

Rural Economic Note

Global Dairy Trade Auction

20 March 2019

Ending on a high and a dry

- We lift our 2018/19 milk price forecast by 35 cents to \$6.60/kg.
- As hot and dry NZ weather has put the squeeze on production and dairy prices too.
- We also see upside risk to our already-bullish 2019/20 milk price forecast of \$7.00/kg.

Summary

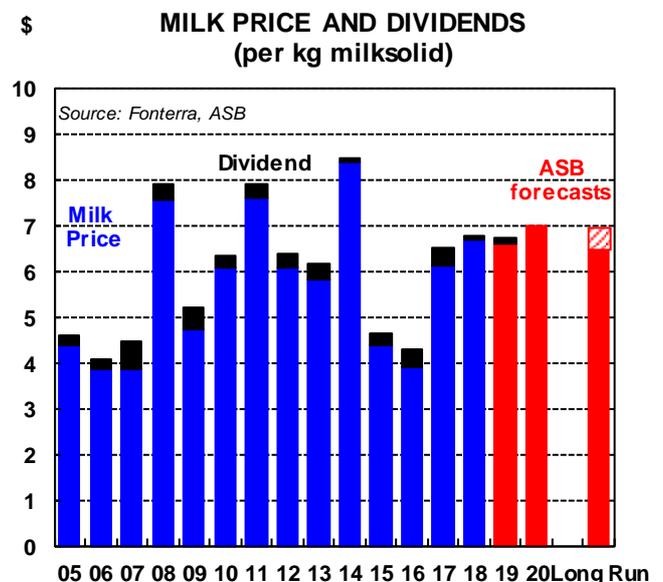
The 2018/19 season is ending on a high – at least from a milk price point of view. Today, we lift our 2018/19 milk price forecast by 35 cents to \$6.60/kg. For comparison that puts us at the top end of Fonterra’s \$6.30-\$6.60/kg forecast range, announced back on 28 February.

This forecast lift follows another strong dairy auction overnight. Indeed, whole milk prices have lifted 10.2% since we last updated our forecast in February and prices have now risen for eight successive auctions.

The price lift, however, is somewhat of a double-edged sword. At the same time we lift milk price forecast, we are cutting our 2018/19 production growth forecast to 3%, from 5% previously.

On a net income basis, the changes are positive for the dairy sector as a whole. We estimate that the two changes add up to a circa \$450m lift in forecast nationwide (i.e. for all suppliers) dairy incomes for the season. Note, though, that there will be significant variation on a regional basis, based on the severity of the hot and dry weather in each region.

The 2019/20 season is shaping up strong too. The global dairy market is tight as global supply is on the whole soft. At the same time, demand particularly from Asia, including China, remains firm. On this basis as well as the dry NZ conditions, we see upside risk to our already-bullish 2019/20 milk price forecast of \$7.00/kg.



Auction results, 19 March

Dairy auction prices were firm overnight, posting their eighth successive auction gain. Key whole milk powder (WMP) prices jumped 4.0%, while overall prices lifted 1.9%. Overall prices have lifted 21.4% since the start of the year.

Butter and casein prices led the gains, surging 9.7% and 9.3% overnight. Notably, butter prices have now lifted back above US\$5,000/MT. Skim milk powder and anhydrous milk fat prices bucked the trend, dipping 2.4% and 3.1%, respectively.

Much of the price lift can be put down to recent dry and hot NZ weather. Indeed, the lift in WMP and butter – products that NZ dominates the global export market – is consistent with this recent move being a NZ story. With the dry weather in mind, we have cut our nationwide 2018/19 milk production growth forecast to 3% from 5% previously.

Looking further ahead, we continue to note that slowing NZ production growth is compounding sluggish production offshore. Dairy production is falling in Australia, while EU and US production growth is a modest 1% per annum or so. Moreover, global dairy stocks are now much lower than in previous years. Lower stocks means less of a buffer for dairy markets in the event of any supply shock. Meanwhile, **global demand is also firm.** In particular, demand is firm in Asia, including Greater China.

All up and as we have noted in our previous reports, the combination of these factors point to the start of a new dairy price cycle. **Accordingly, we expect global dairy prices to lift further over 2019.**

Implications

As per above, we lift our 2018/19 milk price forecast by 35 cents to \$6.60/kg.

Looking ahead, we also see upside risk to our already-bullish 2019/20 milk price forecast of \$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.

We also note that we expect that 2018/19 production growth will now be lower than previously anticipated. We have cut our production growth forecast for the season to 3%, from 5% previously.

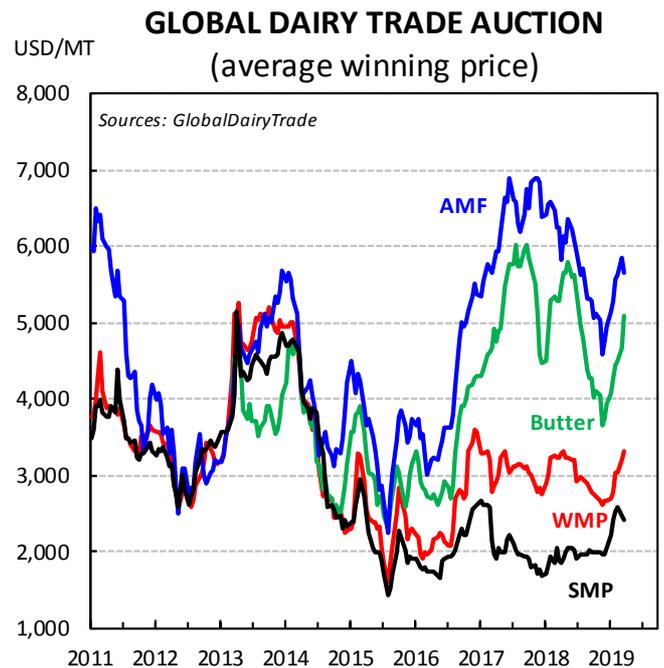
We estimate that the two forecast changes add up to a circa \$450m lift in forecast nationwide (i.e. for all suppliers) dairy incomes for 2018/19. Note, though, that there will be significant variation on a regional basis, based on the severity of the hot and dry weather in each region.

Farmgate Milk Price Forecasts

	2018/19		2019/20	Long Run
	Fonterra	ASB	ASB	ASB
Milk Price*	\$6.30-\$6.60	\$6.60	\$7.00	\$6.50-\$7.00

* per kg of milk solids (excluding dividend).

Product	% change in index since last auction	Annual % change in index	Weighted Average Price US\$/MT
Whole Milk Powder	4.0%	5.0%	3,317
Skim Milk Powder	-2.4%	25.9%	2,405
Anhydrous Milk Fat	-3.1%	-8.6%	5,662
Butter	9.3%	-3.1%	5,089
GDT Price Index	1.9%	3.0%	n.a.



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