

War, what is it good for?

- Dairy prices sunk further in overnight auction.
- As we suspect the effects of lower Russian demand and its import ban start to weigh on global dairy markets.
- Following this result, we have moved our \$5.80/kg milk price forecast to “under review”.

Global dairy markets remain under pressure. Earlier in the year, bumper production drove down prices. Now we suspect the effects of the Russian dairy import ban as well as the slumping Russian economy are helping sink dairy prices further.

We had expected that NZ could stand to benefit from the Russian import ban. Russia banned our two biggest dairy export competitors, the EU and US (plus Australia), from its dairy markets. NZ was spared from the ban and some commentators expected that Russia would look to us to fill the dairy gap.

As it turns out, markets have anticipated that extra European milk, in particular, will hit markets soon. No doubt markets were tipped off by the European Milk Board’s call for voluntary production cuts amongst other things. As a result, the prices for key EU exports such as cheddar and SMP have fallen hard over recent auctions.

The Russian economy is also in a tailspin. The Russian rouble has fallen 10% against the USD since the end of June, increasing the price of imports. This will hurt Russian demand, including for dairy. In this respect, war is most definitely bad for business.

Auction Results

Stream	Product	% change in index since last event	Annual % change in index	Weighted Average Price US\$/MT
Milk Powder Stream	Whole Milk Powder (WMP)	-4.3%	-46.8%	2,673
	Skim Milk Powder (SMP)	-9.5%	-42.3%	2,600
	Anhydrous Milk Fat (AMF)	-5.8%	-33.8%	3,360
Mixed Stream	Butter	-5.6%	-20.5%	2,753
	Butter Milk Powder (BMP)	-12.9%	-26.4%	3,174
Cheese & Casein Stream	Cheddar	-4.9%	-18.5%	3,275
	Casein	-14.3%	-12.7%	8,232
GDT Price Index		-6.0%	-42.2%	n.a.

Detail

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Dairy prices fell across the board in last night’s auction. Overall prices were down 6.0%, with all of the seven main products we monitor posting falls.

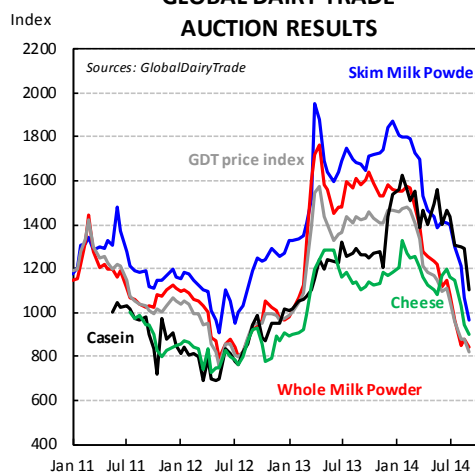
Overall prices now stand 42.2% lower than a year ago. Since the most recent peak in February of this year, overall prices are down 44.5%, and over this period, prices have fallen in 13 out of 14 auctions.

SMP, BMP and casein posted the biggest falls, dropping 9.5%, 12.9% and 14.3% respectively. Meanwhile, WMP fell 4.3% and the other products recorded falls in the 5% to 6% range.

We suspect the Russian import ban may be putting pressure on prices

SMP and cheddar have fallen hard of late; we suspect the Russian import ban may be putting more pressure on prices for these products which have strong European supply relative to NZ-dominated products (WMP and AMF). Note EU products have been banned by Russia, but NZ products have not; plus NZ is not a big Russian

GLOBAL DAIRY TRADE AUCTION RESULTS



Both SMP and cheddar prices have fallen in excess of 20%

supplier, while the EU is. For most of the year to date, SMP prices have been above WMP, but this has reversed rapidly. Both SMP and cheddar prices have fallen in excess of 20% over the last three auctions.

It appears markets have driven prices down in anticipation of extra European product.

First up, we had expected that the Russian import ban of EU, US and Australian dairy products would translate into demand for NZ products and thus support prices. Then second, we expected that European milk would end up in our key export markets and prices would come under pressure. On the evidence from this auction, it appears markets have jumped to the second stage of this process, and driven prices down in anticipation of extra European product.

WMP forward prices continue to point to future price support, but at the expense of short-term weakness. For example, WMP contracts for delivery in 2 and 4 months' time fell between \$120 and \$140 from the previous auction, while prices for later-dated contracts were largely unchanged.

WMP prices appear to be holding up better than SMP at this stage. In terms of the milk price, WMP has a weighting of slightly above 60%, while for SMP the weighting is around 20%.

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The Russian developments have spooked the market, adding to volatility. Near-dated contract prices, in particular, have borne the brunt. However, with later-dated contracts holding up better, we are reluctant to fully build in this price weakness.

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Russian developments aside, the market appears to have ample supply currently, but less so further out. This remains consistent with our long-held view that global supply will tighten over the next year, at the same time that global demand should firm. That said, with roughly a quarter of the season's prices now set, this season's price recovery is quickly running out of time.

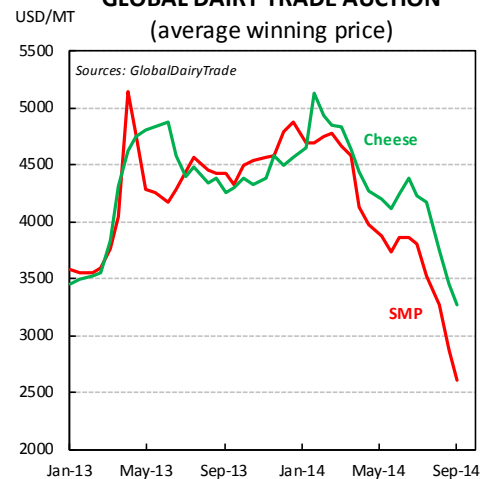
We maintain our forecast for the 2014/15 season at \$5.80/kg.

Implications

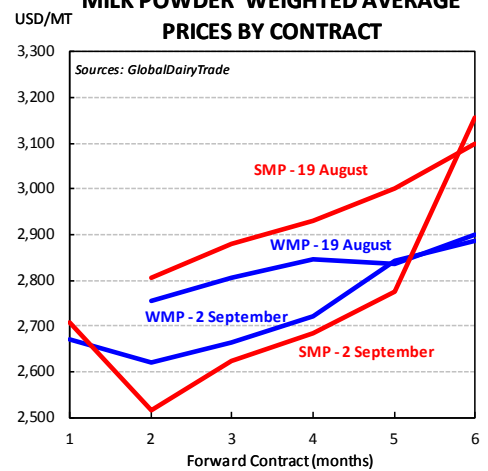
The risks to our \$5.80/kg milk price have clearly moved to the downside. Indeed, the risks are even more obviously down for Fonterra's \$6.00/kg forecast, which Fonterra reaffirmed just last week.

All up, we maintain our forecast for the 2014/15 season at \$5.80/kg of milk solids. However at this juncture, we move our forecast to "under review" and keep a watchful eye on upcoming dairy auctions and other dairy market developments.

GLOBAL DAIRY TRADE AUCTION
(average winning price)



MILK POWDER WEIGHTED AVERAGE PRICES BY CONTRACT



	2013/14		2014/15	
	Fonterra	ASB	Fonterra	ASB
Milk Price*	\$8.40	\$8.40	\$6.00	\$5.80

* per kg of milk solids

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