ANZ Research

NZ Forecast Update: Farmgate milk price

22 July 2020

Contact

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Farmgate milk price forecast revised up

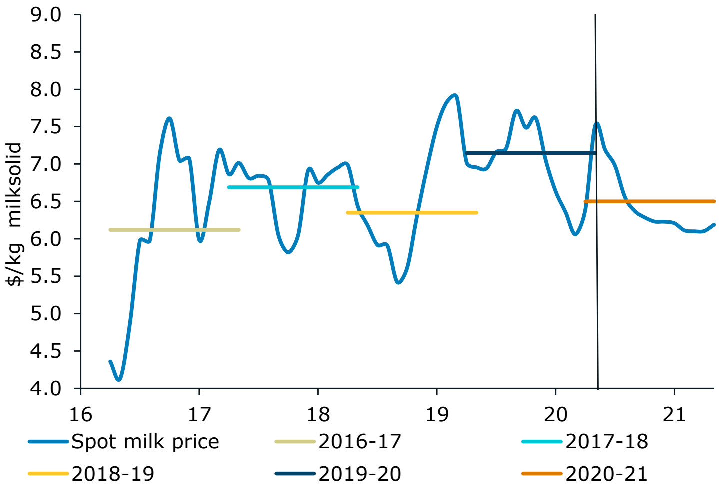
Key points

- Our farmgate milk price forecast for the 2020-21 season has been revised up 75c to $6.50/kg MS.
- Dairy commodity prices continue to perform strongly, putting returns in a much stronger position as new season milk starts to flow. But we do anticipate dairy commodity prices will ease later in the season.
- Our outlook for the NZD remains unchanged with ongoing strength in the currency expected.

Dairy commodity prices resilient

Our farmgate milk price forecast for the 2020-21 season has been revised up to $6.50/kg MS. Global dairy commodity prices have defied expectations recording strong gains in the past few months. The GDT Price Index has lifted 7.5% in the past 3 months.

Figure 1. Farmgate milk prices



Source: Fonterra, ANZ Research

Returns at the farmgate will be tempered by the persistently strong NZD. We anticipate the NZD will trade in an elevated range throughout the current season. The NZD is highly sensitive to changes in global economic conditions so there is a high degree of uncertainty in currency forecasts. A portion of foreign exchange (FX) requirements will have already been hedged by processors but given it is still very early in the season there will still be a reasonable amount of exposure to further movements in FX.

Global economies have, to date, been supported by central bank and government funding. This has kept prices for equities and commodities at higher levels than anticipated. How long this equity market strength can be maintained is debatable. We anticipate these persistent global economic headwinds will become evident in coming months, and at some point this is likely to put downward pressure on commodity prices.

But for now we are confident that the current strength in the market warrants a significant upgrade in our milk price forecast for the current season.

Dairy commodity prices stronger than expected

The recent rally in dairy commodity prices puts our exporters in a much better position to attain stronger prices as the bulk of the new season product starts to trade. The new dairy production season commenced at the beginning of June but the milk is really just starting to flow now as calving gets underway.

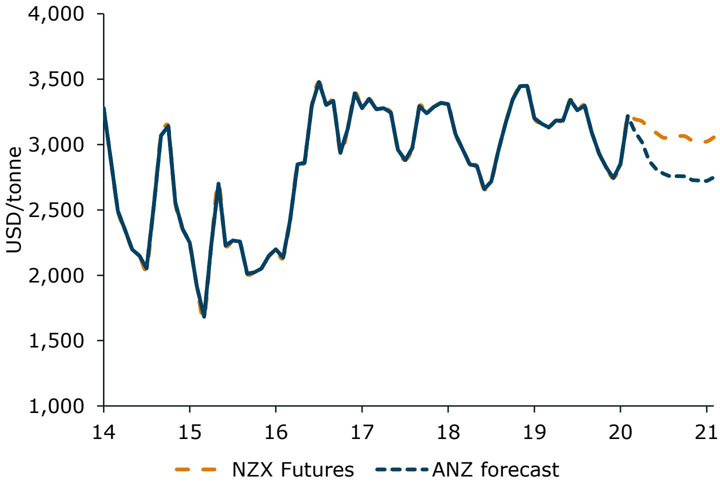
Often we see weakness in dairy markets at this time of the season as larger volumes of product start to trade. But this season dairy markets have remained resilient, defying expectations and wider global economic concerns.

Global dairy markets have been partially supported by the backing provided by the EU and US governments to their farmers. In fact, the US government support program has been so successful it has seen cheese prices shoot up from depressed levels to record prices. While this doesn't completely represent what is happening in the wider US dairy market, it has provided a much needed boost to sentiment.

Pricing in the US internal market doesn't always align with what is happening in global dairy markets but the general price direction can indirectly influence sentiment in wider global dairy markets.

Whole milk powder (WMP) is now trading at about USD3200/tonne, which is 9% higher than the average price attained in the past five years. Demand for WMP has remained resilient throughout the COVID-19 crisis. However, we remain cautious about the future direction of prices, and believe that we may see a sharper correction in the months ahead than the fall currently priced in GDT and futures markets. Our more conservative view can be seen in figure 2.

Figure 2. Dairy commodity price basket



Source: NZX, GDT, ANZ Research

The price levels we are using in our model have lifted considerably from our previous update. We are now anticipate dairy commodity prices will trade at an average price of USD2900/tonne across the current season. This is 7% lower than futures prices currently imply.

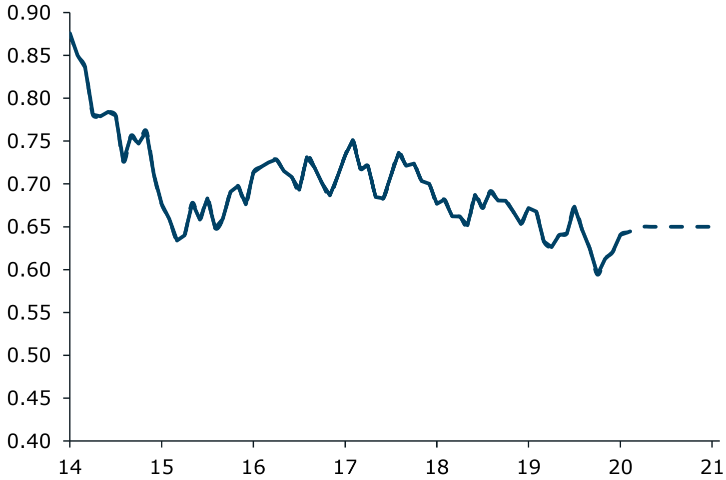
The deterioration in global economic conditions is our main concern. Thus far dairy commodity markets have skirted around the market disruptions caused by COVID-19 but we fear eventually we will see downward pressure on prices as consumers take a more conservative approach to spending as economic pressures mount.

NZ dollar persistently strong

The New Zealand dollar continues to trade at relatively high levels and this trend looks likely to persist for some time. Overnight we saw the NZD break above USD0.66, which was driven primarily by weakness in the USD.

Typically the NZD weakens when global risks are high, but so far our currency has been extremely resilient. New Zealand has managed to contain the health risks associated with COVID-19 to a larger degree than many other countries. The disease is still ravaging the US and this is tempering the value of the USD.

Figure 3. NZD/USD monthly average



Source: RBNZ, ANZ Research

We continue to anticipate the NZD will trade near current levels for the 2020-21 dairy season. Taking into account that a portion of foreign exchange required for the current season will have already been hedged this puts the effective exchange rate at US$0.64 in our milk price model.

Global uncertainty remains

Global market trends remain extremely uncertain, which makes forecasting milk prices even more challenging than normal. It is always difficult to predict how dairy commodity markets and the NZ dollar will perform but this season there are added dimensions of uncertainty. The milk price is highly sensitive to movements in the exchange rate and commodity prices as displayed in the table below.

Table 1. Farmgate milk price sensitivity table

			NZD/USD effective			
		USD/t	0.60	0.62	0.64	0.66
Commodity price basket	10%	3190	8.05	7.75	7.35	7.15
	5%	3045	7.60	7.30	6.95	6.70
	Base	**2900**	**7.15**	**6.85**	**6.50**	**6.30**
	-5%	2755	6.70	6.40	6.10	5.90
	-10%	2610	6.20	5.95	5.65	5.45
	-15%	2465	5.75	5.50	5.20	5.05

While dairy commodity prices have been extremely resilient to date, future risks tend to lie to the downside. So we continue to suggest taking a conservative approach to budgeting for the dairy season ahead.

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