

# Review of SMP UHT Results for TE207

Summary of Findings, 19 March 2018



## Introduction

On 8 March 2018, Global Dairy Trade (GDT) announced that it had initiated a review of certain aspects of Trading Event 207 conducted on 6 March 2018 (GMT) as a prudent step to provide continued assurance to market participants.

The review looked at the factors leading to price outcomes for Fonterra Skim Milk Powder (SMP) Ultra High Temperature (UHT) products in contract periods 1 – 3. The winning prices for these products ranged between:

- 46 – 61% higher than corresponding prices in the previous Trading Event;
- 48 – 69% higher than corresponding prices for Medium Heat, compared to the normal differential of around 4%.

## Review conclusions

Although the UHT price outcomes were unusual, the review found that the winning prices achieved in Trading Event 207 are consistent with the structure of the GDT Events trading platform which was designed to ensure that the price level for each product, and differences in prices across products, are determined by the interactions of demand and supply. As in any marketplace, the underlying factors can vary from product to product and from Trading Event to Trading Event.

A similar outcome occurred in June 2017 (Trading Event 190) when some UHT winning prices were more than 20% above Medium Heat prices.

The key finding of this review is that the price outcomes observed for UHT in Trading Event 207 reflect that multiple bidders had strong needs to secure higher quantities than offered in the Trading Event. GDT has also received feedback that contract execution will progress as normal between the successful buyers and the seller.

Other key conclusions regarding supply and demand conditions are as follows:

- The UHT supply quantities offered by Fonterra were consistent with previous Trading Events;
- In particular, in both absolute and percentage terms, the UHT supply quantities in Trading Event 207 were larger than was offered in Trading Event 206 and larger than at the same last year;
- The number of participating bidders on UHT was only slightly below the one-year average;
- First-round demand-to-supply bid ratios were somewhat higher than the three-year average but still within the normal range for UHT;
- The winning bidders are regular buyers with long histories of bidding on UHT at Trading Events;
- Their purchase quantities were comparable to their individual purchasing histories.

The review also concludes that:

- No evidence has been found to indicate a breach of the GDT Trading Event Rules by any of the relevant buyers, seller, Trading Manager or GDT;
- The Trading Manager followed standard operating procedure throughout the Trading Event;
- The price index change of +44.8% for SMP Contract Period 1 was calculated correctly;
- There was no connection between the unusual price outcomes for UHT and the delayed publication of prices on the GDT public website;
- The delayed publication was due to a technical issue on the public website, as reflected by the fact

that the UHT results were published without delay on GDT Insight and NZX dairy futures market (and with summary results available without delay to subscribers of our Email Alerts).

The conclusions of this review are based on reports from the Trading Manager, GDT's detailed analysis of Trading Event data, and feedback received from the relevant buyers and sellers. The report has been reviewed by Bill Shields as Chair, GDT Events Oversight Board.

Global Dairy Trade  
19 March 2018

## **ANNEX: Summary of Trading Event process**

This Annex provides a brief explanation of how announced prices and bidding demand evolved during Trading Event 207.

The discussion focuses on contract periods 2 and 3, where the supply quantity for UHT was less than the total SMP supply in each of those contract periods. (The trading process for contract period 1 was similar but differs in the details due to the full supply quantity of SMP Contract Period 1 being available as UHT product).

After a typical start to the Trading Event, bidding demand became concentrated on Medium Heat and UHT, with no sustained demand for the three other SMP products offered by Fonterra.

Demand for Medium Heat was moderate and became balanced with supply during the first 10 bidding rounds, at prices within  $\pm 2\%$  of their winning prices in the previous Trading Event for the relevant contract periods.

However, multiple bidders continued to bid on UHT, which led to the total demand for Fonterra SMP in the relevant contract periods falling below the available supply, while UHT remained oversubscribed.

Consistent with standard operating procedure, the Trading Manager used their discretion from round 10 to apply progressively larger price increments on UHT to reduce the chance of a prolonged Trading Event. Price increases could not be applied to Medium Heat as demand for this product had previously fallen below its supply and it had become subject to a rollback which remained in effect.

The GDT Events trading platform prevents individual bidders from submitting bid quantities that are larger than each product's supply. This means that no individual bidder can cause a product to be oversubscribed, and excess demand can only arise due to bids being submitted by two or more competing bidders.

Moreover, in any bidding round where a product's price has increased since the previous round, each bidder chooses whether to submit a new bid and what quantity they wish to bid.

With multiple bidders largely maintaining their demand for UHT as the Trading Event progressed, and with Medium Heat remaining subject to rollback, the prices for UHT in contract periods 2 and 3 diverged progressively further from their corresponding Medium Heat prices.

This process continued until round 22 where demand and supply were balanced for all products and the Trading Event could be closed.

End