

Rural Economic Note

Global Dairy Trade Auction

20 February 2019

Dairy price cycle emerging from hibernation

- Conditions for a new dairy price cycle have begun to emerge.
- Global dairy supply is tightening, with little backstop in terms of stocks.
- As a result, we see upside to our 2018/19 milk price forecast of \$6.25/kg and set our 2019/20 forecast at a bullish \$7.00/kg.

Summary

Since the spring of 2016, global dairy prices have traded within a relatively narrow range. Looking at whole milk powder prices for example, the range has been around US\$1,000/MT.

Notably, this relative price calm followed the other extreme. In the three or so years prior, the range was a massive US\$3,700/MT. That was global dairy's super cycle.

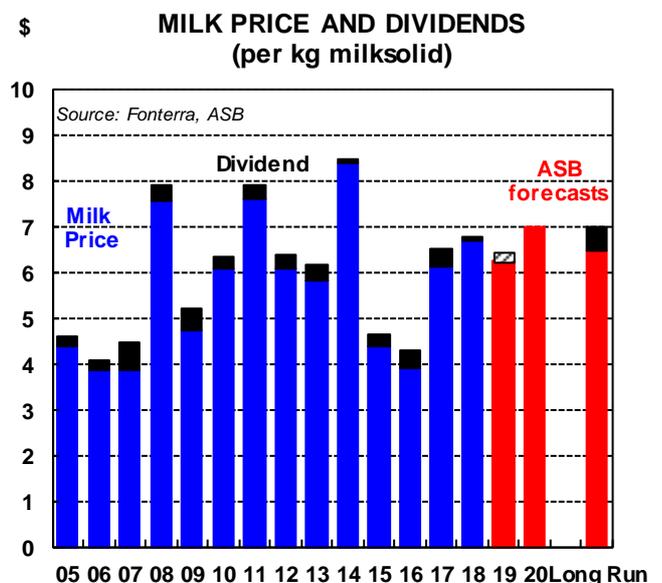
It now appears that we are entering a new dairy price cycle. However, this cycle will be different again – we anticipate that the next dairy price cycle will be more moderate than the super cycle, but at the same time more amplified than the recent price calm.

The conditions for the start of a new cycle have begun to emerge. Essentially those conditions boil down to supply growth increasingly lagging behind demand growth, with little prospect of catch up in the short-term. We go into more detail on these conditions below.

The key implication of the new global dairy cycle initially is higher dairy prices. With that in mind, we see upside to our 2018/19 milk price forecast of \$6.25/kg. But more so, the cycle is priming the 2019/20 season. As a result, we set our initial 2019/20 milk price forecast at a bullish \$7.00/kg.

Conditions are in place for a new dairy price cycle

Over 2018, very strong NZ production has offset supply softness in the EU, US and Australia. EU and US supply are both set to end 2018 up a modest 1% or so on 2017 and we anticipate more of the same over 2019. Meanwhile, Australian production is down 5% on a season to December basis. In contrast, NZ supply is 5.6% ahead of last season on a season to January basis.



However, **we anticipate that this is as good as it gets for NZ supply**. Growing conditions were very favourable over the first eight months of the season, but this is unlikely to last. Already very hot weather has started to put the brakes on production over February. In addition, despite strong recent production NZ's dairy herd is actually smaller than in prior seasons.

Accordingly over 2019, **we anticipate NZ supply annual growth to slow to around 1%**. Growth at this level across the major exporters (the EU, NZ and US) won't be enough to keep up with annual global demand growth of circa 2%.

Moreover, **global dairy stocks are now much lower than in previous years**. EU intervention stocks had been a buffer against any supply tightness; however, now these stocks have been sold down, making supply vulnerable to shocks. With the above in mind, we anticipate global dairy prices will lift over the first half of 2019.

We would point out that there are still risks to this view. For now, we assume that global demand remains firm and that weakness in global growth does not spill over into weaker demand for dairy. In particular, we assume that the Chinese household sector remains a bright spot in an otherwise weaker-performing Chinese economy. The other caveat we add is that we base our view on a NZD/USD average of around 0.69.

We also point out that it is still very early days for the 2019/20 season forecast. Our \$7.00/kg forecast is the midpoint of a very wide forecast range. For example, from Fonterra's opening forecast in May the average difference between the start and end forecasts is around \$1.30/kg.

Implications

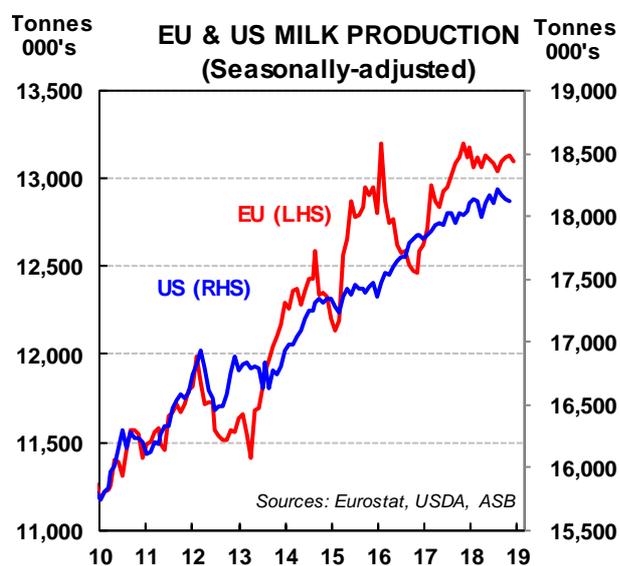
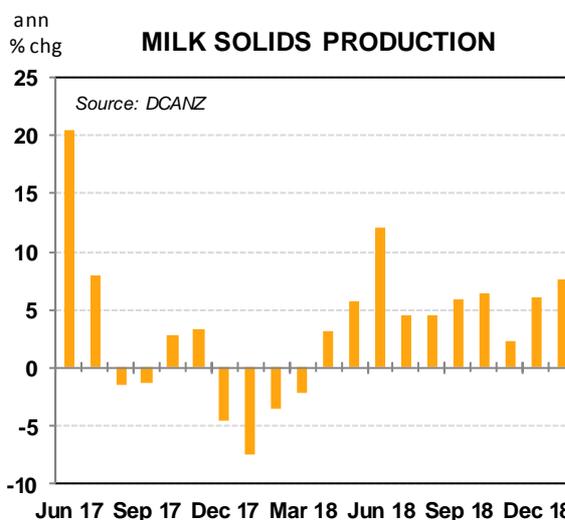
With the above in mind, **we see upside risk to our 2018/19 Fonterra milk price forecast of \$6.25/kg**. This forecast is towards the top of Fonterra's \$6.00 to \$6.30/kg forecast range. If we were to use a similar 30-cent range, our forecast would be \$6.10-\$6.40/kg.

In addition, **we set our initial 2019/20 milk price forecast at a bullish \$7.00/kg**. However, we point out the obvious in that the 2019/20 season has yet to begin. Hence, this forecast comes with a very wide range as noted in the text above.

Farmgate Milk Price Forecasts

	2018/19		2019/20	Long Run
	Fonterra	ASB	ASB	ASB
Milk Price*	\$6.00-\$6.30	\$6.25	\$7.00	\$6.50-\$7.00

* per kg of milk solids (excluding dividend).



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