

### Catching breath

- The first step in dairy's price correction is complete.
- As prices have now corrected higher on the back of a pullback in global supply.
- From here we expect prices to consolidate, before prices lift again later in the season.

#### Summary

It's time to take a breath. The dairy price correction over August and now September has been both swift and large.

In the last auction [report](#), we discussed why we expect this price correction to stick – in this report, we discuss how we anticipate the rest of the season to play out.

First up, we expect prices to consolidate over coming auctions. As mentioned, dairy markets will need time to digest the rapid price turnaround and assess where to next.

From there, we expect prices to lift again later in the season. Indeed, while the market now anticipates weak global production, we see scope that the weakening in supply accelerates faster than most analysts expect. With that in mind, we look to NZ spring production data for a key test of our view.

#### Auction comments

Overall dairy prices were strong overnight for the third successive auction. Since July, overall prices have lifted just shy of 30%.

The bounce was broad-based, with all product prices rising. However, WMP (up 3.7%) took a back seat to other products and, in particular, milk fats. Indeed, both AMF and butter surged by around the 15% mark. Meanwhile, laggard SMP made up some lost ground (at least to WMP), lifting 10%.

At this juncture, the initial dairy price correction is largely complete. Indeed, dairy markets now share our view that the outlook for global production is weakening rapidly. From here, it becomes a question of how weak.

For now, we expect prices to consolidate over coming auctions as markets will need to take a breath. For example, the relatively flat prices across the different WMP contracts hints that that may now be the case.

However, we expect continued production weakness to lift prices again later in the season. On that basis, we look to NZ spring data that support or challenge our view that global production will weaken further.

Also, with the EU's production now also clearly on the wane, we expect the wedge between NZ-dominated products (WMP) and EU-dominated ones (SMP) to narrow. For example, June EU production data showed a 1.6% fall compared to June 2015.

#### Implications

Last night's auction result reaffirms our 2016/17 milk price forecast of \$6.00/kg. Moreover, we see the risks around our forecast starting to balance. For example, the high NZD is slowing dairy price gains in NZD terms. On the flipside, auction prices are above where we expected them to be at this stage.

#### Season-end Forecasts

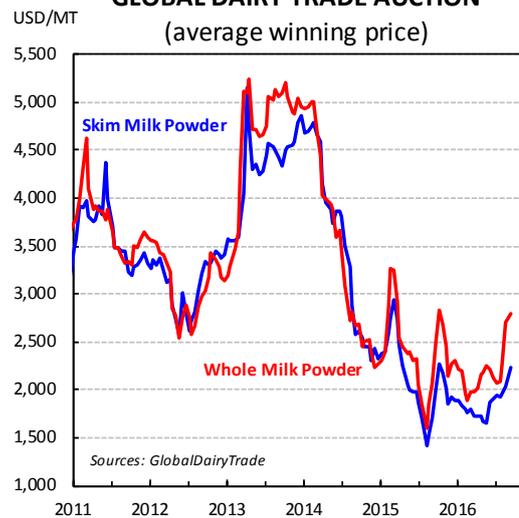
	2015/16	2016/17		Long Run
	Fonterra/ASB	Fonterra	ASB	ASB
Milk Price*	\$3.90	\$4.75	\$6.00	\$6.50-\$7.00

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

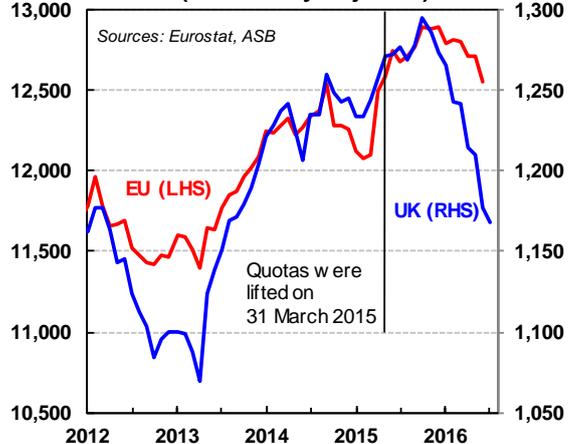
#### Auction Results

Product	% change in index since last auction	Annual % change in index	Weighted Average Price US\$/MT
Whole Milk Powder (WMP)	3.7%	41.4%	2,793
Skim Milk Powder (SMP)	10.0%	29.8%	2,224
Anhydrous Milk Fat (AMF)	15.4%	59.1%	4,769
Butter	14.9%	34.7%	3,764
GDT Price Index	7.7%	37.3%	n.a.

GLOBAL DAIRY TRADE AUCTION  
(average winning price)



EU & UK MILK PRODUCTION  
(Seasonally-adjusted)



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