

The big wet

- Dairy auction prices lifted overnight, albeit by less than expected.
- Indeed, it appears markets need more convincing that wet weather is weakening production.
- From here, we expect choppy prices over coming auctions, before prices lift again over the rest of the season.

Summary

Rain is normally welcomed by farmers as manna from heaven. But recently we've seen a case of where sometimes you can have too much of a good thing. This spring has been wet, very wet, in the Waikato and other parts of the North Island.

This 'big wet' has slammed the brakes on the production in an area representing circa 40% of NZ's production. For example, Fonterra has reported that October milk collections in the Waikato are running 10% behind this time last season. Moreover, the likelihood that this production can be made up later this season is low.

For us, this development is the confirmation that NZ production will fall hard this season. We have forecast a 5% nationwide decline compared to last season. And on this basis, we expect dairy prices to continue their rise over the season.

Dairy markets, however, need a little more convincing. While markets appreciate that a drought can stunt production, wet weather hurting production is a harder sell. Accordingly, we expect markets will wait for data to confirm weak production before bidding prices higher again. All up, we continue to expect a finalised milk price of \$6.00/kg for 2016/17.

Auction comments

Dairy prices lifted overnight, although by less than indicated by futures pricing ahead of the auction. Key WMP prices (up 2.9%) led the way. SMP prices, however, fell by a touch (down 0.3%).

Following reports of very wet weather and falling NZ production, futures prices had indicated a more significant WMP price lift (circa 6% to 8%). Fonterra reported that early October milk volumes in the key Waikato region have been down around 10% vs. the same time last season.

However, it appears dairy markets are not yet convinced that production has fallen as hard as Fonterra describes. In particular, in light of the auction volume reductions ahead of the auction, the auction price lift was small (Fonterra reduced the volume of WMP on offer at this auction by 5% compared to its previous indication, and also reduced the total forecast volumes on offer for the next 12 months by 2%).

From here, we expect prices to be choppy over coming auctions as markets wait for confirmation of weak NZ production. In our view, however, weak production is largely locked in and thus we expect prices will lift again later in the season. On that basis, we look to production data over coming months that supports or challenges our view that NZ production is indeed weak this season.

Implications

We stick with our 2016/17 milk price forecast of \$6.00/kg.

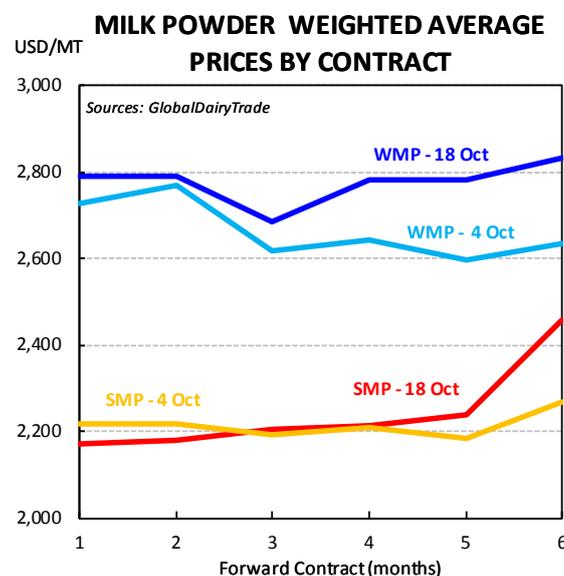
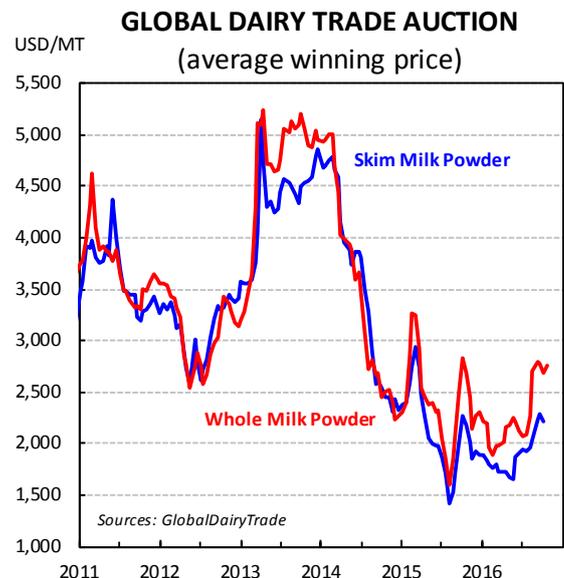
Season-end Forecasts

	2016/17		2017/18	Long Run
	Fonterra	ASB	ASB	ASB
Farmgate Milk Price*	\$5.25	\$6.00	\$6.50	\$6.50-\$7.00

* per kg of milk solids (excluding dividend).

Auction Results

Product	% change in index since last auction	Annual % change in index	Weighted Average Price US\$/MT
Whole Milk Powder (WMP)	2.9%	7.4%	2,760
Skim Milk Powder (SMP)	-0.3%	1.0%	2,204
Anhydrous Milk Fat (AMF)	1.1%	30.2%	5,007
Butter	2.6%	45.0%	3,984
GDT Price Index	1.4%	10.7%	n.a.



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