

16 May 2018



## What Will Fonterra Forecast?

- **Fonterra's first 2018/19 milk price forecast due by month end**
- **Current pricing, currency suggest something in the mid-\$6 to \$7 range**
- **We lift our 2018/19 milk price forecast to \$6.60**
- **Latest dairy auction solid**

Global dairy prices rose 1.9% at auction overnight. This more than recoups the 1.1% dip at the previous, early-May, event. While recent moves have been generally modest, the GDT Price Index has wriggled its way up to its highest level since September last year.

At the latest auction, wholemilk powder (WMP) prices rose a marginal 0.2%, on an index basis (average prices sit at a healthy \$US3,226/T). Fat prices rose firmly with butter up 2.4% and AMF up 5.8%. Skimmilk powder rose 3.0%.

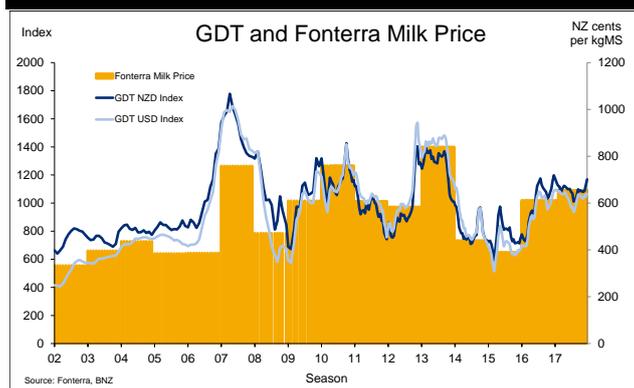
Recent market conditions indicate potential for a mild lift to Fonterra's \$6.55 milk price forecast for the current 2017/18 season before the season's payments are complete in a few months' time.

Today's auction result is also a solid one ahead of Fonterra's first forecast for the 2018/19 season (starting 1 June). Even more so in the context of a falling NZD over recent weeks that has boosted NZ dollar denominated dairy prices – the ones that matter for the NZ milk price. GDT prices, expressed in NZ dollars, are at their highest level in a year.

Our calculations suggest if current global dairy prices and currency levels were to persist over the coming 18

months it would generate a milk price in the mid-\$6 to \$7 range. This might be where Fonterra places its first forecast for the new season (as strange as it is to try and forecast a forecast). The co-op is due to announce its first forecast for the new season before the end of the month. Of course, what Fonterra ultimately forecast will depend on many factors including its views on the NZD and hedging position as well as its outlook for dairy product prices over the coming 12 months or so. We would imagine limited financial market reaction to a forecast in the range of mid-\$6 to \$7, as we've outlined.

GDT and Fonterra's Milk Price

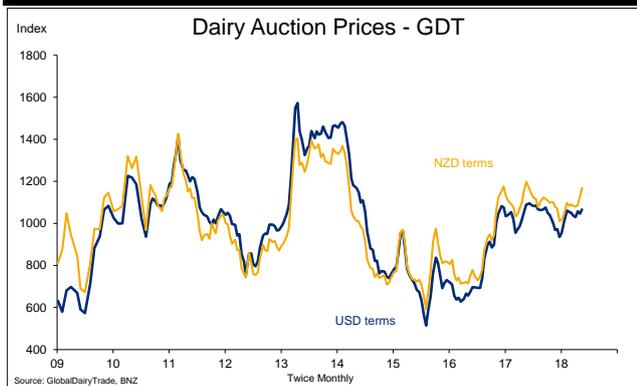


For where the 2018/19 milk price eventually lands in over a year's time, it is as difficult as ever to predict. But, to us, the price outlook as improved over recent months so we lift our own 2018/19 milk price forecast to \$6.60, from \$6.10 previously. This follows from recent favourable dairy price dynamics, firmly rising oil prices (despite a stronger USD), some sell down of the massive EU stockpile of skimmilk powder without undue influence on the broader market, and a lower NZD to date.

Of course, our upgraded forecast of \$6.60 sits within a wide range of outcomes that are possible when the 2018/19 season's milk price is finalised in over a year's time. Risks to any milk price forecast are large and ever present.

Our 2018/19 milk price forecast is dependent on our view that international dairy product prices will drift somewhat lower over the year ahead as EU milk production expands and changes to the EU intervention scheme (tendering rather than minimum price buying) may weigh on prices

### Buoyant



(over and above the influence of the large SMP stockpile). We are also wary of the US export focus increasing and dairy prices still looking stretched relative to grains.

At this point, we would highlight that a higher than forecast milk price is likely if international prices do not drift lower as we anticipate and/or if the NZD were to continue to decline.

Our 2018/19 milk price forecast is underpinned by our expectations that WMP prices will range between US\$3,000/T and US\$3,300/T over the next year or so (amid a host of other assumptions regards other international product prices, product mix, operating costs, and foreign exchange rates – the latter includes our forecast for NZD/USD and an assumption that this translates to an effective average rate for Fonterra in the low-70s). NZD/USD has averaged just over 0.71 over the past 18 months.

In the bigger picture, a third consecutive milk price above \$6 will support good cashflow to the dairy industry. For the economy, buoyant dairy prices are beneficial to the nation's terms of trade and helpful to the external accounts and overall growth. However, these positives are currently being tempered by higher oil prices. And there is some concern around the chilling effect that the cow-disease *Mycoplasma bovis* might have on production, activity, and investment as it affects farm operations and lifts costs.

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