

Rural Economic Note

Global Dairy Trade Auction & Fonterra 19/20 Interim Results

18 March 2020

Comfort food

- The NZ dairy (and the broader food) sector is better placed than many others to manage the considerable fallout from COVID-19.
- While we retain our relatively positive outlook for the NZ dairy sector, we have nonetheless adjusted our 19/20 milk price forecast down to \$7.30/kg.
- Meanwhile, Fonterra is reporting early signs of turning its performance around.

Summary

The NZ dairy sector looks to be in a better place than most. Global dairy prices have fallen on the back of the coronavirus outbreak, but the lower NZD/USD means that the outlook for farmgate milk prices remains healthy. At our current forecast levels for the milk price, the majority of farmers are likely to remain profitable.

In addition, **Fonterra is reporting early signs of turning its performance around**, maintaining its earnings guidance in its half-year results. While still early days for the co-op, the results announced today are an encouraging start.

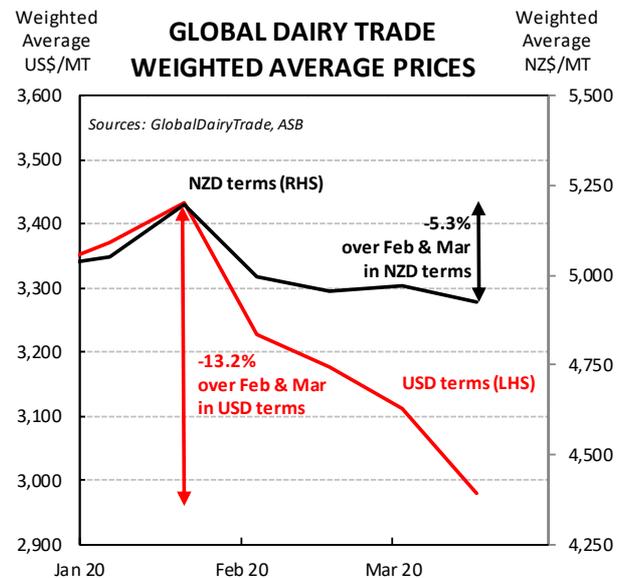
More broadly, **our view is NZ's food export sector will prove relatively resilient during these unprecedented times.** A good example of this is in China where food imports are being fast-tracked for entry via the putting in place of 'green lanes' at Chinese ports.

Nonetheless, **these are unprecedented times.** As a result, we will continue to regularly update our views and our forecasts are subject to change. However, we note that being a food exporter in times like this is, in a way, quite comforting.

Auction results, 17 March

Dairy auction prices fell for the fourth consecutive auction overnight. Key whole milk powder (WMP) prices dipped 4.2%, while overall prices fell 3.9%.

The 4.2% WMP price fall was noticeably less than the circa



Product	% change in index since last auction	Annual % change in index	Weighted Average Price US\$/MT
Whole Milk Powder	-4.2%	-15.6%	2,797
Skim Milk Powder	-8.1%	4.3%	2,527
Anhydrous Milk Fat	1.0%	-23.5%	4,331
Butter	0.3%	-20.7%	4,144
GDT Price Index	-3.9%	-9.0%	n.a.

10% fall indicated by the futures market and our pick for a 7% fall ahead of the auction.

Nonetheless, **dairy prices in USD terms are materially lower than prior to the COVID-19 virus outbreak.** On a weighted average basis, overall prices have fallen 13.2% over February and March (see chart above).

Comfortingly for farmers, the NZ dollar is partially offsetting these falls. Indeed, the circa 8% decline in the NZD/USD over February and March means that in NZD terms prices are down a more modest 5.3%.

At a higher level, **we anticipate that NZ’s dairy and food exports are going to hold up relatively well.** Indeed, we anticipate that global food demand is likely to remain firm (outside of premium foods) as food consumption is prioritised in household budgets. A good example of this is in China where food imports are being fast-tracked for entry via ‘green lanes’ at Chinese ports.

Fonterra 19/20 Interim Results

Fonterra reported today normalised Earnings Before Interest and Tax (EBIT) of \$584 million over the first half of its financial year, up from \$312 million over the same period last year. On this basis, it was able to reaffirm its forecast earnings for the year at 15-25 cents per share.

These results are encouraging at this early stage. Fonterra CEO, Miles Hurrell stated that Fonterra is “a very different Co-op to this time last year – we’re prioritising New Zealand milk and staying focused on what we know we’re good at and what makes a difference to our farmer owners, unit holders, employees and communities.”

While we acknowledge these early signs of improvement, a long road lies ahead. Indeed, Fonterra needs to generate consistent profits over a number of financial years before it can claim to have genuinely turned the corner.

Meanwhile, Fonterra reaffirmed its 19/20 milk price forecast range at \$7.00 to \$7.60 per kg. With this in mind and on top of the recent auction results, **we move our own forecast to the middle of Fonterra’s forecast range.**

Implications

We adjust our 2019/20 milk price forecast down by 10 cents to \$7.30/kg. While making that adjustment, we continue to point out that there remain many moving parts to dairy markets currently and our forecast may require tweaking over the coming months. Our 20/21 forecast is unchanged at \$7.50/kg.

Farmgate Milk Price Forecasts

	2019/20		2020/21	Long Run
	Fonterra	ASB	ASB	ASB
Milk Price*	\$7.00-\$7.60	\$7.30	\$7.50	\$6.50-\$7.50

* per kg of milk solids (excluding dividend).

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