

Rural Economic Note

Global Dairy Trade Auction

17 January 2018

Mixed blessings

- Dairy prices lifted overnight, supported by the impact of dry weather and production forecast downgrades.
- The price strength reaffirms our 2017/18 milk price forecast of \$6.50/kg.
- However, with the weather since improving, we expect that some of this price strength will prove temporary.

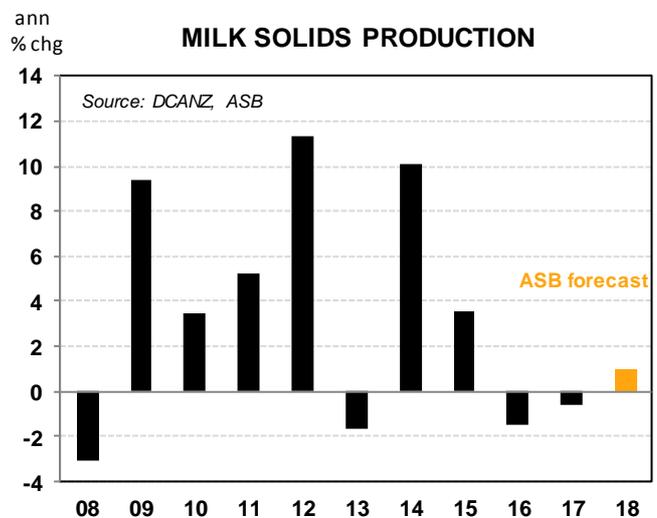
Summary

2017/18's wild weather is continuing to throw a spanner in the works for NZ dairy production. Early in the 2017/18 season, wet weather hampered production, although better weather in late spring saw production rebound.

More recently, **it has been the turn of dry weather to hamper production.** Indeed the NZ Government declared a drought for parts of the North Island in December. More generally large parts of the country have been dry. Accordingly, Fonterra reported that its December milk collections were 5.5% below December 2016.

As a result, **we have cut our nationwide (i.e. for all processors) 2017/18 production growth forecast to 1%, from 3% previously.** Fonterra has also cut its forecast aggressively to -3%, from flat previously.

While wild weather is hard work for farmers, stalling production is supporting NZ dairy prices. And this strength reinforces our more optimistic 2017/18 milk price forecast of \$6.50/kg (recall that Fonterra's forecasts \$6.40/kg).



Farmgate Milk Price Forecasts

	2017/18		2018/19	Long Run
	Fonterra	ASB	ASB	ASB
Milk Price*	\$6.40	\$6.50	\$6.50	\$6.50-\$7.00

* per kg of milk solids (excluding dividend).

Auction Results, 16 January

Dairy auction prices rose across the board overnight. Overall prices lifted 4.9%, with whole and skim milk powder jumping 5.1% and 6.5%, respectively. Butter prices also regained some lost ground, spiking 8.8%, while all of the other products that we monitor posted gains.

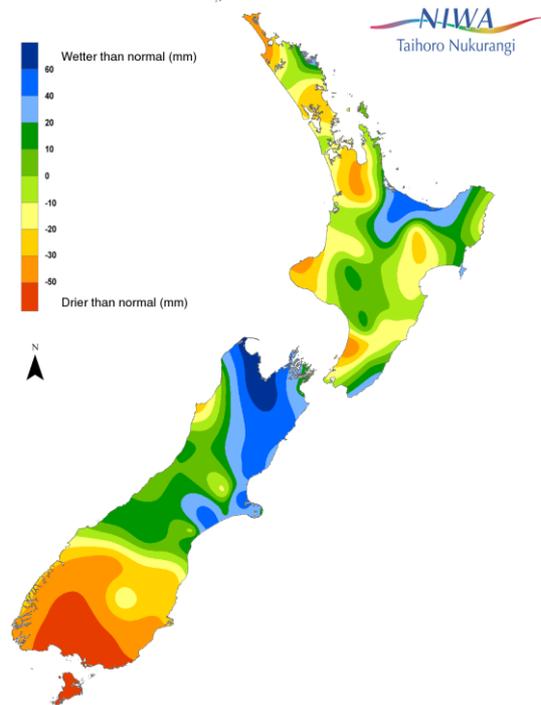
Interestingly, the price strength matched futures pricing ahead of the auction. In contrast, over the second half of 2017 futures pricing prior to auctions had often overshot the results.

The strong auction result follows very dry NZ weather over December. This dry weather culminated in a drought declaration for parts of the North Island. Moreover, we have cut our production growth forecast for the 2017/18 season to 1%, from 3% previously.

However, **we expect that some of this price strength will prove temporary.** In particular, the weather over January has improved, with rain in many parts and more forecast. As such, production is likely to improve later in the season. Also, in our view Fonterra’s -3% production growth forecast is overly pessimistic.

All up, the total effect on this season’s milk price is still higher than anticipated earlier. **As a result, we are now more confident in our 2017/18 milk price forecast of \$6.50/kg than we were as at the end of 2017.**

Soil moisture anomaly (mm) at 9am on 16/01/2018



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