

Rural Economic Note

Global Dairy Trade Auction

18 October 2017

Red herring

- Dairy prices eased a touch overnight.
- With the fall coming despite materially weak NZ spring production.
- With that in mind, we downplay this auction result and maintain the view that prices rise by year end.

Summary

D-day has arrived for NZ dairy production. Wet weather has now stalled spring production. And weak production at this time of the season is likely to impact the season as a whole.

Subsequently, **we have revised down our nationwide (i.e. for all processors) milk production growth forecast for the season to 3%, from 4% previously.** This is a similar revision (albeit a tad smaller) to Fonterra’s forecast revision on Monday; Fonterra revised its growth forecast for the season on its collections down to 1%, from 3% previously.

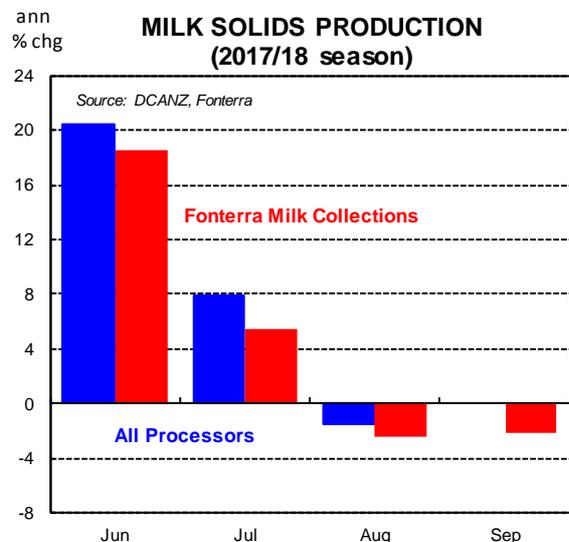
With this in mind, **the auction result came as a surprise.** After all, NZ production is the dominant driver of dairy prices for the products that matter to NZ. There are some factors in play which may have contributed to the weak result. In our view, however, these factors are all secondary to the material change in NZ production.

Accordingly, we stick with our 2017/18 milk price forecast of \$6.75/kg. Indeed, we expect weak NZ production to translate into higher auction prices by the end of the year.

Details

Dairy auction prices eased a touch overnight, with overall prices down 1.0%. The result contrasts to futures pricing ahead of the auction, which had pointed to gains.

The price fall was broad-based, **although AMF – the sole product to rise – posted a record high.** WMP prices fell a modest 0.5%, while SMP and butter slid 5.6%.



Key auction results

Product	% change in index since last auction	Annual % change in index	Weighted Average Price US\$/MT
Whole Milk Powder (WMP)	-0.5%	9.9%	3,014
Skim Milk Powder (SMP)	-5.6%	-16.8%	1,797
Anhydrous Milk Fat (AMF)	5.2%	39.0%	6,841
Butter	-2.5%	41.4%	5,736
GDT Price Index	-1.0%	15.7%	n.a.

Despite the dip in prices overnight, we expect prices to push higher over coming months. In particular, very wet NZ

weather has led to a stall in NZ production. For example, Fonterra has reported that its September milk collections were 2.1% lower than September 2016. Moreover, Fonterra has cut its production growth forecast for the season to 1%, from 3% previously. We agree with this sentiment, and have also cut our nationwide (for all processors) production forecast for the season to 3%, from 4% previously.

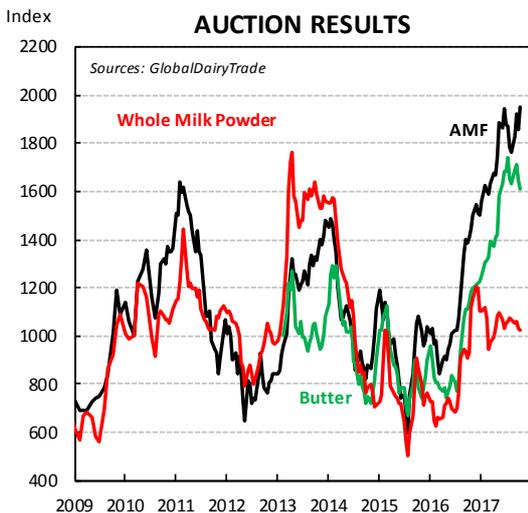
On this basis, **we suspect that recent price weakness relates to the seasonal peak in auction volumes.** In addition, Fonterra’s recent increases to auction volumes, which go against the grain of the change in production outlook, may also be a factor. However, these factors are temporary and the weaker supply fundamentals will dominate over a longer period, sending prices higher by year end.

Farmgate Milk Price Forecasts

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

* per kg of milk solids (excluding dividend).

GLOBAL DAIRY TRADE AUCTION RESULTS



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