

## GlobalDairyTrade Auction

22 January 2014

- Dairy prices lifted 1.4% on a trade-weighted basis at the latest GlobalDairyTrade event.
- Powder prices were the laggards, with the WMP index up 0.1% and the SMP index down 0.5%.
- In contrast, other product price indices were up between 2.2% and 10.8%.

### Event Results

	% change in index since last event	Annual % change in index	Weighted Average Price US\$/MT
Whole Milk Powder (WMP)	0.1%	53.7%	4,943
Skim Milk Powder (SMP)	-0.5%	35.6%	4,698
Anhydrous Milk Fat (AMF)	2.2%	72.5%	5,641
Butter	10.8%	n.a.	4,657
Butter Milk Powder (BMP)	3.0%	53.8%	5,244
Milk Protein Conc.	7.2%	39.4%	9,657
Cheddar	10.4%	47.0%	5,133
Casein	4.2%	59.4%	12,390
GDT Price Index	1.4%	46.9%	n.a.

### Comment

The latest GlobalDairyTrade Event was encouraging. Prices achieved were strong across the board, and importantly, there appears to be a convergence in product prices, which, if it continues, may be more favourable to Fonterra's current production capacity.

Fonterra noted in December that the divergence in prices between powders and other products left the forecast milk price effectively stuck at \$8.30 per kg of milk solids. Fonterra's *cheese and casein stream* was lagging behind its *milk powders stream*, where extremely high prices have been recorded, but production was at full capacity.

In effect, this means that further gains in milk powder prices cannot be passed on to farmers, but price gains in cheese and casein potentially could. With this in mind, our focus has been on to the relative prices of Fonterra's two streams at recent events:

The mix of price changes in latest event are encouraging, shown in the results table above.

1. **Milk powders stream** (green section of the results table); and
2. **Cheese and casein (and the rest) stream** (the red section of the results table).

Note: the orange section includes products which span both streams.

The *cheese and casein stream* products all posted large gains, with casein rising 4.2% after posting a 7.3% gain a fortnight ago. And cheddar gained 10.4% after lifting a more modest 1% at the previous event. In contrast, the *milk powders stream* products were a mixed bag again. WHP and AMF posted gains of 0.1% and 2.2% respectively, while SMP posted a 0.5% fall. The convergence in prices is captured in the chart of prices over the season to date shown in the first chart below.

However, it is worth noting all prices in this stream remain elevated, albeit slightly down on the peaks of early 2013 in the case of SMP and WMP, as seen in the same chart with an extended time period (chart 2).

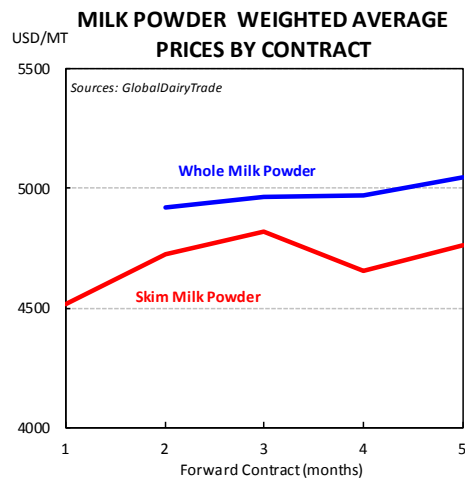
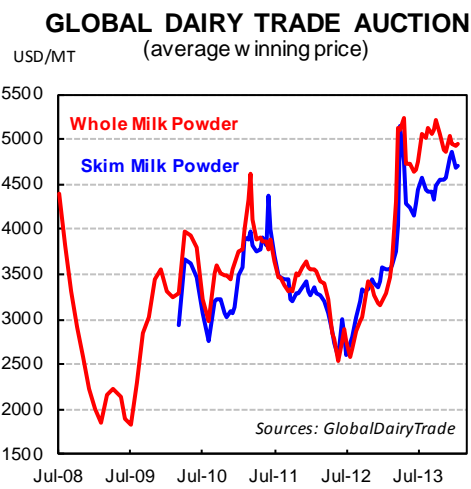
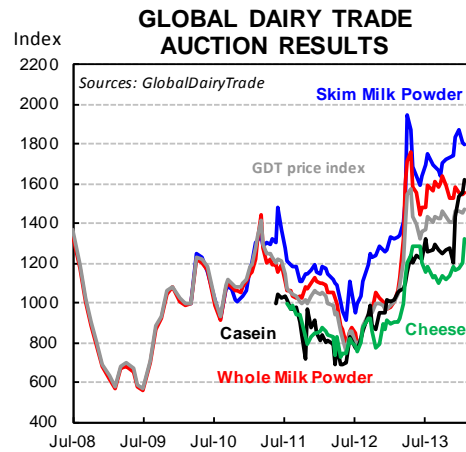
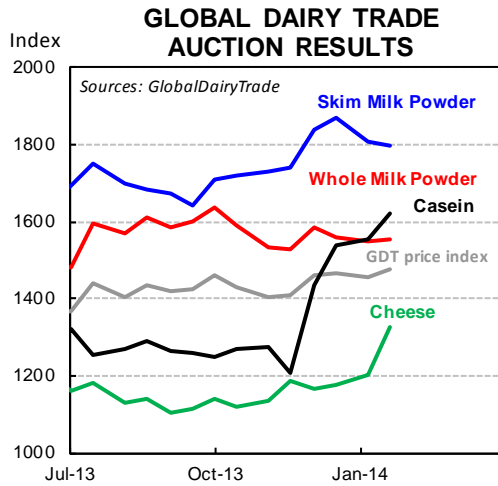
Within the powder auction results, the prices for the longer-term contracts provide further encouragement (Charts 3- 4). While SMP prices dipped modestly for contracts 1 and 2 (February and March 2014 delivery), prices rose for contracts 3-6 (delivery out to July 2014). WMP price changes were mixed across the four contracts traded. However, for both WMP and SMP, prices rise from the short-dated contracts out to the long-dated contracts, suggesting that buyers expect the market to remain fairly tight at the tail end of the southern hemisphere season.

WMP forward contracts show the weighted average price for New Zealand products rising from around \$4,900 for delivery in two months' time to \$5,050 for delivery in five months' time. SMP prices show the weighted average price for New Zealand products rising from around \$4,500 for delivery in one month's time to \$4,700 for delivery in six months' time.

Overall, dairy markets remain tight and prices are well-supported. Fonterra's milk powder production constraints have added to the tightness.

In its December update, Fonterra forecast 6% growth over this season. With reasonable summer rain to date, we see some upside risk to this forecast. And production at the tail end of the season may be able to be channeled into powders (if that remains the best strategy) as total processing volumes decline. In this vein, the convergence in prices that appears to be starting is also favourable.

Overall, the dairy markets remain very robust. This season's production continues to look favourable, and price signals encouraging. Accordingly, we continue to think the prospects for 2014 dairy sector income remain solid.



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