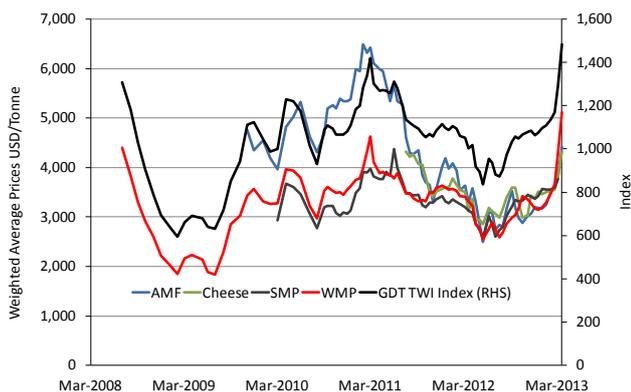




Fortnightly Dairy Update

20 March 2013

GlobalDairyTrade Dairy Auction Prices



Summary

Dairy prices surged to record levels in Tuesday night's GlobalDairyTrade auction as drought hit local milk production. Rising prices have the potential to reduce (but not eliminate) the negative impact of drought on GDP.

Overall, dairy prices rose 14.8% on a trade-weighted basis in the Tuesday night auction. This increase took dairy prices to the highest level in the 5-year history of the GlobalDairyTrade auctions.

Drought in the North Island is slowing milk production rapidly, forcing dairy prices upwards for now. That said, rain has been recorded in recent days, though not at levels enough to break the drought.

We see room for dairy prices to head up further over the first half of 2013. The tight supply conditions in New Zealand induced by drought, coupled with improving Asian growth, particularly in China, are providing significant, although temporary, upward pressure on dairy prices. As we expect the NZD to average US\$0.85 over 2013 (from the US\$0.83 currently), prices should also improve in NZD terms, albeit more modestly.

Implications

With dairy prices at these levels there are upside risks to our Fonterra payout forecast (mainly to the milk price forecasts). With this in mind, we will be watching milk production data and price movements over the next few auctions closely.

In turn, any increase in the milk price component of the payout will reduce the drought impact on GDP relative to official estimates. The Minister of Finance released estimates earlier in the week, showing a drought impact of between 0.5 and 1.0 percentage points of GDP.

Production falling rapidly

Turning to our milk production estimates for the season. We estimate that 2012/13 milk solids production may be equal to the

	Change since last auction	Price index USD/Tonne
Anhydrous Milk Fat (AMF)	16.3%	\$4,416
Butter Milk Power (BMP)	8.6%	\$3,904
Cheddar	13.7%	\$4,315
Skim Milk Powder (SMP)	7.7%	\$4,050
Whole Milk Powder (WMP)	21.2%	\$5,116
TWI (All Products)	14.8%	

Westpac forecasts of Fonterra payout*

	2012/13	2013/14	2014/15
Total Payout*	\$6.10	\$6.40	\$6.70
Including:			
Milk Price	\$5.65	\$5.90	\$6.20
Earnings per share	\$0.45	\$0.50	\$0.50

* Before retentions for a fully shared-up farmer.

previous season or be as much as 2% down; we show the midpoint of this estimate (down 1%) in the chart below.

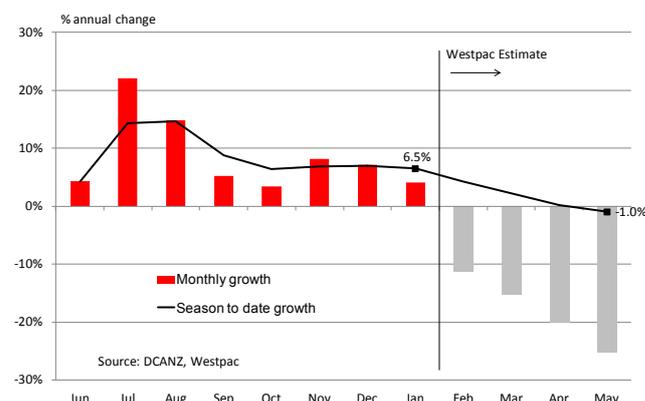
Despite January production data showing a 6.5% year to date increase compared to the same period last year, more up-to-date estimates suggest it's all downhill from there.

A wide range of results for the season remain possible, depending on when or if drought-ending rains come.

The long range weather forecasts for a return to average rainfall and soil moisture levels; if these forecasts pan out, we expect production to recover over the 2013/14 season.

Nathan Penny, Economist

2012/13 Milk Solids Production



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