

Rural Economic Note

Global Dairy Trade Auction

07 February 2018

Weather's wild ride

- Dairy prices lifted overnight, supported by the recent stall in NZ dairy production.
- The price strength reaffirms our 2017/18 milk price forecast of \$6.50/kg.
- However, on the back of recent rain we expect that some of the auction price strength will prove temporary.

Summary

NZ weather this dairy season has been all over the place.

Three weeks ago, we reported that dry weather had led to a stall in dairy production. Whereas earlier in the season, wet weather had similarly hampered production.

Now in January and February, **the wild ride has continued with storms and flooding in some parts.** Also rain has been widespread, helping improve growing conditions for most of the country.

As we mentioned in our last report **this season's weather has been a mixed blessing.** While production has weakened, dairy auction prices have firmed so far over 2018.

All up, **this strength reinforces our more optimistic 2017/18 milk price forecast of \$6.50/kg.** On the production side, we expect the improved weather will lead to production growth of 1% compared to last season. That said, there will be wide variations across the country given the varying extent of storms, drought and rainfall.

Auction Results, 6 February

Dairy prices rose across the board overnight. Overall prices lifted 5.9%, with WMP and SMP jumping 7.6% and 7.2%, respectively. Butter prices also bounced for the second-successive auction, surging 7.9%.

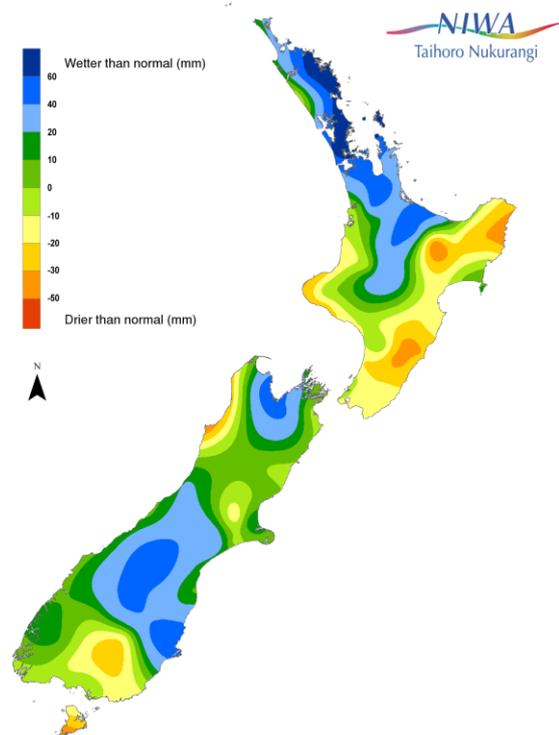
The price strength largely matched futures pricing (from Monday; Tuesday was a public holiday in NZ) **ahead of the auction.** It appears that futures prices are a better indicator for auction results when price moves are decisive i.e. plus

Farmgate Milk Price Forecasts

	2017/18		2018/19	Long Run
	Fonterra	ASB	ASB	ASB
Milk Price*	\$6.40	\$6.50	\$6.50	\$6.50-\$7.00

* per kg of milk solids (excluding dividend).

Soil moisture anomaly (mm) at 9am on 06/02/2018



or minus 5% or more; whereas it is a poor predictor for smaller movements.

The result follows a recent stalling in NZ dairy production. December production, for example, was 4.6% behind December 2016.

However, **we expect that some of this price strength will be temporary.** In particular, weather to date in 2018 has improved, with most regions receiving substantial rain. As such, production is likely to improve later in the season. Also, in our view Fonterra's -3% production growth forecast is overly pessimistic.

All up, the total effect on this season's milk price is still higher than anticipated earlier. **As a result, we are now more confident in our 2017/18 milk price forecast of \$6.50/kg than we were as at the end of 2017.**

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