ANZ Research

NZ Forecast Update: Farmgate milk price

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Contact

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Farmgate milk price forecast revised up

Key points

- We have revised up our farmgate milk price forecast for the 2020-21 season by 50c to $7.20/kg MS.
- Our forecast for the 2021-22 season remains unchanged at $6.40/kg MS.
- Dairy commodity prices have commenced 2021 at a higher level than expected, and with demand expected to match supply in the coming months, this has mitigated the risk of a sharp decrease in dairy commodity prices in the short term.
- The recent strength in the NZD will impact the 2021-22 season's milk price more than the current season; hence we continue to have a conservative outlook for next season.

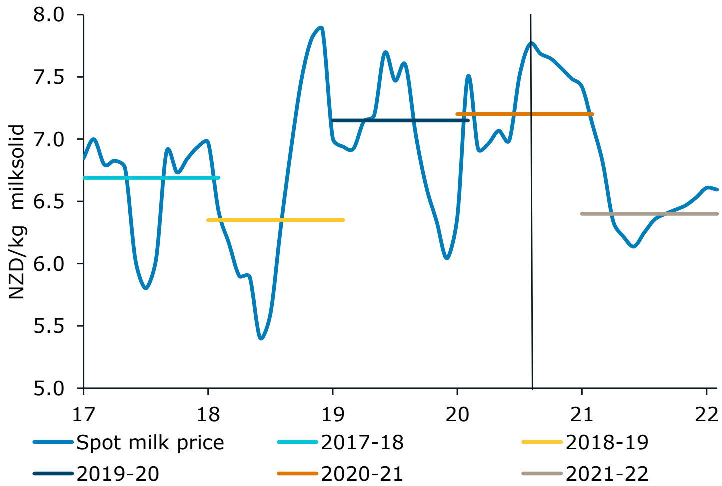
Milk price forecast revised up

We have revised up our farmgate milk price forecast for the 2020-21 season to $7.20/kg MS, from $6.70/kg MS. This forecast is now towards the upper end of Fonterra's milk price guidance of $6.70 - $7.30/kg MS. Milk price futures are currently priced at $7.05/kg MS, having peaked at $7.11/kg MS in early December.

Global dairy commodity prices have continued to firm – gaining 3.9% in the first Global Dairy Trade (GDT) event of 2021. This follows on from prices firming in the latter part of 2020.

We do remain cautious about the longer-term outlook and still see scope for dairy commodity prices to soften in the second half of 2021, which will impact the milk price for next season.

Figure 1. Farmgate milk prices



Source: Fonterra, ANZ Research

Global milk volumes increasing

Global milk supply has continued to expand but so far demand is keeping pace. There has been an enduring lift in milk supply in some of the major dairy-exporting regions of the world, including the United States, EU, Australia and New Zealand. It was feared that this extra supply would not be able to be absorbed by the markets but thus far demand appears to be holding up well, despite some consumption channels being compromised by social distancing restrictions put in place to prevent the spread of COVID-19.

The additional milk being produced in the United States is currently matched by additional demand created by the Government-funded scheme to provide food boxes to those in need. These food boxes must contain drinking milk and other dairy products such as cheeses and yoghurts. Funding for this programme was recently extended to the end of April.

The dairy portion of this stimulus programme is expected to absorb 2.5–3% of the total milk being produced in the US when considered on a milk equivalent basis. This is very similar to the rate of growth in milk supply seen recently. In the second half of 2020 milk supply in the US increased by just over 2%.

In Europe the expansion of milk production has been more modest, with growth of about 1% observed in 2020. While there were disruptions to demand patterns in the early lockdowns, the supply channels have now adjusted to the increase in retail demand at the expense of food service.

The recent growth in EU milk production has mostly been achieved through increased yields as cow numbers have decreased. In 2021 growth is expected to remain modest. Any significant growth in the EU will no doubt result in larger volumes of product being exported, which potentially would be negative for global prices. However, at present production is at its seasonal low and output won't peak until about April/May.

The tighter restrictions on people movements that have been put in place to prevent the spread of the new, more contagious, strains of COVID-19 could result in some reduction in demand for dairy products, but in general demand has remained relatively strong through previous lockdowns.

In the Southern Hemisphere, farms in both Australia and New Zealand benefitted from excellent conditions for pasture production during the spring and early summer. This has resulted in solid growth in milk production in both countries, with Australia up 1.3% for the season to date (July-Nov) and New Zealand ahead by 0.6% in the first half of the 2020-21 season (June-Nov).

Growth in milk supply in both countries has been driven by favourable weather rather than an expansion of the land used for dairying or increased intensity. Industry growth has now stalled in both countries. In New Zealand, tightening environmental legislation, as well as high levels of debt at the farm level, has curbed growth. In Australia, dairy herd numbers are falling as access to labour and water, and many years of low profits, is resulting in farms moving into alternative uses.

Growth in the second half of the season is expected to be a little more muted than in the first half due to less favourable pasture growth. Minimal growth was recorded in the peak production months of October and November. Milk production growth is expected to be about 1% for the full 2020-21 season for both New Zealand and Australia. This rate of growth can typically be absorbed by demand growth.

Demand growth keeping up with supply

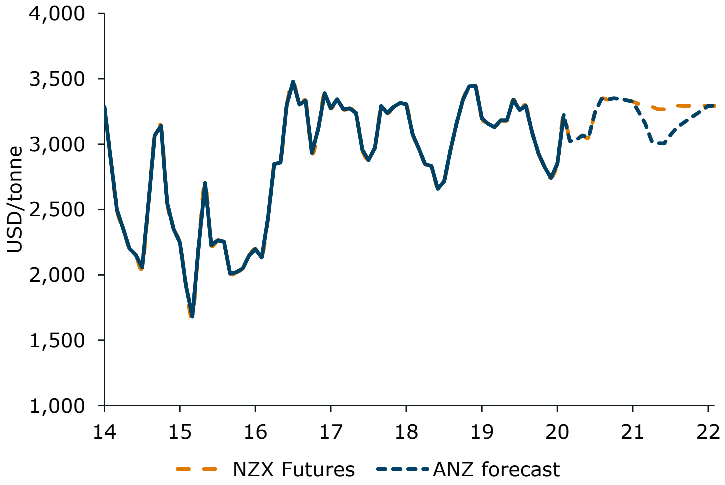
Demand for dairy products is still growing despite the economic and logistical challenges brought about by COVID-19. Many dairy products can easily be prepared and consumed at home and the industry has managed to divert goods typically destined for food service into retail channels. Processed dairy products also have a relatively long shelf life, which means the product retains its value if supply chain disruptions result in delays getting the product through to end users.

Indeed, there continue to be delays in getting product into and out of certain ports, including some key ports in China, which is increasing shipping times. To offset the longer time to get product to market, shipping firms have lifted their prices, since the delays mean they can make fewer journeys.

New Zealand dairy product is still getting to market relatively well due to the strong ties between the Kotahi partnership – which includes Fonterra – and the international shipping company Maersk. But in some cases product has to be offloaded at alternative ports.

There have been some concerns that buyers may have stocked up on product to limit upside price risks and to ensure they have sufficient supply on hand to counteract any logistical challenges, suggesting weaker demand ahead. It is not clear at this stage if any significant stocks of product are being stored in-market, but the strength of demand evident at the first GDT event would indicate otherwise. Buyers were still very keen to secure product – particularly product contracted for immediate supply.

Figure 2. Dairy commodity price basket



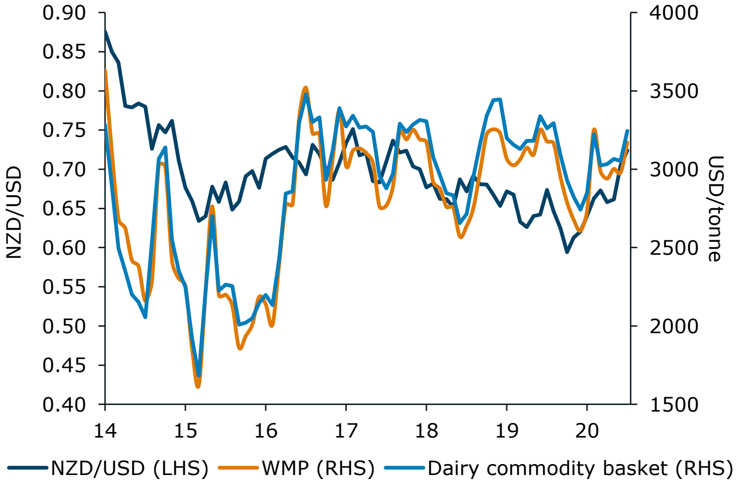
Source: NZX, GDT, ANZ Research

More certainty in farmgate milk price forecast

The farmgate milk price for the 2020-21 season is becoming more certain as about 70% of the product that will be produced from this season's milk supply will now be contracted. Most of the FX requirements for this season will also have been put in place, thereby limiting the impact of the rising NZD on the farmgate milk price for the 2020-21 season.

However, the rising NZD will curb returns for next season. Commodity prices may also ease next season – particularly if the milk supply in the Northern Hemisphere continues to rapidly expand. Economies still have a long way to go to offset the economic impact of COVID-19 and further lockdowns are likely to dampen demand for dairy products.

Figure 3. NZD vs dairy prices



Source: RBNZ GDT, ANZ Research

Thus, dairy commodity prices are likely to be subject to downward pressure at some point in 2021. We therefore continue to take a cautious approach to next season's milk price. At this point all signals indicate next season's milk price will be lower than the current season.

Table 1. Farmgate milk price sensitivity table (2020-21 season)

			NZD/USD effective				
		USD/t	0.63	0.64	0.65	0.66	0.67
Commodity price basket	10%	3500	8.45	8.30	8.15	8.00	7.85
	5%	3340	8.00	7.85	7.65	7.55	7.40
	Base	**3180**	**7.50**	**7.35**	**7.20**	**7.05**	**6.95**
	-5%	3020	7.00	6.90	6.75	6.60	6.50
	-10%	2860	6.55	6.40	6.30	6.15	6.05
	-15%	2700	6.05	5.95	5.80	5.70	5.60

Source: ANZ Research

Looking ahead to next season

Dairy commodity futures contracts trading on the NZX show a relatively flat forward pricing curve. If prices do remain near current levels, then next season's milk price is likely to be higher than the $6.40/kg MS we are currently forecasting, but it is very unlikely to match the current season's milk price due to the stronger NZD. We anticipate the NZD will trade above USD0.70 through to the end of next season, appreciating up to USD0.74 by the end of 2021.

The recent focus on COVID-19 has highlighted the virtues of our primary industries but we can't rest on our laurels. We need to continue planning ahead to ensure our farm businesses are in a good position to withstand future financial shocks and also position our industry to take advantage of the growing focus on sustainability.

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