

# Rural Economic Note

Global Dairy Trade Auction

16 January 2019

## EU comes to the aid of the dairy party

- Dairy prices have started 2019 positively.
- As the EU finally sells down its intervention stocks.
- This development has taken away some of the downside risks to our 2018/19 milk price forecast of \$6.00/kg.

### Summary

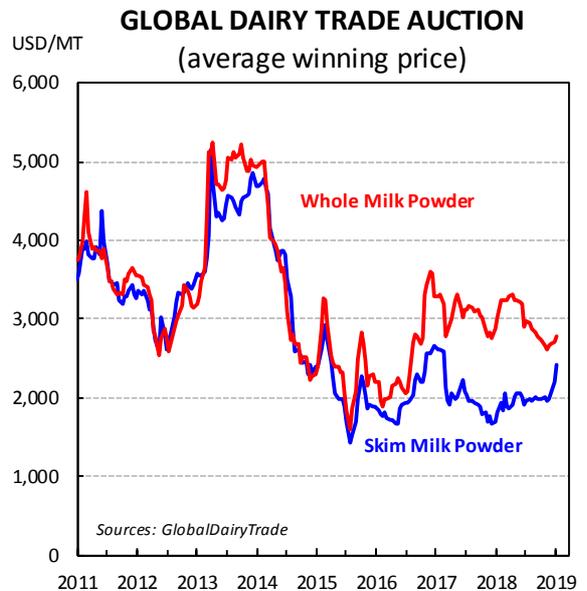
**The EU has come to the aid of the dairy party.** And it's about time too!

**Over the last few years, the spectre of large EU intervention stocks has cast a shadow over skim milk powder prices.**

Global dairy prices have also been impacted more generally, albeit to a lesser degree. Now though, the EU has sold down a significant portion of these stocks, which looks to be enough to convince the dairy market to release the shackles on skim milk prices.

Indeed, **the premium between whole milk and skim milk powder prices is fast closing.** That premium which had averaged over 40% between 2016 and 2018 is now down to 15% following the result overnight.

This development is giving a timely boost to global dairy prices, going a long way to offset the downward pressure on prices from bumper NZ supply. Moreover, **the improved dairy price outlook has removed some of the downside risk to our 2018/19 Fonterra milk price forecast of \$6.00/kg.**



### Auction Results, 15 January

**Overall dairy auction prices lifted 4.2% overnight,** the fourth successive price gain. Overall prices have lifted 11.3% during this two-month period, reversing some of the circa 20% fall over the six months prior.

**The price lift was broad-based.** Five out of the six products we monitor posted gains. Skim milk prices led the way, jumping 10.3%. Meanwhile, whole milk powder (WMP), butter, anhydrous milk fat and cheddar prices posted gains of between 3.0% and 4.6%.

Product	% change in index since last auction	Annual % change in index	Weighted Average Price US\$/MT
Whole Milk Powder	3.0%	-6.1%	2,777
Skim Milk Powder	10.3%	26.6%	2,405
Anhydrous Milk Fat	3.2%	-18.7%	5,294
Butter	4.6%	-12.5%	4,262
GDT Price Index	4.2%	-6.0%	n.a.

Moreover, the auction result was more in line with futures pricing than has been the case recently. Futures pricing leading up till the auction had indicated a whole milk powder lift of 4%+, whereas we had expected a 1% lift.

As discussed above, much of the lift looks to have been by the EU’s recent sell down of its skim milk powder intervention stocks. Over 60,000 tonnes of skimmed milk powder stocks were sold in December in the biggest sale since public tenders began in 2016. The December sale reduced EU stocks to around 100,000 tonnes (down from 380,000 in 2017) and cleared stocks from major dairy producers, including Germany, Netherlands Poland and Belgium.

That said, a weaker US dollar also helped boost prices overnight. Since the last auction, the US dollar has fallen over 1%, and thus accounted for around a quarter of the overall 4.2% auction price rise.

While the change in market sentiment is likely to have an ongoing positive impact on prices, we still remain wary of the impact of strong NZ production. Anecdotally, December production data (released next week) is likely to show a strong rebound from November’s modest result. With this in mind, dairy prices may give back some of their December and January gains.

### Implications

We reconfirm our 2018/19 Fonterra milk price forecast at \$6.00/kg and note the improved dairy price backdrop has removed some of the downside risk to the milk price outlook.

### Farmgate Milk Price Forecasts

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

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

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