

18 October 2017

Dairy Dip

- **Dairy prices ease at auction**
- **Skim milk powder prices slump further**
- **As EU considers what to do with its stockpile**
- **We tab down our 2017/18 milk price forecast to \$6.30**

The GDT Price Index fell 1% at auction overnight, to be down 5.1% since a recent peak back in June. There was no bounce back from the possible dent from China's Golden Week holiday at the previous early-October auction. Even if that event did have some influence, other news over recent weeks has put clear downward pressure on international prices dimming the outlook for milk prices in NZ.

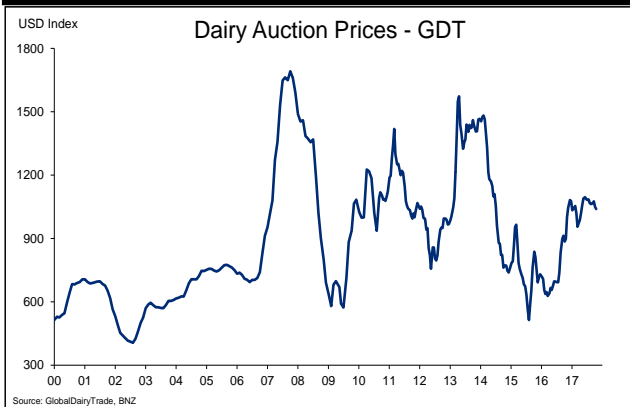
The news includes buying being halted at the EU intervention scheme, talk of unwinding its existing massive stockpile (that stands not far shy of 400,000 T) and altering how the mechanism will work in future that could remove the previous price floor. Skim milk powder (SMP) prices have fallen further from already low levels. SMP prices sank 5.6% at today's auction, to their lowest

level since May last year. Prices have not been helped by rising EU milk supply and forecasts of further gains next year. In its latest short term outlook, the European Commission forecasts EU milk production to lift 1.2% in 2018 after growing 0.4% in 2017. SMP prices look set to remain weak for some time. EU milk supply and treatment of the SMP stockpile remain important factors for the price outlook.

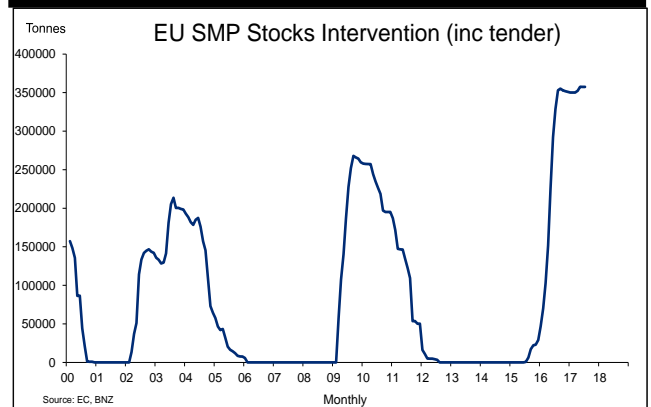
Meanwhile, whole milk powder (WMP) prices eased 0.5% at today's auction, with average prices sitting at \$US3,014/T. WMP prices did rise 1.8% for the December 2017 contract period, likely reflecting a slow start to NZ milk production this season as well as Chinese buying to take advantage of the upcoming usual lower import tariff rates at the start of the calendar year as part of the NZ-China FTA. But WMP prices for longer dated contracts fell by circa 3% to around \$US2,900/T, providing a generally softer hue to the product's prices overall.

Overall, the general level of dairy prices at this auction combined with an NZD/USD hanging around in the low

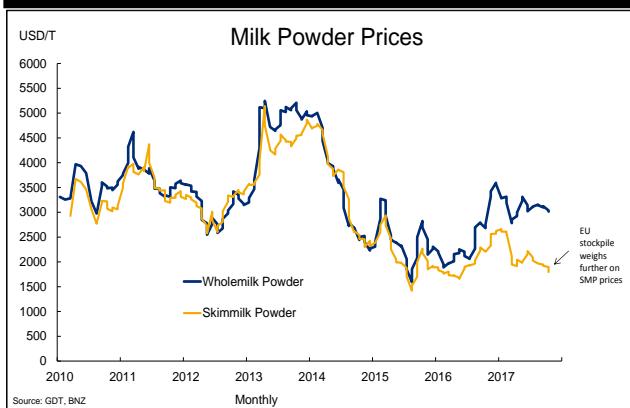
Dairy Prices Easing



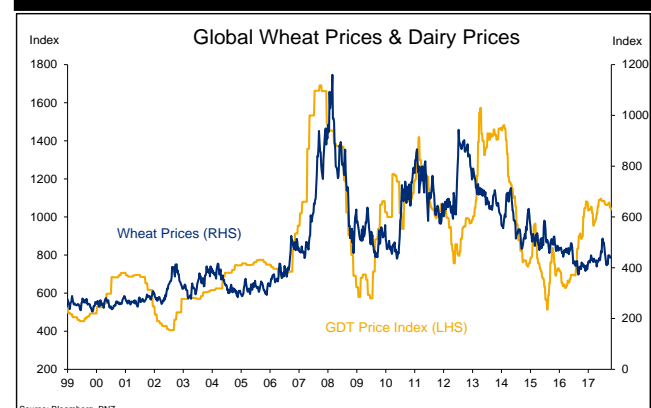
Big Stock



SMP Very Weak



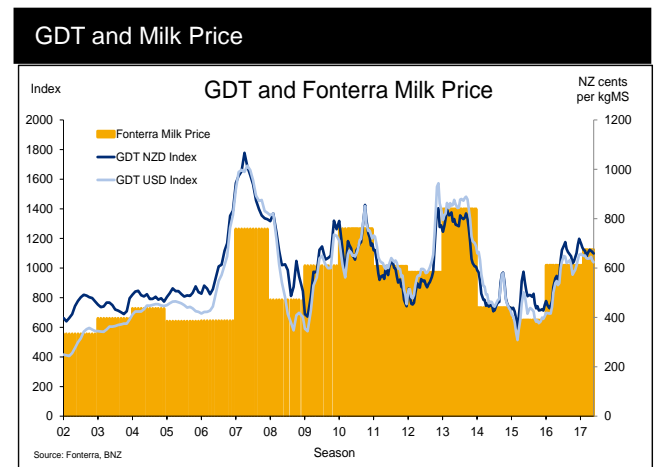
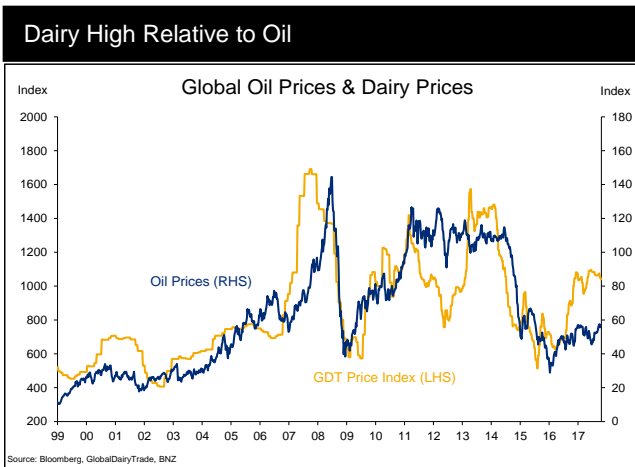
Dairy High Relative To Grains



70s makes forecasts for Fonterra’s milk price of \$6.75 for the 2017/18 season more tenuous. If current market conditions were to persist for the remainder of the season, our calculations suggest the milk price would be around \$6.40. Even that may prove a bit on the high side given the potential downward price pressure stemming from the EU and the fact that dairy prices still look a bit stretched relative to international oil and grain prices. US milk production continues to rise. Strong milk fat prices (albeit with signs they will soften ahead) have not been enough to offset the decline in powder prices. All this sees us tab down our milk price forecast to \$6.30 from

the \$6.75 we had nudged it up to a couple of months ago. Something a bit lower is possible on the EU news, while something higher is possible, if NZ milk production continues to lag last year, and Chinese demand was to prove strong over coming months. We think \$6.30 currently sits more comfortably in the middle of a wide range of possible outcomes. An outcome of \$6.30 would still see this season’s milk price comfortably above the previous season’s final milk price of \$6.12.

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