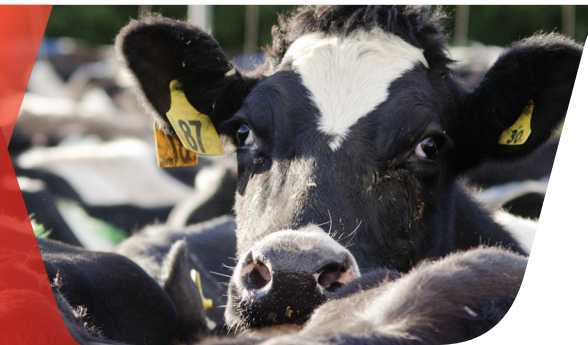


Dairy Update.

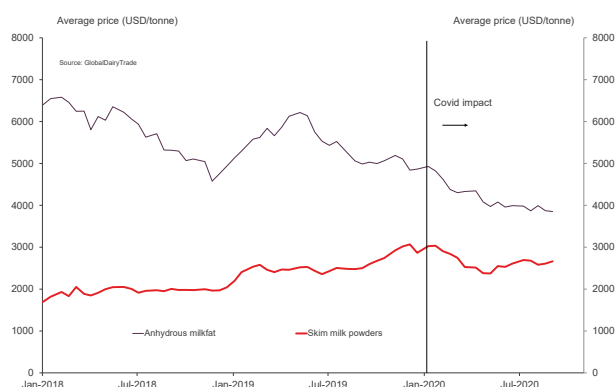
2 September 2020



Covid trims the fat.

- Dairy auction prices fell for the third successive auction overnight.
- We note that Covid-19 continues to weigh on prices, particularly for milk fat.
- At current levels prices remain consistent with our 2020/21 milk price forecast of \$6.50/kg, but we continue to highlight the risks to our forecast.

Milk fat and protein prices



Covid is literally trimming fat (prices).

A clear pattern has emerged in dairy commodity prices. That is, milk fat's price premium over protein has been trimmed.

We assert that Covid has been the key driver of this wedge. Chiefly, this owes to the fact that milk fats, or in lay terms creams and butters, are heavily exposed to restaurants, bakeries and other food service outlets. Think indulgent restaurant desserts and pastries! And Covid restrictions coupled with a general reluctance of people to eat out has reduced demand for these products.

Looking at the numbers, the pattern is clear. Anhydrous milk fat prices have dipped (over 20%) post-Covid and have shown no sign of rebounding. Moreover, anhydrous milk fat prices are now at their lowest level since mid-2016 or around about the time when butter and other milk fats began their renaissance. Recall that scientific evidence had shown that milk fats were not as unhealthy as previously feared and this had led to a resurgence in demand.

In contrast, protein numbers have proved more resilient. Skim milk powder prices also fell earlier in the year, but since May prices have rebounded and erased over half of the earlier price losses.

Together these observations suggest that the July surge in dairy prices was a largely an aberration. Or put differently, the July rebound was not a signal that dairy markets were returning to normal. Indeed, over coming months, we will look to milk fat prices for a more definitive sign that dairy prices have turned a corner.

At the same time, while overall dairy prices are down on year-ago levels, we expect that the worst of the Covid impact is over. On that basis, we are sticking with our 2020/21 milk price forecast of \$6.50/kg.

Nathan Penny, Senior Agri Economist

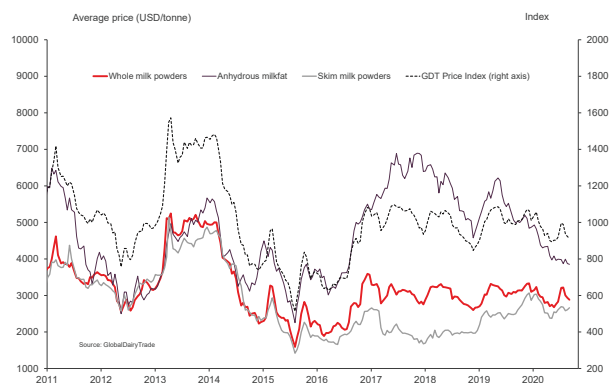
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GlobalDairyTrade Auction Results, 2 September 2020

| | Change since last auction | Prices USD/tonne |
|--------------------------|---------------------------|------------------|
| Whole Milk Powder (WMP) | -2.0% | \$2,884 |
| Skim Milk Powder (SMP) | 1.8% | \$2,663 |
| Anhydrous Milk Fat (AMF) | -0.5% | \$3,852 |
| Butter | -1.2% | \$3,334 |
| GDT Price Index | -1.0% | 913 |

Dairy prices



Farmgate milk price forecasts

| | 2019/20 | | 2020/21 | |
|------------|---------|---------------|---------|---------------|
| | Westpac | Fonterra | Westpac | Fonterra |
| Milk price | \$7.15 | \$7.10-\$7.20 | \$6.50 | \$5.90-\$6.90 |

Dairy auction results, 2 September.

Dairy auction prices fell for the third consecutive auction. Key WMP prices posted a 2.0% dip, while overall auction prices declined 1.0%.

WMP prices have now slipped 11.3% since the end of July, while overall prices have fallen nearly 8%. Prices remain below their pre-Covid levels after having wiped those price losses over July.

The divergence between protein and fat prices also continued. Skim milk powder prices (protein) lifted 1.8%, while butter and anhydrous milk fat prices dipped 1.2% and 0.5%, respectively.

Last night's 2.0% WMP price fall came as a surprise. We had pencilled in a circa 1% price rise, based essentially on what the dairy futures were showing.

We remain cautiously optimistic on the outlook, but risks remain high.

Despite the price fall overnight, current prices remain consistent with our \$6.50/kg milk price forecast for 2020/21. However, while we had allowed for prices to fall, we are running out of runway. In other words, if dairy prices continue to fall over coming auctions, noting that the largest auctions for the season are near, we will consider revising our milk price forecast lower.

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