

Rural Economic Note

Global Dairy Trade Auction

05 December 2018

Looking a gift horse in the mouth

- Dairy prices snap the run of seven consecutive falls overnight.
- However, we suspect that currency movements explain most of the price gain.
- With that in mind and signs of further NZ production strength, we anticipate that dairy auction prices are more likely to stay soft than rise over the next few months.

Summary

Never look a gift horse in the mouth or so the saying goes.

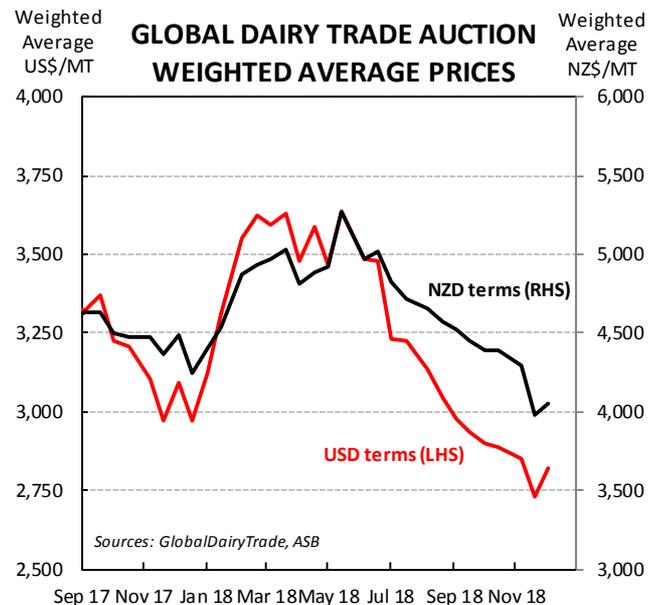
On this basis, we should take the positive dairy auction result and be happy. After all, prices rose across the board and the rise snapped a run of seven consecutive falls.

Nonetheless, we are suspicious. First, the rise is similar to falls in the US currency over the past fortnight. In particular, the Chinese yuan has lifted making the USD-priced products cheaper for Chinese buyers.

Secondly, **we suspect already-strong NZ dairy production may, in fact, strengthen further.** Recent favourable weather and growing conditions are likely to translate strong or even stronger production numbers over summer. And remember that October production was already an all-time high.

On this basis, **we look through the result overnight and expect that dairy prices are on the whole likely to remain soft over the next few months.**

Moreover, we re-confirm our recently lowered 2018/19 milk price forecast of \$6.00/kg. Also, we expect that Fonterra will shortly trim its forecast to be more in line with our own.



Auction Results, 4 December

Dairy auction prices lifted 2.2% overall overnight. The price lift comes on the back of seven consecutive price falls. So despite the rise, overall prices remain 18.8% lower than as at the start of the 2018/19 season.

The price lift was also broad-based. Six out of the seven products we monitor posted gains. Butter milk powder

Product	% change in index since last auction	Annual % change in index	Weighted Average Price US\$/MT
Whole Milk Powder	2.5%	-4.1%	2,667
Skim Milk Powder	0.3%	6.0%	1,970
Anhydrous Milk Fat	3.9%	-30.6%	4,755
Butter	2.7%	-17.9%	3,745
GDT Price Index	2.2%	-11.1%	n.a.

posted the largest gain of 16.9%, while anhydrous milk fat and butter posted solid rises of 3.9% and 2.7%, respectively. Whole milk powder was up 2.5%, with skim milk powder posting a 0.3% rise. Only cheddar prices fell (down 2.2%).

For a change, the auction result was in line with futures pricing ahead of the auction. Futures had indicated a whole milk powder lift of circa 2%, breaking a run of auctions where futures had overstated whole milk powder auction movements.

On close examination however, the price lifts may have more to do with currency movements than changes in dairy market fundamentals. For example, since the last auction the Chinese yuan has lifted around 1.7% against the USD, making products cheaper for Chinese buyers. Recall that China is the largest buyer at the dairy auctions and that auction products are priced in USD.

With this in mind, we expect that the strength of NZ production will continue to keep downward pressure on dairy prices over next few months. Indeed, we suspect that recent favourable weather and growing conditions mean that the risk is that production growth strengthens further from its already-strong position. Recall that October production was at an all-time high.

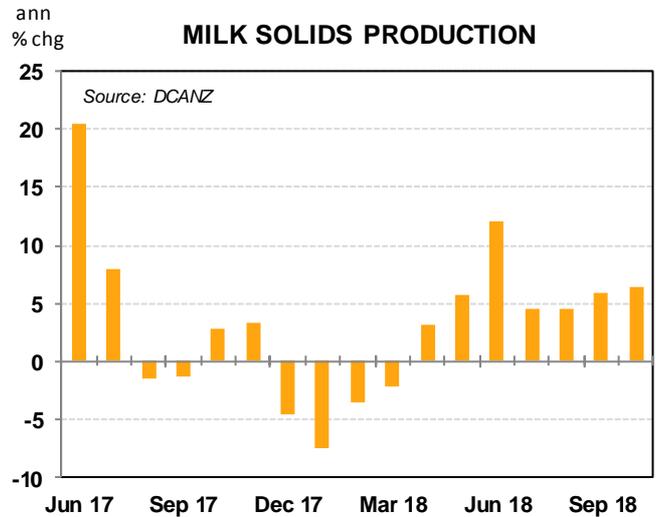
Implications

We reconfirm our 2018/19 milk price forecast at \$6.00/kg. Also, we expect that Fonterra will shortly trim its forecast to be more in line with our own.

Farmgate Milk Price Forecasts

	2018/19		Long Run
	Fonterra	ASB	ASB
Milk Price*	\$6.25-50	\$6.00	\$6.50-\$7.00

* per kg of milk solids (excluding dividend).



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