

From the Trading Floor

KEY MARKET DRIVERS

- Time for hard decisions in the Dairy Industry
- US Cheese and Butter remain strong relative to rest of the world
- 66% of infant going into China is European origin
- Would farmers outside USA embrace 'hedging tools'?

- Latest "Recovery" forecasts are coming out and without looking I would bet that the recovery is 6 months awaythe same as it has been for the last two years. At the end of the day demand around the world remains OK but still subdued compared to previous exuberant buying. So if there is going to be a price recovery, it must be due to a material correction on milk supply in some big producing regions (note plural) = NZ / E.U. / USA or China. Until such time that commentators can point to an actual real reduction in milk supply, (not just a forecasted reduction in milk that never really eventuates) we will continue to swim in an oversupply of milk and pricing will hover at these low levels. So barring weather or disease events, which are both by nature unpredictable, the focus is on milk pricing around the world as that is the real trigger available to reduce milk production.
- Despite recent falls, the US Cheese and Butter pricing remains at a large premium to the rest of the world. Such is the domestic demand and relative protection from imports (outside strict quotas) these two markets can operate at a disconnect from the rest of the world for prolonged periods. The only situation that would force pricing down to world levels is if US domestic inventories get to unmanageable levels. The monthly storage reports become increasingly critical data points.
- Despite the focus and noise around Infant formula production in Oceania (new start-ups and expansion of existing production) with the huge Chinese market being target number 1. It remains a fact that the biggest source of infant formula into China is of European origin. Representing nearly 66% of imports into China. These are long established brands who will not give up their market share easily. Therefore the new entrants will have a tough battle ahead to displace that existing status-quo.
- USA USA farmers have had the ability to hedge their milk supply (lock in pricing for a fixed period) now since 1996. New Zealand are about to launch a Milk price futures market which settles against the Fonterra milk price (settles once a year), replacing the Guaranteed Milk Price program that had been in place. This will enable farmers to lock in their milk price for up to 3 years. Farmer price risk management is a good and necessary thing for the global dairy industry – it gives farmers margin stability and it can then give customers input cost stability. However, our experience has been farmers in Oceania are interested but sometimes slow to embrace hedging tools on milk, and likewise processors find it difficult to build price risk management tools for their farmers. It will be interesting to watch on whether and how quickly this hedging mechanism will be embraced – in the US it is now second nature, and in the EU interest is growing quickly.

Matt Cooper, Director, Ausfine Foods

DAIRY FUTURES

15-Feb	SMP	NDM	WMP	Cheese	AMF	Butter
Exchange	NZX	CME	NZX	CME	NZX	CME
Feb-16	1,730	1,693	1,815	3,362	3,325	4,731
Mar-16	1,650	1,742	1,745	3,395	3,350	4,701
Apr-16	1,700	1,745	1,785	3,397	3,280	4,739
May-16	1,675	1,768	1,870	3,411	3,300	4,739
Jun-16	1,695	1,808	1,980	3,494	3,325	4,739
Jul-16	1,700	1,841	2,100	3,580	3,350	4,718
Change	-2%	-1%	-3%	0%	-3%	-3%
Op interest	2,361	5,579	15,413	19,919	404	4,050

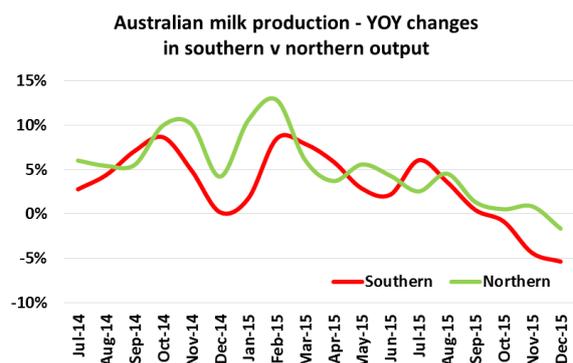
FUTURES by Scott.Briggs - sbriggs@ausfine.com

NZX dairy futures for WMP and SMP were pointing to 10% down going into this week's event – so with WMP coming in better than that, we have finally seen some green on the NZX futures market for the first time in a few months. Buyers seem to be comfortable buying Q2 in around these \$1800-1900/t levels, with patient demand for Q3-4 closer to \$2000-2100/t. EEX SMP futures have rallied a little over the last month, despite a fairly weak outlook – key point being that the Euro has rallied the best part of 7-8%. Finally, US futures markets seem to be slowly ticking down, with the idea setting in that the US will have a strong flush but had already built high cheese stock levels.

AUSTRALIAN INDUSTRY NEWS

Milk forecast lowered

In its February Situation & Outlook Report, Dairy Australia (DA) forecasts 2015/16 milk season output to be 1%-2% lower than the previous season. As well as lower farmgate prices, higher feed and water costs due to dry weather; and attractive beef returns which have encouraged cow culling. DA reported December milk output was down 4.5% with season to date output 0.2% behind the previous season.



Another milk powder project

Blue Lake Dairy Group, which has Chinese links is reportedly planning a new powder plant for SE South Australia. If realised it would be the second plant slated in the south-east of the state as Midfield Group is building a plant at Penola to produce up to 30,000t of milk powder per year.

Weather highlights

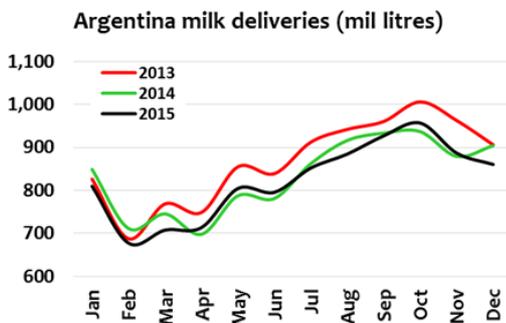
- In Australia, showers across eastern parts of NSW, VIC dry with possible showers in the weekend.
- In NZ, heavy northerly rain in western and northern parts of both islands. Strong north to northwest winds with severe northerly gales in north Canterbury.
- In the US, warm and dry across California, with the east coast still dealing with the ramifications of flooding rain and severe thunderstorms.
- Possible thunderstorms and chances of precipitation in Brazil's south. Dry across central regions of Argentina's Pampas.
- Rising temperatures across central Europe as winter wears off, chances of rain across northern central Europe late in the week.

Fonterra Jan intake down just 2%

Fonterra's milk collection in January 2016 showed that improving production conditions continued to sustain milk flows well above expectations, with plant intakes just 2% lower than the same month in 2015. While North Island plants collections were 6% lower, South Island intakes were 4% higher, now on a par for the year-to-date with the prior year. The likely net effect for all NZ processors is expected to be at or less than 0.5% lower for the month than the comparative..

Argentina's milk output dipped in Dec

After months of bouncing around the comparative, December's milk flow in Argentina dipped 5% below the prior year, pulling the annual result down by 1.2%.



US milk forecast up

The latest USDA WASDE report has revised its milk production forecast for 2016 up by 1.6% from last month's forecast. The milk price forecast has been revised down to US\$15.30-US\$16/cwt from US\$15.35-US\$16.15/cwt.

Butter price forecasts were raised as domestic demand remains strong and cheese prices are unchanged. The NFDM and whey price forecasts have been lowered as the US prices of these products reflect weakness in international markets. The lowered commodity prices reflect the pressure on these products due to large global supplies and a strong US\$.

Milk stronger in EU states

The latest report on German milk production from the last week of January, saw milk tracking 4.7% ahead of the same week last year and 2.4% higher than same week in 2014. Meanwhile, indications are that Irish output will continue to be well ahead (more than 25% up in a seasonally low month) when January numbers are eventually reported by the Commission. Irish co-op Glanbia recently announced its January payout remains at 25c/l, with 1c support payment to members.

GDT falls further

The GDT price index dropped 2.8% at this week's auction, making it the fourth consecutive auction where prices have weakened. A total of 22,021t of products was offered at the auction, which falls well under the 12-month average of 28,836t.

Cheddar and WMP prices declined 9.7% (to US\$2,535) and 3.2% (to US\$1,890/t), respectively. SMP shed 1.7% (to US\$1,762) and butter lost 2.4% (to US\$2,834). Rennet casein average weighted price fell 11.7% (to US\$3,852). The only commodity to increase its average weighted price was AMF by 1.2% (to US\$3,527).

