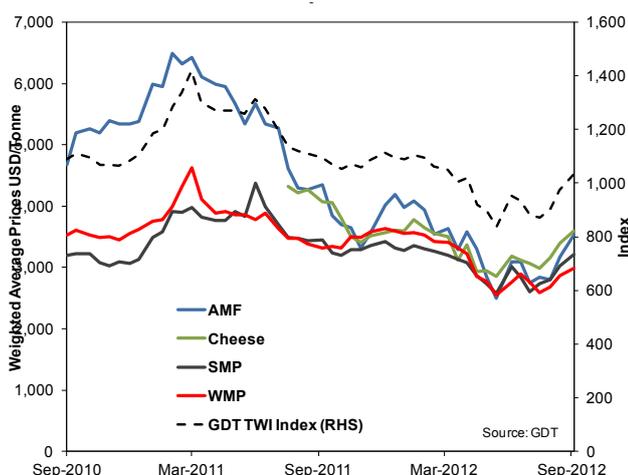




Fortnightly Dairy Update

5 September 2012

GDT Dairy Auction Prices



	Change since last auction	Price index USD/Tonne
Anhydrous Milk Fat	11.8%	\$3,530
Butter Milk Power	15.8%	\$3,091
Cheddar	5.3%	\$3,593
Skim Milk Powder	7.5%	\$3,211
Whole Milk Powder	4.3%	\$2,978
TWI (All Products)	6.0%	

Westpac Payout Forecasts

	2011/12(f)	2012/13(f)	2013/14(f)
Payout (before retentions)	\$6.55	\$5.70	\$6.40

Dairy prices continued to climb in last night's GlobalDairyTrade auction. On a trade-weighted basis prices were up a healthy 6%. Higher prices were recorded for all products on offer including a 7.5% lift in SMP prices and a 4.3% increase in WMP prices. On a trade-weighted basis, prices have now risen in each of the last three auctions and are now 23% above the low point in May 2012.

But for Fonterra improving prices in recent auctions haven't been enough to entirely offset NZD strength and the weakness in dairy prices observed earlier in the year. Consequently last week Fonterra lowered its total payout forecast by 30c for the current 2012/13 season, with the strength of the NZD shouldering much of the blame. Fonterra is now forecasting a total payout of \$5.65-5.75/kg (comprising a \$5.25 milk price and 40-50c distributable profit). This is consistent with Westpac's own forecasts of Fonterra's payout for the 2012/13 season which, at \$5.70, had until the downgrade been below Fonterra's forecasts.

The recent improvement in dairy prices has at least in part been driven by expectations of slower growth in global supply. There has been very little improvement in US conditions, with the latest US drought monitor update reporting 85% of the corn crop, 63% of hay and 71% of cattle areas experiencing drought, which has led to both reduced yields and earlier harvests. And adverse

weather conditions haven't just been restricted to the US. Dry weather and deteriorating crop prospects have also hit parts of Russia, Ukraine and Kazakhstan (with the area an important global wheat exporter). This has raised fears of the possibility that Russia will limit wheat exports in order to protect domestic supplies (as it did a couple of years ago). To date, however, the Russian government has denied any intention to do so. Nonetheless, grain prices remain at very high levels, which will be pushing up feed costs for dairy producers and is likely to slow growth in supply.

Slower growth in global milk supply combined with expected stronger growth in China next year mean we expect to see dairy prices eventually gradually improve further (though perhaps not quite at the same pace we have seen of late).

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