

Rural Economic Note

Global Dairy Trade Auction

19 February 2020

Twin watch: coronavirus and drought

- We trim our 2019/20 milk price forecast by 10 cents to \$7.40/kg.
- This forecast change is the net price impact of coronavirus (down) and NZ drought (up).
- We also trim our 2019/20 dairy production growth forecast to -0.5% and note the material drought hit to farm production and incomes in some key dairying regions.

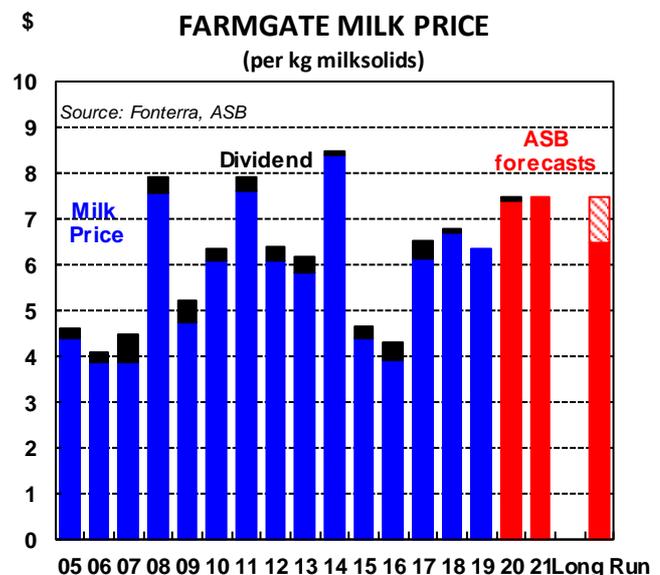
Summary

The impact of the coronavirus on dairy markets is starting to run its course. The disruption to dairy markets is most notable in supply chains, with many Chinese factories (that use dairy inputs) closed.

Nonetheless, **the price impact has been modest to date.** In total over February, whole milk powder prices have fallen 8.6%, which does not make the top 30 of monthly auction falls. Moreover, Chinese buyers remain active, albeit cautious, on the auction platform. **These signs remain consistent with our central view that the coronavirus impact on dairy prices will prove modest and short-lived.**

Meanwhile, **key NZ dairy regions are very dry, and an official drought has been declared in Northland.** A declaration for the Waikato and other regions may not be far away. As a result, we have trimmed our 2019/20 production growth forecast to 0.5% down on 2018/19 – this crimping of production and NZ supply will lift dairy prices as soon as next month in our view.

The net impact of these changes is a modest cut to our 2019/20 milk price forecast from \$7.50/kg to \$7.40/kg. However, we acknowledge there are many moving parts to dairy markets currently and our forecast may require further tweaks over the coming months. We also note for some farmers hit by the dry, the lost production will be the more significant impact on farm bottom lines.



Auction results, 18 February

Disruptions from coronavirus outbreak drove dairy auction prices lower for the second successive auction overnight. Key whole milk powder (WMP) prices dipped 2.6%, while overall prices fell 2.9%.

The WMP price fall was in line with expectations. Futures pricing ahead of the auction had pointed to a circa 2.5% fall. WMP prices have now fallen 8.6% over February.

Nonetheless, **we regard the total fall over the month as relatively modest.** Indeed, the monthly fall doesn't even make it into the top 30 monthly falls in auction history. Moreover, **Chinese buyers remain active, albeit cautious, consistent with the view that the virus impact will prove short-lived.**

At the same time, **NZ drought conditions have begun to bite and we expect that will begin to lift dairy prices from as soon as next month.** An official drought has been declared in Northland, but almost more crucially, it is very dry in the key Waikato region as well as in other parts of the country.

Implications

With this in mind, **we have cut our 2019/20 production growth forecast to -0.5%.** Accordingly, **we have also factored in a rebound in dairy prices over the remainder of the season.**

The net impact of these changes is a modest cut to our 2019/20 milk price forecast from \$7.50/kg to \$7.40/kg. However, we acknowledge there are many moving parts to dairy markets currently and our forecast may require further tweaks over the coming months.

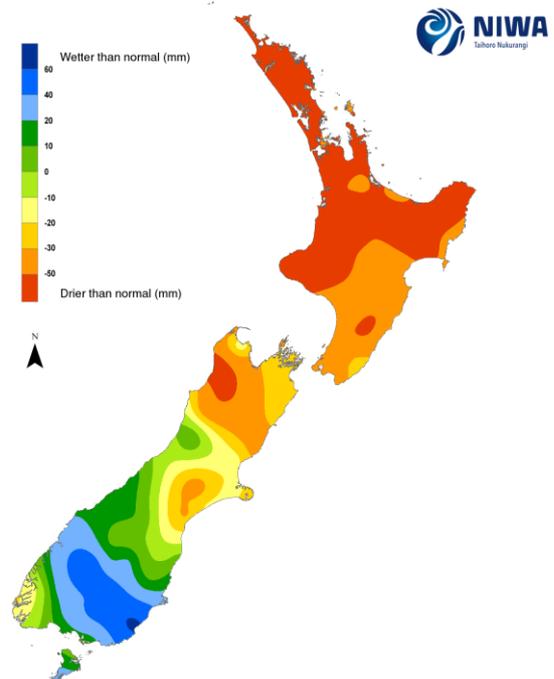
We also note for some farmers hit by the dry, the lost production will be the more significant impact on farm bottom lines. Indeed, while our nationwide production growth forecast is -0.5%, some farmers are likely to see production drops compared to last season in the vicinity of 10%.

Farmgate Milk Price Forecasts

	2019/20		2020/21	Long Run
	Fonterra	ASB	ASB	ASB
Milk Price*	\$7.00-\$7.60	\$7.40	\$7.50	\$6.50-\$7.50

* per kg of milk solids (excluding dividend).

Soil moisture anomaly (mm) at 9am on 18/02/2020



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