

Rural Economic Note

Global Dairy Trade Auction

08 August 2018

New, lower, stake in the ground

- The overnight dairy auction result was unremarkable, with overall prices unchanged.
- However, the result confirmed that key Chinese demand has shifted lower and taken prices with it.
- On the back of this price shift lower, we place our 2018/19 milk price forecast of \$6.50/kg under review.

Summary

Dairy prices have shifted lower. Over the past 5 auctions overall dairy prices have fallen 9%, with whole milk powder prices down by a similar 8%. Notably, once strong butter prices have fallen hard, down around 17% over this period.

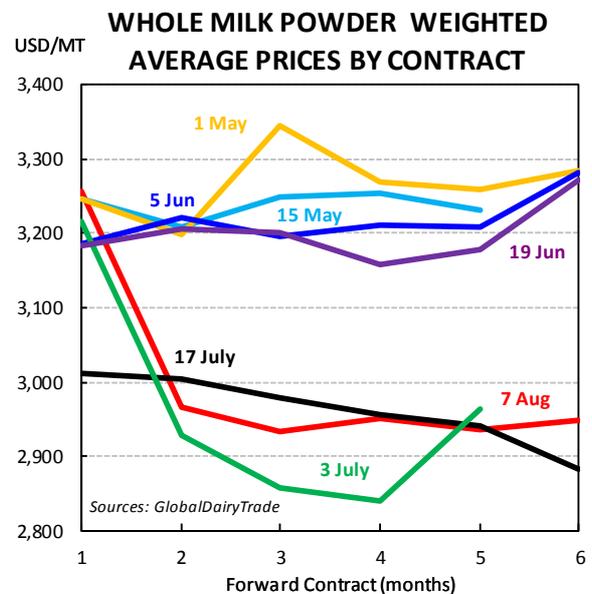
Initially, with global demand still firm, the fall looked like it could prove temporary. **But this no longer appears the case.**

The catalyst for change has been the escalation in US-China trade tensions, but the mechanism through which dairy prices have been impacted has been currencies. In particular, the Chinese yuan has fallen against not just the USD, but also the NZD.

The falling yuan has stunted Chinese buying power and lowered demand from our number one dairy market.

Moreover, as the US-China trade tensions drag on, the more likely the yuan is to stay at this lower level, with Chinese dairy demand likely to remain lower too.

It follows that lower demand equals lower prices. For farmers, this means there's risk to our 2018/19 milk price forecast \$6.50/kg and Fonterra's \$7.00/kg forecast. We had already factored in some risk from improved NZ production this season. But lower global dairy demand comes on top of this. The low NZD is providing some offset, but not by enough to fully compensate for the overall dairy price fall. All up and for now, **we stick with \$6.50/kg, but we formally put our milk price forecast under review.**



Auction Results, 7 August

Dairy auction prices were unchanged overnight (see results table over page). The result broke a run of four consecutive falls, although prices remain around 9% lower than as at the end of May.

By product the auction was mixed. Key whole milk powder (WMP) were effectively unchanged (up 0.1%), while skim

milk powder prices slipped a touch (down 0.3%). The WMP price rise also contrasted with the small rise signalled by the futures market ahead of the auction.

Milk fat prices were also a mixed bag. Butter prices slid 3.2%, while anhydrous milk fat (AMF) prices rose 1.2%. Butter prices are now 17% lower than back in late May.

Product	% change in index since last auction	Annual % change in index	Weighted Average Price US\$/MT
Whole Milk Powder	0.1%	-4.9%	2,958
Skim Milk Powder	-0.3%	-3.7%	1,972
Anhydrous Milk Fat	1.2%	-8.8%	5,709
Butter	-3.2%	-17.4%	4,802
GDT Price Index	0.0%	-9.1%	n.a.

While an unremarkable result on the day, our key takeout is that auction prices in USD have now shifted lower and look there to stay for the time being. The last three auctions have produced results within a very tight range. In addition, auction volumes will rise and then peak through September and October, making a price rebound less likely over the coming months.

On this basis, **we expect prices to bounce around at these lower levels over coming months.** At the same time, the escalating US-China trade tensions pose an ongoing risk, particularly if the yuan loses more ground against the NZD.

Implications

For now, we stick with our 2018/19 milk price forecast of \$6.50/kg, but we have formally put our milk price forecast under review.

Farmgate Milk Price Forecasts

	2017/18	2018/19		Long Run
	Fonterra/ASB	Fonterra	ASB	ASB
Milk Price*	\$6.75	\$7.00	\$6.50	\$6.50-\$7.00

* per kg of milk solids (excluding dividend).

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