

## From the Trading Floor

### KEY MARKET DRIVERS

- E.U. Extends intervention to Feb 2017 / Proposes to incentivise to reduce production
  - US Mid-West stare down the barrel of "Dome of Doom"
  - Kiwi milk down big in June but condition reports look good for start of new season
  - Rumblings of milk pricing change in Australia continue
- The E.U. Commission has announced a €500 million agricultural aid package which includes a significant focus on the E.U. Dairy industry. Part of the package is an extension on the intervention buying program through to February 2017. The volume cap is now extended to 350,000MT, volumes are currently sitting around the 250,000MT. Interestingly close to 10,000MT of SMP continued to flow into the program last week despite reports that market pricing is now above intervention pricing levels. Also in the aid package was a €150 million package allocated toward creating an incentive to reduce production, i.e. Get paid to not produce milk.
  - US residents in the Mid-West are being warned of a looming "Dome of Doom", which is a band of extreme hot weather due to set-up camp over the middle of the country for the next few days. Interestingly you would expect a sharp rise in Corn & Soy Bean prices on that news, especially at such an important time of the growing season, but the opposite has happened with prices for both grain types sharply lower. Probably because of the rain that is forecast to arrive in behind the hot weather, but "Dome of Doom with a nice cool change" doesn't sound nearly as cool.
  - Our Kiwi friends have reported a sharp YoY drop in milk for June. Down 10.5% from 2014/15 season. However important to note this is at winter low production and relatively small differences in volumes can have a large effect in percentage terms. All reports we are hearing from across the ditch are that the winter has been relatively mild to date with good rain fall. Indicating very good conditions are on hand for the beginning of the new season which officially kicks off on in early August.
  - Further to the opinion piece we have published previously there continues to be a rumbling of discontent from farmers and industry players here in Australia around how milk is priced and the need for a risk mitigation tool (Futures / derivative trading). We have reports from a number of different bodies and groups who are looking to formulate different structures which provide greater autonomy to farmers in the way their milk is priced and to establish a settlement mechanism that would allow milk futures / options to be traded.

**Matt Cooper, Director, Ausfine Foods**

### FUTURES

- We have seen quite a lot of trade over the previous 2 weeks in the NZX futures for WMP and SMP. There seems to be a reasonably strong but patient buyer of WMP for Q1 ETA, between \$2200-2300 FAS, which is likely aligned to the China FTA window. At the same time, there are a few reasonably active sellers: with the physical market fairly quiet at the moment for Q4 ETD, as buyers and sellers seem to be about \$200 apart, NZ/AU WMP sales books are likely going to need to get more active in the next 6 weeks and it looks as though 1 or 2 parties are using the futures to do so.
- The SMP market has also built a "premium for risk" in Q4, on the back of declining milk growth and the impact of intervention in the EU. That said, spot markets are stuck around the intervention equivalent levels (+/- \$50) and struggling to move, which means this risk premium may dissipate as we move into Q4.
- An outstanding launch for the NZX milk future, which is linked to the Fonterra NZ milk price and gives farmers an opportunity to hedge their milk price and get on with the business of farming to budget. Open interest (total amount of open hedging) is now over 3m kgMS, or about 30,000MT of WMP equivalent

**Scott Briggs, Derivatives Trading Manager, Ausfine Foods**

## DAIRY EXPORT INDEX

**Index stabilises** – The dairy export index declined marginally last week, down 0.1%. Commodity prices were all unchanged. For its second consecutive week, WMP remained at US\$2,050/t, having dropped the week prior. Butter prices remained at US\$2,950/t, while SMP sat at US\$1,950/t for its fourth consecutive week. Mirroring SMP, cheddar was priced at US\$2,900/t for the fourth week in a row. The A\$ rose marginally to **US\$0.758**, shaving the index by **0.16** points to **146.87**.

Australasian dairy export index (Jan 2011-now)



## AUSTRALIAN INDUSTRY NEWS

### Chinese firm lifts MG stake

Chinese government-owned NG Fung Ltd has raised its stake in Murray Goulburn for the third time in six weeks, to 7.1% following the purchase of more than two million units in steady trading since 17 June. With its purchase, NG Fung Ltd has 14.5m units MG securities following a substantial investment in the MG trust when it floated last year.

The Hong Kong based company is part of a large global integrated food group, spanning rice production, food research and development, production, processing, wholesale, retail, transportation and international trade. NG Fung may sense a bargain – MGUT units were quoted at \$1.29 earlier this week, steadily climbing off a floor of 82.5c in mid-May.

### Rabo: Return to profit next year

Rabobank senior analyst Michael Harvey predicts that dairy farmers will be profitable in 2017/18, however, Australian production will slump 3% this season.

Harvey says flexibility is key to producing milk in Australia now with low costs and pasture allowing farmers to strip costs in downturns. While New Zealand colleagues heading into their third year of low prices have reduced costs by an estimated NZ\$1.50/kgMS, variable seasons and domestic market requirements for flat milk production limit the ability of Australian farmers to follow suit.

## Weather highlights

- In Australia, rain across eastern Victoria early in the week.
- In NZ, rain is spreading in the north of the North Island and across the South Island.
- Warm and dry across California, possibility of thunderstorms across the Midwest late in the week.
- Hot and dry in central Brazil, possible rain further south. Rain over the weekend in northern parts of Argentina moving further south next week.
- Rain in the Netherlands all week, southern Germany warm with chances of rain by the end of the week.

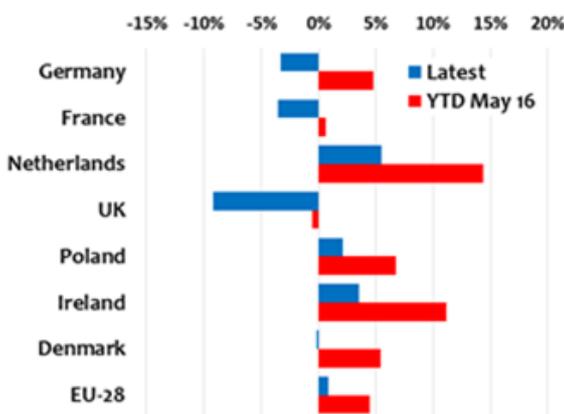
## Fonterra's NZ intake down in June

According to the latest Global Dairy Update, total Fonterra New Zealand milk collection declined 10.4% YOY in the lowest production month of June to 9.9m kgMS from 11.1m kgMS last year. The South Island saw a 22.3% fall while the North Island recorded a 6.1% decline relative to the same month in 2015. Fonterra exported 215,000t of dairy products in June with more ingredient sales direct to customers, and announced it has reduced inventories by 11% since this time last year.

## Cuts in EU milk output getting deeper

Official Eurostat figures indicate EU-28 milk production increased 0.8% YOY in May, down from a 1.7% YOY growth in April. Latest data indicates further slowing, UK deliveries were down 9.2% for the two weeks ending July 2. German and French production is also falling, down 3.3% and 3.5% YOY in the last week of June respectively. Our local intel indicates Dutch production is up 5.5% YOY in June, while Irish June deliveries are up in the 1-6% YOY range across the major processors with Glanbia supplies up 4% and Dairygold reportedly up 2%.

EU-28 YOY milk output growth



## Argentinian WMP exports decline

During the first five months of the year, Argentinean exports of WMP fell 5% relative to the same period in 2015, a difference of 2,910t. Over the same period, butter and SMP shipments were also down, 53% and 11%

respectively. Cheese and whey exports rose however, up 12% and 5% to 19,055t and 25,298t respectively.

## US fluid milk sales flat

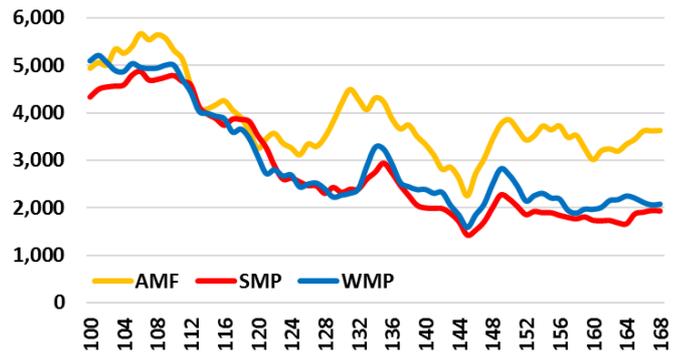
In the three months to May, total fluid milk sales had improved to be flat against a year earlier, falling just 0.1% relative to the comparative. In each of the last three months for which data is available, total fluid milk sales posted a near-flat result. Total organic milk product sales rose 5.4% YTD while total conventional product sales fell 0.6% over the period.

## GDT flat, despite WMP improvement

There was no change in the GDT price index this week, on a slightly smaller offering than the previous event of 31,348t. This is still well up on the 10 auction average of 22,656t.

The weighted average WMP price improved by 0.8% to US\$2,079/t, after weakening at the previous three auctions. Conversely, SMP was 0.6% lower at US\$1,927/t after improving in the past three events. The average weighted butter price fell 5% to US\$2,687/t, while AMF edged up 0.2% to US\$3,628/t.

GDT weighted average auction prices by event, US\$/t



## DAIRY FUTURES

Futures mixed – CME futures continue to outperform NZX, although the butter curve is weakening in December and January.

	20-Jul	SMP	NDM	WMP	Cheese	AMF	Butter
Exchange	NZX	CME	NZX	CME	NZX	CME	
Aug-16	1,960	2,030	2,040	3,880	3,780	5,237	
Sep-16	2,050	2,108	2,130	3,880	3,810	5,280	
Oct-16	2,120	2,172	2,250	3,880	3,830	5,291	
Nov-16	2,135	2,218	2,280	3,834	3,830	5,224	
Dec-16	2,180	2,264	2,345	3,774	3,835	4,982	
Jan-16	2,235	2,381	2,380	3,721	3,700	4,717	
Change	-1%	2%	-1%	4%	0%	3%	
Op interest	4,418	4,360	16,976	21,687	604	4,553	