ANZ Research

NZ Forecast Update: Farmgate milk price

24 March 2023

Contact

Susan Kilsby for more details.

Confused by acronyms or jargon? See a glossary here.

Milk price forecasts revised down further

Key points

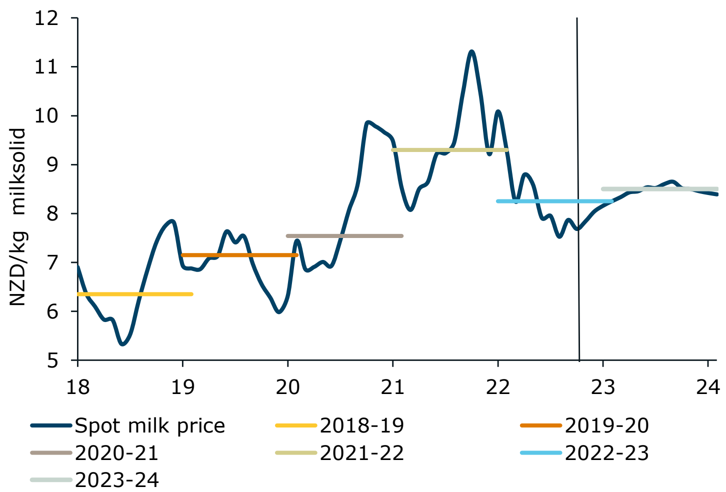
- We have revised down our farmgate milk price forecast for the 2022-23 season by 25c to $8.25/kg milksolid.
- Our forecast for the 2023-24 season has also been revised down 25c to $8.50/kg milksolid.
- Dairy commodities have not rebounded as quickly as hoped, with increased milk volumes and softer demand from some geographies putting downward pressure on commodity prices.

Milk price drops to lower end of Fonterra forecast

Dairy commodity prices have continued to decline in recent months, and this trend now appears unlikely to abate in the next few months due to expanding global milk supplies. We now forecast a farmgate milk price of $8.25/kg milksolid (MS) for the 2022-23 season. This is at the lower end of Fonterra's latest price guidance of $8.20-$8.80/kg MS. Milk price futures are currently trading at $8.33/kg MS for the current season.

Looking ahead to the 2023-24 season, we now expect a milk price of $8.50/kg MS, 25c lower than previously forecast. This is aligned with the price of next season's milk price futures contract. Dairy companies typically release their initial pricing for the following season in late May.

Figure 1. Farmgate milk prices



Source: Fonterra, ANZ Research

The NZD has been volatile lately in response to the uncertainty brought about by the recent instability in global finance markets, following the collapse of several overseas banks. Dairy company foreign exchange requirements for the current season will be largely hedged now, therefore movements in the NZD will have a greater impact on next season's milk price.

Dairy commodity prices still trending down

Dairy commodity prices have come under pressure in recent months. We were hoping the recent lift in demand from China would pull prices higher, but this has been offset by softer demand from other regions and increased availability of dairy products.

Global demand for dairy products was particularly weak in late 2022, when China was largely locked down to reduce the spread of COVID-19. This resulted in demand for dairy products falling sharply at both the consumer and wholesale level within China.

China dairy import volumes fell 16% in 2022, and 2023 imports have dropped further. In January and February this year China imported just over 95,000t of whole milk powder, 68% less than the same months the previous year.

Typically, January is a massive month for imports of NZ milk powder into China. This has primarily been driven by tariff differentials applicable to a specific volume of product imported each year. These volume-based safeguards will be completely phased out in 2024, but still apply this year. However, due to the uncertainty around consumer demand for dairy products when the lockdowns were in place, we did not see the usual surge in imports to secure product at the lower tariff rate.

Demand from Chinese importers for product has lifted since Chinese New Year, but at the same time we are seeing slightly weaker demand from other regions, as well as increased milk flows from several regions.

When demand from China fell, more dairy products were exported into other regions such as South East Asia. We are now seeing a little less demand from these regions due to a build-up in their stock positions.

Global milk supplies expanding

Milk flows are increasing, particularly in the Northern Hemisphere. Milk output typically increases at this time of the season and peaks in May, which is late spring in the Northern Hemisphere. In additional to the typical seasonal lift in milk output, we are also seeing growth in output relative to the same time the previous season.

Latest US data shows milk production expanded 1.1% y/y during the first two months of 2023, with an additional 37,000 cows in milk this February. Strong growth in Texas, New York State, and Idaho offset reduced production from California, which will take time to recover from the recent prolonged drought.

Farmgate milk prices are declining in the US, which may well limit growth in milk output later in their season. Many US farmers hedge their milk price income and feed costs, therefore it takes a little longer for changes in pricing to impact farm profits.

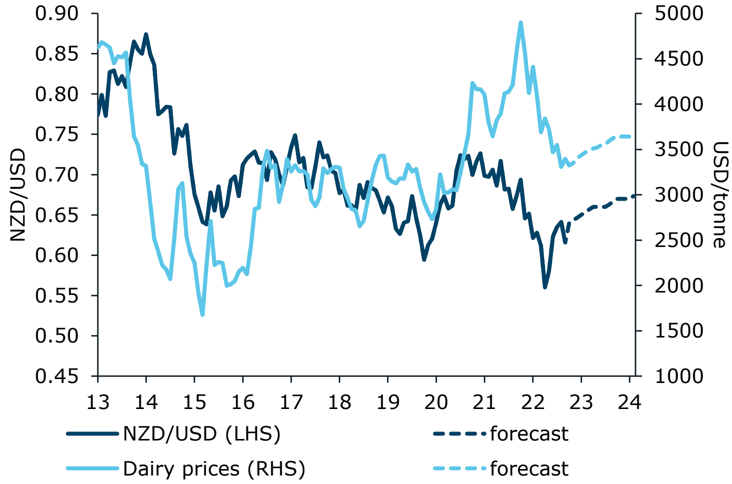
European dairy producers have also started the year strongly, with milk intake up 1% y/y for the EU in January. Output consistently increased in the second half of 2022, and this trend is unlikely to abate anytime soon. In percentage terms the strongest growth is coming from Eastern European member states, whose production was negatively impacted last year. Germany is delivering the largest increase in milk volume terms, followed by the Netherlands, Belgium and Poland.

Milk production in New Zealand has also improved during the second half of the season. Official milk production data for February showed growth of 2.3% y/y. For the season to date, production is still back 1.1%. But this is likely to be clawed back a little further in the final months of the season. Growing conditions vary considerably from region to region, but overall conditions are generally favourable for pasture production this autumn.

Currency volatile, but expected to trend higher

The NZD has been particularly volatile recently due to the turmoil in global markets. Looking forward, we anticipate the NZD will continue to firm over the medium term. Any increase in the NZD does erode returns at the farmgate level, but effective exchange rates are still expected to be lower next season, than the current season, due to processors' hedging policies.

Figure 2. Dairy prices vs NZD



Source: GDT, NZX, RBNZ, ANZ Research

Summary

Global dairy markets are not quite as robust as we hoped, which will put downward pressure on prices. But as demand from China improves this will help to soak up the surplus dairy products currently available.

The NZD is steadily climbing, which will erode returns. However, currency hedges already in place will slow the impact on farmgate prices.

Table 1. Farmgate milk price sensitivity table (2022-23 season)

			NZD/USD effective				
		USD/t	0.650	0.655	0.660	0.665	0.670
Commodity price basket	10%	3940	9.45	9.35	9.25	9.20	9.10
	5%	3760	8.90	8.80	8.75	8.65	8.60
	Base	3585	8.40	8.30	**8.25**	8.15	8.10
	-5%	3410	7.90	7.80	7.75	7.65	7.60
	-10%	3230	7.35	7.30	7.20	7.15	7.05
	-15%	3050	6.80	6.75	6.70	6.60	6.55

Source: ANZ Research

Table 2. Farmgate milk price sensitivity table (2023-24 season)

			NZD/USD effective				
		USD/t	0.62	0.63	0.64	0.65	0.66
Commodity price basket	15%	4090	10.45	10.25	10.05	9.90	9.70
	5%	3740	9.40	9.20	9.00	8.85	8.70
	Base	3560	8.85	8.65	**8.50**	8.30	8.15
	-5%	3380	8.25	8.10	7.95	7.80	7.65
	-10%	3200	7.70	7.55	7.40	7.25	7.10
	-20%	2850	6.65	6.50	6.35	6.25	6.10

Source: ANZ Research

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