

NZ Forecast Update: Farmgate milk price

3 March 2021



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Contact

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Farmgate milk price forecast revised up

Key points

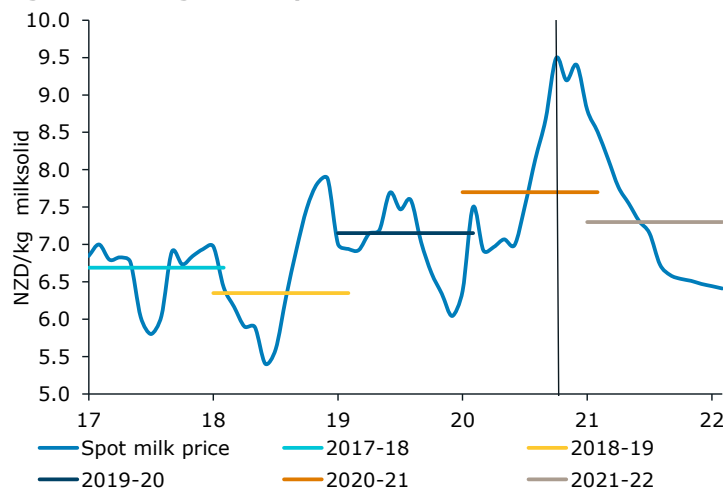
- We have revised up our farmgate milk price forecast for the 2020-21 season by 50c to \$7.70/kg MS.
- Our forecast for the 2021-22 season is now at \$7.30/kg MS.
- Dairy commodity prices have traded in 2021 at a significantly higher level than expected, which has more than offset the stronger NZD.
- Recent NZD strength impacts the 2021-22 season's milk price more than the current season. There is also a much higher degree of uncertainty in the longer-term forecasts; hence a more cautious approach should be taken regarding next season's milk price.

Milk price forecast revised up

We have revised up our farmgate milk price forecast for the 2020-21 season to \$7.70/kg MS, from \$7.20/kg MS. This forecast is now well above the upper end of Fonterra's milk price guidance of \$6.90 - \$7.50/kg MS.

Global dairy commodity prices rocketed up overnight with the GDT Price Index gaining 15% in the latest event, which was driven primarily by stronger whole milk powder prices (+21%). The GDT Price Index has lifted 31% since December and prices are now at their highest level in seven years.

Figure 1. Farmgate milk prices



Source: Fonterra, ANZ Research

Demand exceeds available supply

It is evident that demand for dairy products is currently strong. This is particularly the case for whole milk powder (WMP), for which demand is driven primarily by China. New Zealand is the largest supplier of WMP into the global market. The EU does produce more WMP than NZ but a lot of the product is utilised internally. China is by far the largest buyer of WMP, with its imports being equivalent to about the next seven largest importers combined.

Therefore, WMP pricing does tend to be a China demand vs. a NZ supply story. China's demand for WMP is dependent on a number of factors, none of which are particularly transparent.

- Firstly, consumer demand for products made from milk powders is a major driver. These products include reconstituted milk, infant formula and milk powders designed for home use, confectionary and baked goods etc.
- Dairy products are considered to be healthy, and some see them as an immunity booster, which may be why we are seeing increased demand at present. Dairy products are also regularly gifted at Chinese New Year, so it is possible that this has bolstered wholesale demand as stores restock following the holiday period.
- China's own milk production also impacts demand for imported milk powder. China is a massive producer of milk, producing about 1.5x the amount produced in NZ. There is very little transparency in milk production data, and what is available tends to be unreliable. However, there has been some upward pressure on farmgate milk prices in China recently, indicating demand is exceeding supply.
- The other factor which impacts demand is the quantity of milk powder in storage throughout the supply chain. Once again, there is no transparency, but it has been thought that some buyers have been holding additional stocks to mitigate the impact of supply chain disruptions caused by congested ports, adding time to get goods to market.

Most likely it will be a number of these factors contributing to the recent surge in demand for whole milk powder.

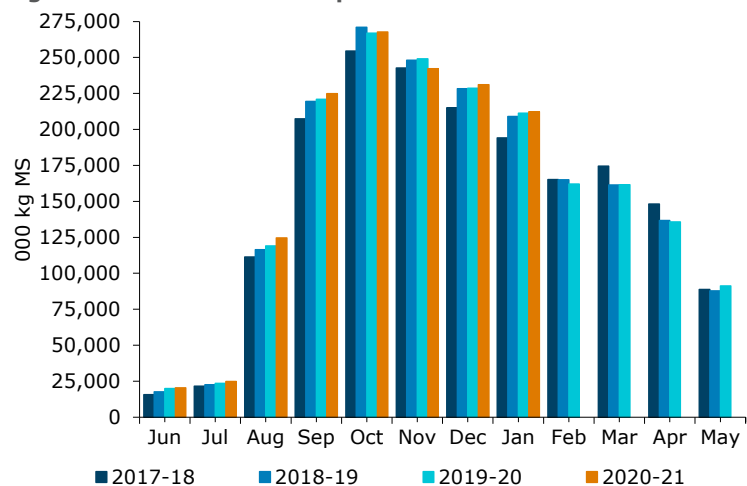
Supply side story

Milk production in New Zealand has been relatively stable for the past six or seven years, with just seasonal changes in weather providing small variations in output. This season NZ's milk production is 0.6% ahead of last season (from July to January). Supplies peaked a little lower than normal but relatively good growing conditions in the early summer resulted in stronger production in December and January.

However, Fonterra's milk production has been decreasing, which is a function of reduced market share and less favourable growing conditions across its collection regions relative to other NZ dairy processors. Fonterra recently announced its January milk production intakes were 0.9% down y/y, which puts its milk intakes for the season at -0.8% compared to last season.

As it is only Fonterra product that is available on GDT, the news of lower milk intakes may have spurred additional buying activity as they look to secure product now before the market potentially tightens further.

Figure 2: New Zealand milk production volumes



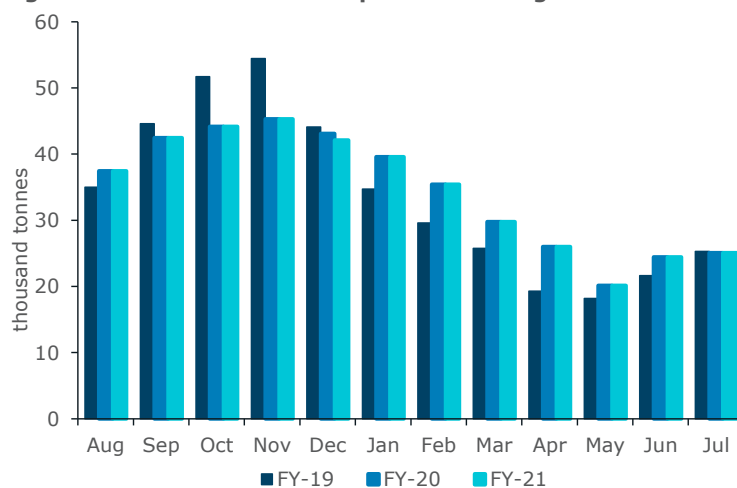
Source: DCANZ

GDT offer volumes

The quantity of WMP available on GDT has not changed recently. There is a seasonality to the supply pattern (see Figure 3) where offerings peak in November each season. Fonterra forecast offer volumes well in advance and then finalise offerings the week prior to the GDT event.

Fonterra did not make any changes to the volume of WMP offered at the first event in March, or consequent events, but they did move some product out of the later-dated contracts (for delivery in July & August) and added that volume into the contracts where delivery was scheduled for May and June. This change was to meet additional customer demand. However, it is now clear that simply adjusting the delivery schedule was not sufficient to meet the level of demand that emerged at the latest GDT event.

Figure 3: Fonterra whole milk powder offerings on GDT



Source: Fonterra, NZX

Fonterra did, however, adjust the offer volumes for some of the other products they sell on GDT. Fonterra has been selling a little less of its other product lines via GDT. The quantity of skim milk powder (SMP), butter, and anhydrous milkfat (AMF) offered in the year to July 2021 is about 14-15% less than the same time last season, although most of these differences occurred in the events that have already been held.

Global milk volumes steadily increasing

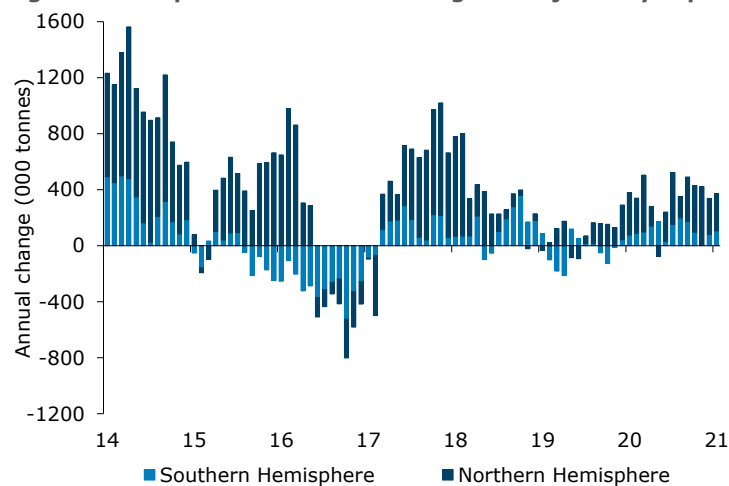
Global milk supply has continued to expand, but so far not fast enough to put downward pressure on prices. Growth is fastest in the US, and this is expected to be sustained, as it is being driven partially by an increase in the number of dairy cows, rather than just being achieved by increasing the rations fed to the milking cows.

Milk production in Europe and the US is starting to lift, but it won't hit its seasonal peak until about May, and then it will take a few more months before we really see the impact of increased volumes of product being offered into global markets.

By that time, production from the Southern Hemisphere will have dropped significantly. Based on the demand we are currently seeing, the increase in Northern Hemisphere production is unlikely to put massive downside pressure on pricing.

At present, it is really just WMP where prices have really taken off. Price movements have been more subdued for products such as SMP and cheese, for which large volumes are supplied from the Northern Hemisphere dairy-exporting nations.

Figure 4: Milk production annual change of major dairy exporting countries



Source: DCANZ, Dairy Australia, USDA, Eurostat, CLAL

Looking ahead to next season

Dairy commodity prices look like they will commence the 2021-22 season at a high level, but there is certainly no guarantee that they will remain at this level. At this stage, it is not completely clear what is actually driving the sharp lift in pricing we are currently experiencing. Therefore, it is difficult to predict how long the current run of stronger pricing will be sustained.

We anticipate we will see some correction in pricing within the next 12 months, and when this occurs it may do so at pace.

The other factor that has a large influence on the farmgate milk price is the NZD. We anticipate the NZD will generally appreciate over the next 18 months, and this will curb returns at the farmgate somewhat. We currently expect the NZD will climb to USD0.77 by December.

Despite the high levels of uncertainty associated with both dairy commodity markets and the NZ dollar, we have significantly upgraded our milk price forecast for the 2021-22 season to \$7.30/kg MS.

Table 1. Farmgate milk price sensitivity table (2021-22 season)

		NZD/USD effective					
		USD/t	0.68	0.70	0.72	0.74	0.76
Commodity price basket	20%	4260	9.90	9.55	9.20	8.90	8.60
	10%	3910	8.90	8.55	8.30	8.00	7.75
	Base	3550	7.90	7.60	7.30	7.05	6.80
	-10%	3200	6.90	6.65	6.40	6.15	5.95
	-20%	2840	5.85	5.65	5.45	5.20	5.05
	-30%	2490	4.90	4.70	4.50	4.30	4.15

Source: ANZ Research

While our primary sectors have performed extremely well throughout the pandemic, we are now dealing with much more volatility and uncertainty in global markets. Most financial shocks are not able to be foreseen, so we need to position our businesses to withstand any shocks that do occur. This will also allow us to take advantage of growth opportunities when they arise.



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