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Dairy Prices Drop

- **International dairy prices slump**
- **On more NZ milk, EU and Indian stock unwind, Chinese growth concerns**
- **Puts downside risk on milk price forecasts**
- **But lower NZD, slower world milk production growth offer support**

The GDT Price Index dropped 5% overnight, led by a 7.3% fall in wholemilk powder prices (with longer dated prices falling by more than 11%). These are material declines and bigger falls than was anticipated on the day. An ugly result. Not a great way to celebrate the 10th birthday of the GDT platform. Prices are nearly 9% lower than a year ago.

The RBNZ included lower dairy prices in its May MPS, but wholemilk powder prices, now at an average of \$US2,905/T, have dipped below the RBNZ's medium term view of US\$3,000/t. It is one factor to put in the weaker-than-expected column.

News late yesterday that Fonterra milk collections were up 6.6% y/y in May shouldn't really have surprised anyone and the milk volume is very low at this time of year. But coupled with product volume picking up seasonally on the auction platform (as it prices NZ's coming season's milk), the strong milk growth headline may have checked some buyers enthusiasm. There was 22.6% more product sold at this auction compared to the previous auction.

A sense of more milk out of NZ added to the downward price pressure stemming from the EU continuing to unwind its massive stockpile of skimmilk powder, India re-entering the world market to lower domestic inventory, and renewed weakness in international grain prices. Today's move lower in dairy prices feels like catch up to weakness in other prices such as grains (which has been a downside risk we have long talked about).

Meanwhile, some growth concerns in China and a softer CNY may have curbed Chinese demand. There appeared no sign of extra Chinese demand for NZ or EU product as a result of the prospect at week's end of higher Chinese tariffs on US product (in retaliation to US tariff threats).

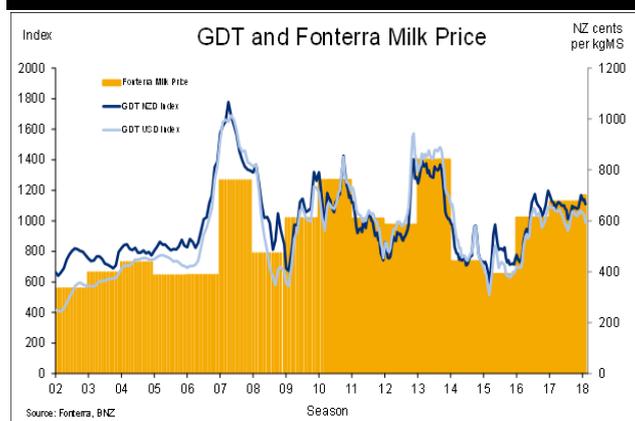
Prices fell across all major product lines: skimmilk powder down 4.6%, butter down 4.0%, AMF down 1.7% and cheese down 4.3%.

This will have all and sundry reassessing milk price forecasts. There is now significant downside risk to Fonterra's \$7 forecast for the 2018/19 season. Our own \$6.60 view was based on a drift lower in international product prices over coming months. It has happened all in one go. So we stay at \$6.60 for now, but note the balance of risks around our view have suddenly become a touch slanted to the downside having been tilted to the upside over recent months.

It is still very early days in the dairy season. For all the negatives in today's auction, it is worth noting that prices often drop in June and July on seasonal grounds so we wouldn't over react to one auction result especially with recent signs that global milk supply growth has been generally underwhelming. EU milk production has not been as strong as it might have been through the Northern Hemisphere peak season. Drought in Ireland is restricting milk production, likewise in Argentina. And US milk production has been sluggish with unhelpful farm economics. NZ's production this season will be important for where prices ultimately track.

It is also important to note that the NZD has weakened over recent weeks offering support to prices expressed in NZ dollars – the ones that matter for the milk price. NZD/USD was down more than 2% since the previous mid-June auction, taking the edge off the drop in international prices.

Lower NZD Softens The Blow



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