

Solid as a rock

- Dairy prices further solidified their large gains overnight.
- Weak NZ (and global) dairy production is pushing prices higher.
- Meanwhile, we continue to see clear upside risk to our \$6.00/kg milk price forecast.

Summary

The spike in dairy prices since July has got legs. Dairy supply has fundamentally corrected, leading to a similar correction in prices. And the auction overnight has seen the price surge further solidified.

If anything, we see prices going higher. In particular, we expect the global production picture to get worse before it gets better. Here in NZ, a very weak season production-wise is all but set in stone. Meanwhile, we still have a view that current data flatter the actual (downward) trend in EU production. This global production tightness may squeeze prices higher yet.

Looking back over the past few months, though, prices have come a very long way. As a result, we are in no particular rush to revise higher our forecast. That said, **there is clear upside to our \$6.00/kg 2016/17 milk price forecast**, and if prices remain at or near current levels, it is simply a matter of time.

Auction comments

In line with expectations, dairy prices further cemented their large gains overnight. Overall prices ticked up 3.5%, paced by a 4.9% lift in WMP prices. Six out of the seven products we monitor rose.

Dairy prices have corrected higher and now sit above long-run averages. For example, WMP and overall prices are 62% and 51% higher than as at the same time a year ago. Meanwhile, WMP prices have moved 12% above the level prices have averaged since auctions began back in 2008.

The relative WMP strength reflects the market's ongoing reaction to the rapid decline (from an already weak position) in NZ production. Prices for WMP, NZ's key product, have surged around a third over the last four auctions, while SMP prices, in contrast, have jumped a less spectacular 18%.

In our view, WMP prices may have further to go, and may challenge US\$4,000/MT in the New Year. In particular, we expect the data on NZ and EU production are set to get worse before they get better. For example, we expect NZ production to fall 5% over the season as a whole from the 3.1% decline for the season to date. Also, we expect flat production in the EU this calendar year, which is less than official EU forecasts of a small rise.

Implications

With another firm result in the bag, there is clear upside to our \$6.00/kg 2016/17 milk price forecast. For now we stick with \$6.00/kg, but the forecast remains "under review".

Season-end Forecasts

	2016/17		2017/18	Long Run
	Fonterra	ASB	ASB	ASB
Milk Price*	\$6.00	\$6.00	\$6.50	\$6.50-\$7.00

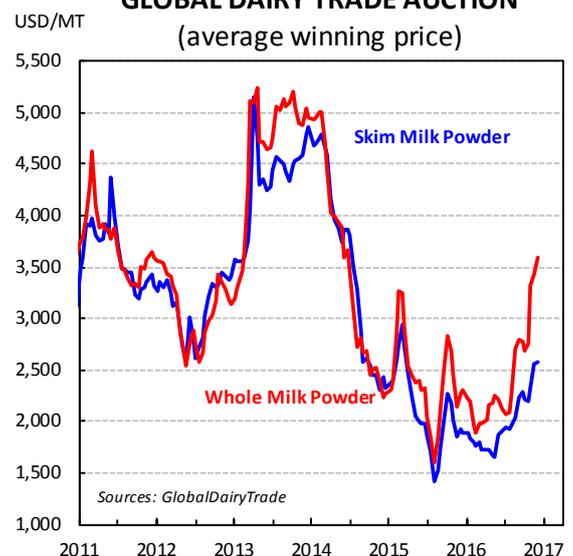
* per kg of milk solids (excluding dividend).

Auction Results

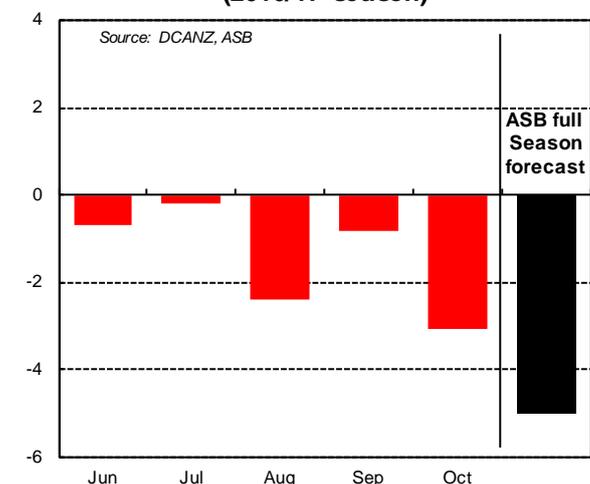
Product	% change in index since last auction	Annual % change in index	Weighted Average Price US\$/MT
Whole Milk Powder (WMP)	4.9%	61.7%	3,593
Skim Milk Powder (SMP)	1.4%	37.4%	2,570
Anhydrous Milk Fat (AMF)	2.9%	58.2%	5,500
Butter	1.7%	47.1%	4,262
GDT Price Index	3.5%	51.0%	n.a.

GLOBAL DAIRY TRADE AUCTION

(average winning price)



MILK SOLIDS PRODUCTION (2016/17 season)



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