

Rural Economic Note

Global Dairy Trade Auction

22 August 2018

Dairy auction fall trumps recent currency gains

- Milk fat prices lead dairy prices lower overnight.
- Moreover, the overnight fall trumps the recent gains from the fall in the NZ dollar.
- All up, we maintain our 2018/19 milk price forecast of \$6.50/kg, but note downside risks.

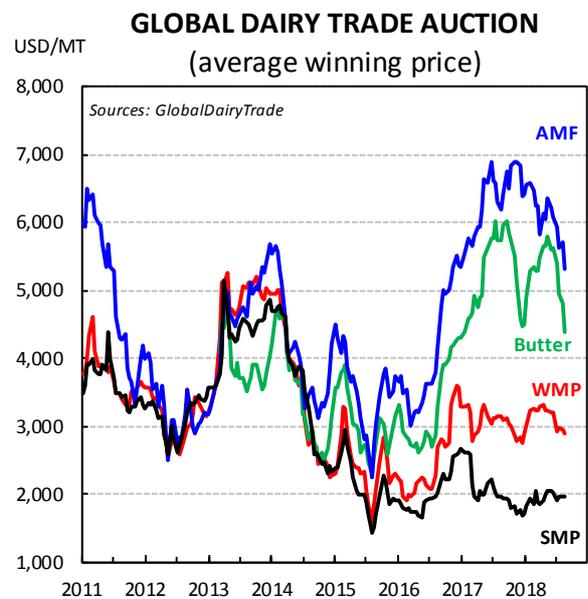
Summary

The recent dairy gains from the lower NZ dollar appear like they may be short-lived. Over the past two weeks or so, the NZD had at one stage fallen nearly 3% against the USD. And this fall was boosting dairy prices in NZD terms.

However, the dairy auction price fall (down 3.6% overall) overnight has trumped these gains. On top of that the NZD has actually regained some ground against the USD this week, so that the NZD/USD fall is now around a more modest 1%.

Notably, last night's fall did not coincide with a change in dairy market fundamentals such as changes to the NZ production outlook. Rather it coincided with Fonterra lifting its milk fat auction volumes forecast for the next 12 months – butter volumes were lifted by around 12%. With this in mind, it was not a surprise to see milk fat prices lead the auction price decline; butter prices fell over 8% for example.

It follows that in the absence of fundamental changes to markets, we stick with our milk price forecast view. Nonetheless, we cannot ignore price falls indefinitely. As a result, we stick with \$6.50/kg 2018/19 forecast, but continue to note downside risks to that number.



Auction Results, 21 August

Dairy auction prices slid 3.6% overall overnight. Overall prices have now fallen in five out of the last six auctions, and are down 12.2% over that period.

The price weakness was broad-based. Key whole milk powder (WMP) dipped 2.1%, while skim milk powder prices slipped 1.3%. The WMP price fall also contrasted with the

Product	% change in index since last auction	Annual % change in index	Weighted Average Price US\$/MT
Whole Milk Powder	-2.1%	-6.4%	2,883
Skim Milk Powder	-1.3%	-5.2%	1,951
Anhydrous Milk Fat	-6.9%	-14.1%	5,321
Butter	-8.5%	-23.4%	4,392
GDT Price Index	-3.6%	-12.0%	n.a.

small rise signalled by the futures market ahead of the auction.

Milk fat prices posted the largest falls. Butter prices dived 8.5%, while anhydrous milk fat (AMF) prices fell 6.9%. Although, the fall coincided with Fonterra lifting its forecast offer volumes for the next 12 months for both butter (up 12%) and AMF (up 7%). Butter prices are now 24% lower than back in late May.

Moreover, the auction price fall trumps the weaker NZD. At one stage following the previous auction, the NZD was around 3% lower than the USD. As a result, the overnight fall exceeds this NZD/USD fall and means dairy prices are a touch lower in NZD terms – and that’s what matters for the farmgate milk price. In addition, the NZD/USD has lifted this week so that the the NZD/USD fall is now around a more modest 1%.

Implications

For now, we stick with our 2018/19 milk price forecast of \$6.50/kg, but continue to note the downside risks.

Farmgate Milk Price Forecasts

	2017/18	2018/19		Long Run
	Fonterra/ASB	Fonterra	ASB	ASB
Milk Price*	\$6.70	\$7.00	\$6.50	\$6.50-\$7.00

* per kg of milk solids (excluding dividend).

ASB Economics & Research

Chief Economist
Senior Rural Economist
Senior Economist
Senior Economist
Senior Economist, Wealth
Economist
Data & Publication Manager

Nick Tuffley
Nathan Penny
Jane Turner
Mark Smith
Chris Tennent-Brown
Kim Mundy
Judith Pinto

nick.tuffley@asb.co.nz
nathan.penny@asb.co.nz
jane.turner@asb.co.nz
mark.smith4@asb.co.nz
chris.tennent-brown@asb.co.nz
kim.mundy@asb.co.nz
judith.pinto@asb.co.nz

Phone

(649) 301 5659
(649) 448 8778
(649) 301 5853
(649) 301 5657
(649) 301 5915
(649) 301 5661
(649) 301 5660

www.asb.co.nz/economics

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