

# Rural Economic Note

Global Dairy Trade Auction

07 February 2019

## Don't look a gift horse in the mouth

- Dairy prices surprised by surging overnight.
- It appears dairy markets are factoring in the risk of drought disrupting NZ production.
- On the back of this result and earlier gains, we lift our 2018/19 milk price forecast by 25 cents to \$6.25/kg.

### Summary

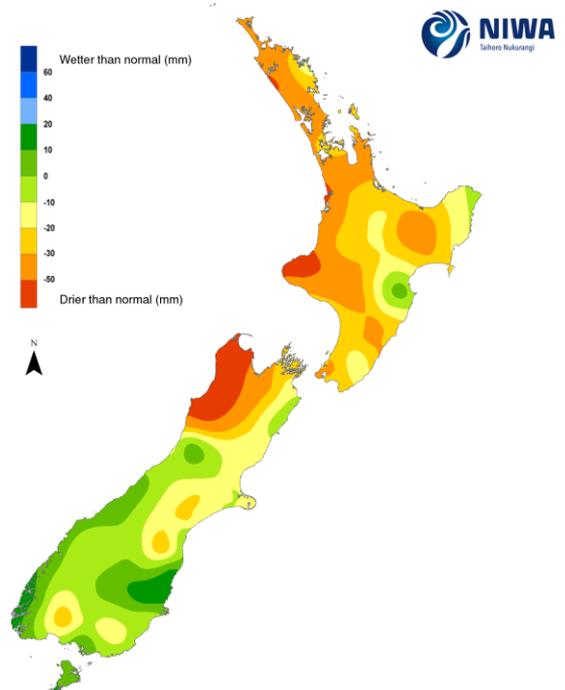
**This morning's auction was one of those cases where we were happy to be wrong.** Indeed, in contrast to our expectations for a small fall, dairy prices spiked higher, with whole milk powder (WMP) prices posting their largest price lift in over two years.

**On the surface, it appears that dairy markets are pricing in the risk of drought disrupting NZ production.** In particular, the move higher in WMP prices – NZ is the dominant WMP exporter – indicates that markets are factoring in an NZ-specific risk.

However, **there is some chance that these price gains prove temporary.** NZ production is on a strong footing, running at more than 5% ahead of last season on a season to December basis. Also, it's still relatively early days in this dry spell, with a drought declaration some time away.

Nonetheless, the price gains overnight are significant and come on top of the solid gains over December and January. And with the season now well-advanced, we are disinclined to look this gift horse in the mouth. As a result, **we lift our 2018/19 Fonterra milk price forecast by 25 cents to \$6.25/kg.**

Soil moisture anomaly (mm) at 9am on 06/02/2019



### Auction Results, 6 February

**Dairy auction prices surged overnight**, posting the fifth successive price gain. Key WMP prices jumped 8.4%, while overall prices lifted 6.7%. Overall prices have lifted 18.7% since this season's low back in November.

**The price lift was broad-based.** Six out of the seven products we monitor posted gains. Casein and WMP prices

Product	% change in index since last auction	Annual % change in index	Weighted Average Price US\$/MT
Whole Milk Powder	8.4%	-5.4%	3,027
Skim Milk Powder	3.9%	22.8%	2,534
Anhydrous Milk Fat	5.8%	-14.4%	5,579
Butter	4.2%	-15.4%	4,445
GDT Price Index	6.7%	-5.3%	n.a.

led the gains, surging 10.9% and 8.4%, respectively. Anhydrous milk fat (up 5.8%) and butter prices (up 4.2%) were also firm, while skim milk powder prices (up 3.9%) also built on recent gains.

**Moreover, the auction result was a welcome surprise.** Futures pricing leading up till the auction had indicated a WMP lift of up to 2%, whereas we had expected a 1% price fall.

**As discussed above, the lift appears to be due to dairy markets pricing in the risk of drought disrupting NZ production.** NZ has been in the midst of a “heat wave” over many parts of the country, including dairying regions over recent weeks. Indeed, there is a material risk that this escalates into a drought and stymies production over the remainder of summer and into the autumn. Most farmers are still well-placed with ample feed on hand from earlier in the season. However, when cows suffer from heat stress their appetites fall and there is little farmers can do. With that in mind, we keep one eye on the weather and the other on milk production over coming weeks.

Interestingly, **the number of auction buyers was very low at this auction.** Given the sizeable auction price gain, this low buyer participation indicates that some buyers are prepared to wait and see whether the dry weather does have a lasting impact on prices. Indeed, it appears that some buyers anticipate (or hope) that the price spike is short-lived.

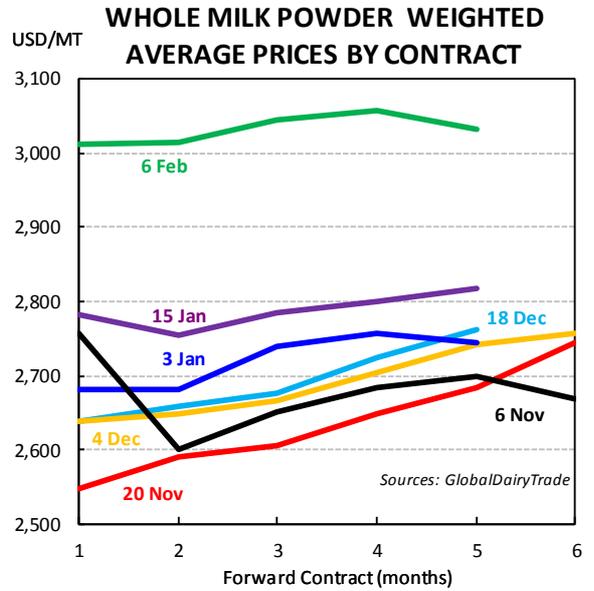
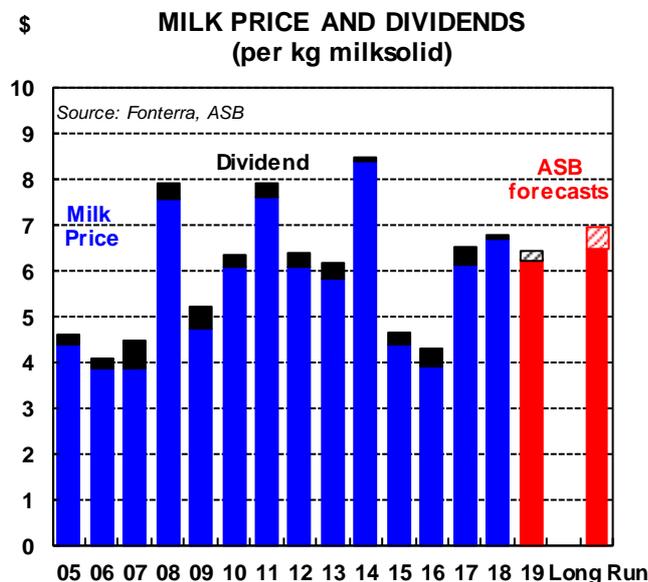
### Implications

With the above in mind, **we lift our 2018/19 Fonterra milk price forecast by 25 cents to \$6.25/kg.** This forecast is towards the top of Fonterra’s \$6.00 to \$6.30/kg forecast range. If we were to use a similar 30-cent range, our forecast would be \$6.10-\$6.40/kg.

### Farmgate Milk Price Forecasts

	2018/19		Long Run
	Fonterra	ASB	ASB
Milk Price*	\$6.00-\$6.30	\$6.25	\$6.50-\$7.00

\* per kg of milk solids (excluding dividend).



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