ANZ Research

New Zealand Dairy Update

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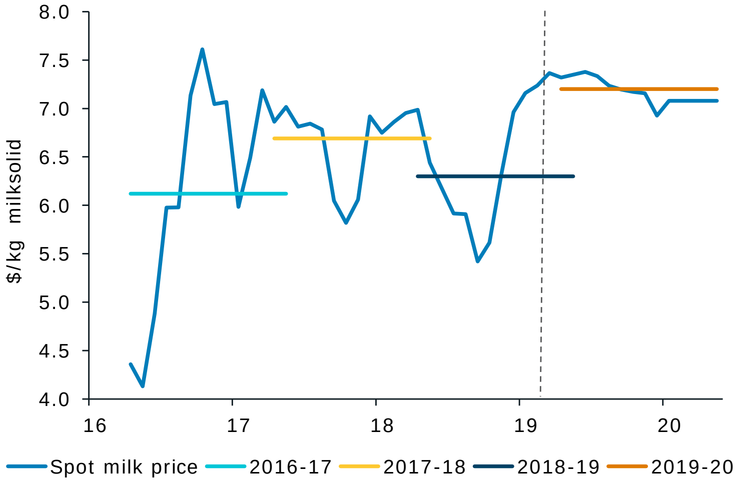
Milk in the money

Forecast returns at the farmgate level have lifted due to dairy commodity prices improving more quickly than expected. This upward trend in pricing is expected to continue into next season.

We have therefore revised our milk price forecast for the 2018/19 season to $6.30/kg milksolids (MS) (previously $6.10/kgMS). Our forecast for next season is now at a healthy $7.30/kg MS (up from $6.90/kgMS).

The 2019/20 forecast is based on a weighted whole milk powder (WMP) price of USD2850/t for next season.[1] This is approximately 5% lower than the current price. Next season's forecast should be viewed with an air of caution due to the longer time horizon. Global growth is slowing, and if this trend is not arrested it could negatively impact demand for dairy commodities.

Figure 1: Farmgate milk prices, historic and forecast



Source: Fonterra, ANZ Research

Easing of global milk supply drives prices up

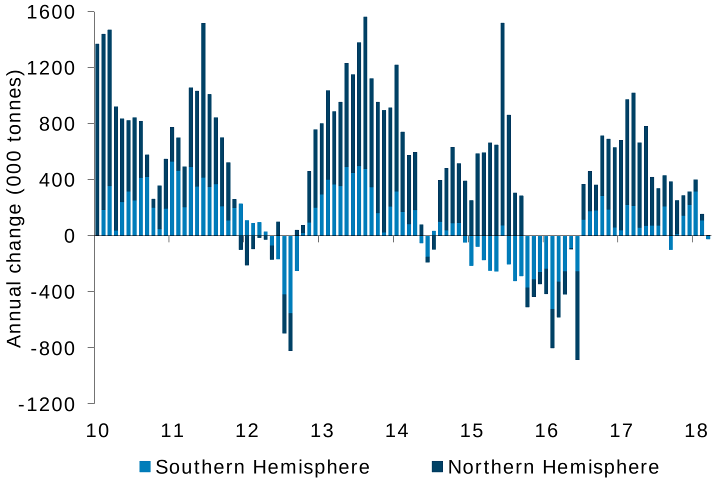
The recent sharp run-up in dairy commodity prices – up 20% in three months – has been supply-side driven. While an uptick in prices was anticipated, and built into previous forecasts, the lift has been more substantial than expected.

Milk flows in the main dairy-exporting nations (aside from New Zealand), have eased to a level where demand is exceeding supply and therefore stocks are being worked through. This fundamental change in the dairy markets is supportive of prices in the short term.

The easing in global production is partially due to the normal seasonal slowdown in the Northern Hemisphere associated with the cooler winter months, but it also reflects the reduced incentive to expand milk production. Returns to farmers in the United States and Europe are generally not high enough to encourage expansion; hence milk output growth rates have slowed.

[1] It also assumes an average exchange rate of US$0.612.

Figure 2: Milk production growth for major exporters



Source: ANZ, Dairy Australia, DCANZ, CLAL, Datum, USDA, European Commission

The skim milk powder (SMP) stocks that were held in the European Commission's intervention programme have now been virtually cleared. These stocks accumulated following the removal of milk price quotas in Europe in 2015, which led to an oversupply of milk. The selling of the intervention stocks back into the market occurred more quickly than anticipated, providing impetus to SMP prices as well as the wider dairy markets.

Demand-side risks for next season's milk price

Looking forward, the risks sit mainly around demand. Only moderate growth is forecast for global milk supply, the slower-evolving part of the equation. However, demand can turn relatively quickly, and indicators show economic growth is slowing in several key markets, including Europe and China.

A fall in European demand for dairy products would result in a larger proportion of Europe's dairy production being exported, which would compete with product sourced from New Zealand. However, as most Europeans consider dairy products to be necessities, European internal demand may not change much.

In China, where dairy sits more at the luxury end of the market, demand can be expected to be more sensitive to economic changes. Economic indicators for Chinese manufacturing are worrying, but overall economic growth is expected to remain high relative to other economies. Other internal structural trends such as urbanisation and westernisation will also help to underpin dairy demand, as will any slowing in China's own milk production. Therefore on balance, China's demand for dairy imports is expected to remain stable. However, trade access remains a key risk. Strong relationships between New Zealand and China help with the flow of goods traded, meaning any souring of the relationship between New Zealand and China would heighten the risk of short-term trade disruptions.

Favourable weather lifts NZ's milk output

Production for the full 2018-19 season is expected to end up about 3.5% higher than last season. Output for the season to the end of January is running +5.5%, but drier conditions in late January and February have started to curb milk flows. Milk output though the late summer and autumn is not expected to match last season, when conditions were unusually favourable for pasture production. Abundant supplies of supplementary feed mean cows are able to be milked on, until pasture growth levels improve. Thus far 2018-19 is shaping up to be a good season with production and returns both at reasonable levels.

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