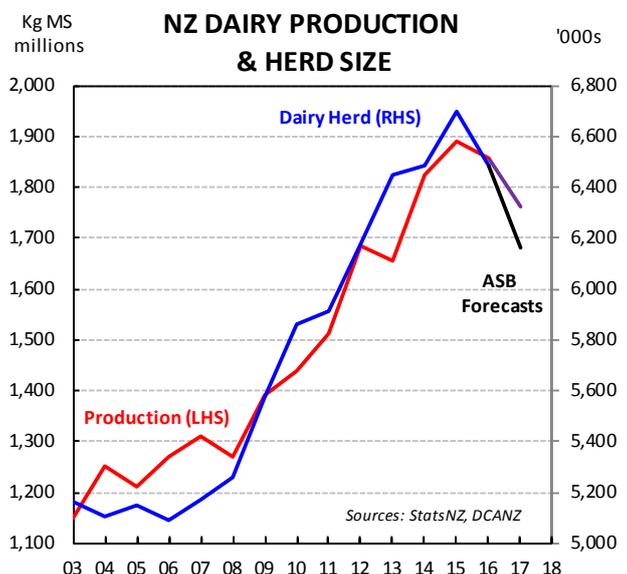
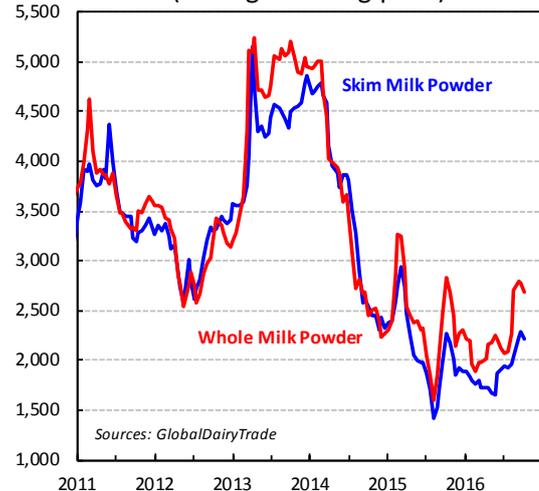
	2016/17		Long Run
	Fonterra	ASB	ASB
Farmgate Milk Price*	\$5.25	\$6.00	\$6.50-\$7.00

* 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)	-3.8%	-0.4%	2,681
Skim Milk Powder (SMP)	-3.9%	-3.2%	2,209
Anhydrous Milk Fat (AMF)	-1.0%	31.9%	4,954
Butter	-0.3%	25.7%	3,891
GDT Price Index	-3.0%	5.8%	n.a.

GLOBAL DAIRY TRADE AUCTION
(average winning price)



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