

NZ Forecast Update: Farmgate milk price

16 June 2020



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Farmgate milk price forecast unchanged

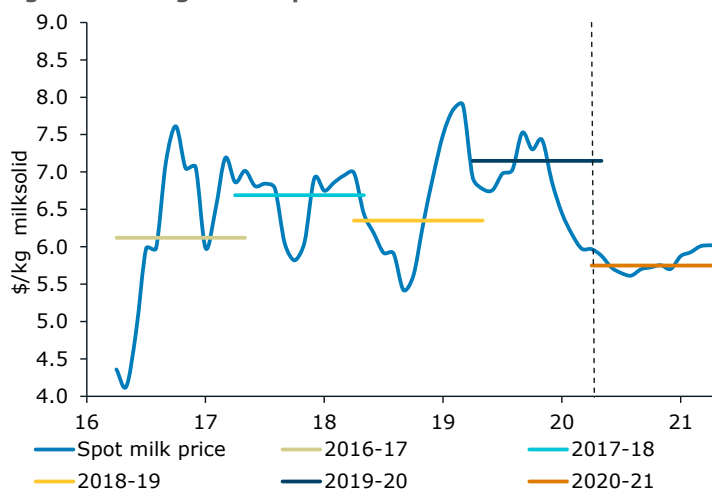
Key points

- Our farmgate milk price forecast for the 2020-21 season is unchanged at \$5.75/kg MS, due to offsetting movements in commodity prices and currency.
- Dairy commodity prices have outperformed expectations but further downside pressure is anticipated as we sell more new-season product.
- The recent rally in the NZD looks like it will stick around for some time, which will cut into dairy returns in local currency terms.

Stronger NZD offsets commodity price resilience

Our farmgate milk price forecast for the 2020-21 season remains at \$5.75/kg MS. Global dairy commodity prices have been falling but the rate of retreat has been slower than anticipated, which is supportive to our milk price returns. Unfortunately, the stronger NZD has eliminated the benefits in local currency terms.

Figure 1. Farmgate milk prices



Source: Fonterra, ANZ Research

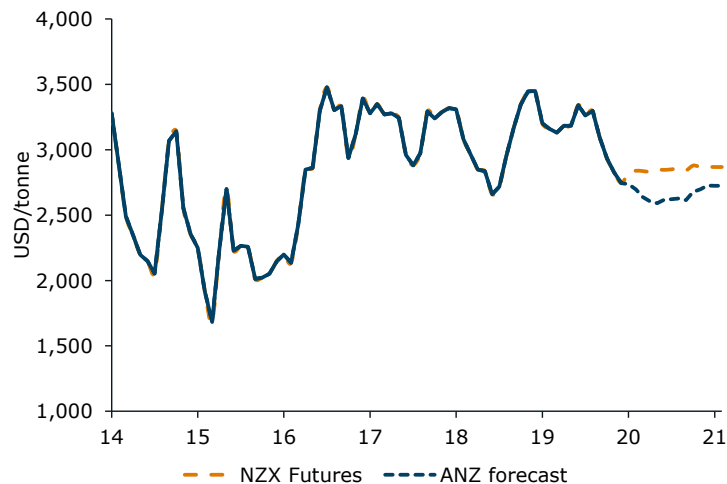
The new dairy production season commenced at the beginning of June and the final farmgate milk price for the 2020-21 season won't be finalised for a further 16 months. A lot could happen during this period of time that will influence global dairy markets and the NZD. No one knows exactly how market demand will perform as countries across the globe battle both the health and economic challenges Covid-19 brings.

Dairy commodity prices stronger than expected

Dairy markets thus far have been more resilient than we anticipated but nevertheless we do expect prices to trend down through the second half of 2020. At present the relatively low volumes of product on offer and support from traditional sales channels have meant dairy commodity prices have eased at a much more sedate pace than many other commodities.

NZX dairy futures prices show a relatively flat forward price curve for the main commodities. Whole milk powder (WMP) is currently trading on this market at prices mainly between USD2700 and USD2800/t throughout the 2020-21 season. This is closely aligned with the 5-year average price for this product of USD2775/t.

Figure 2. Dairy commodity price basket



Source: NZX, GDT, ANZ Research

However, given the weak current global economic environment we expect to see WMP drop below this price level. This is anticipated to occur as larger volumes of new-season product start to hit the market in a couple of months' time. We have therefore built a weighted average WMP of USD2560 into our forecasts, which is about 7% lower than futures prices currently imply.

Proteins expected to outperform fats

Milkfat products (butter and anhydrous milkfat) and cheese are expected to struggle more than milk powders. At present WMP is priced approximately 4% below its 5-year average, while butter is 18% down.

Demand for milkfat products has been curtailed through lockdown periods globally, which have limited the opportunities to eat out of home. Even as lockdown conditions start to ease across the globe, financial constraints will continue to limit eating-out occasions, particularly high-end dining. And there is an ever-present risk of renewed lockdowns on at least a regional basis as the virus flares up and dies down on an ongoing basis.

In this environment demand for more basic products such as milk powders are expected to hold up slightly better than milkfat products.

Skim milk powder (SMP) is currently trading above its 5-year average but this is due to SMP prices being curbed in recent years by a build-up of European Commission-owned stock of this product. SMP is now trading about USD100/t below WMP, which is considered a normal differential.

Volatile NZD

The New Zealand dollar has found more support in the current market environment than we were anticipating. Partly it reflects the good news that we beat back Covid-19 and so are in a better position than most, but it is not good news for farmers as overseas returns are eroded by a stronger NZD in farm-gate terms.

The pace and the scale of the fiscal and monetary responses across the globe is helping to support economies and the near-term data flow is positive as the disruption associated with lockdowns ease.

Global equity markets have been incredibly resilient in the current economic environment. It now appears that the scale of the economic shock to date has not been sufficient to drive risk assets and general risk appetite lower, and this has been supportive of the NZD.

Figure 3. NZD/USD



Source: RBNZ, ANZ Research

How long this dynamic will last is extremely difficult to know, but the recent strength seen in the NZD now looks like it will hang around for some time. We therefore no longer anticipate a significant fall in the NZD in the months ahead. We now anticipate the NZD will maintain a value of near USD0.65 through into 2021.

Highly uncertain times

The global economic environment is still anticipated to weaken further but exactly how this will play out for dairy commodity prices is very uncertain. The following table shows just how sensitive the farmgate milk price is to small movements in the NZD and commodity prices.

Table 1. Farmgate milk price sensitivity table

Commodity price basket	USD/t	NZD/USD effective			
		0.56	0.60	0.64	0.68
10%	2904	7.80	7.15	6.50	6.05
5%	2772	7.35	6.75	6.15	5.70
Base	2640	6.90	6.30	5.75	5.30
-5%	2508	6.45	5.90	5.35	4.95
-10%	2376	6.00	5.45	4.95	4.60
-15%	2244	5.55	5.05	4.55	4.20

While market uncertainty remains so high we suggest a conservative approach is taken to budgeting for the dairy season ahead.



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