

NZ Forecast Update: Farmgate milk price

7 October 2021



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Contact

Susan Kilsby for more details.

Farmgate milk price forecast revised over \$8

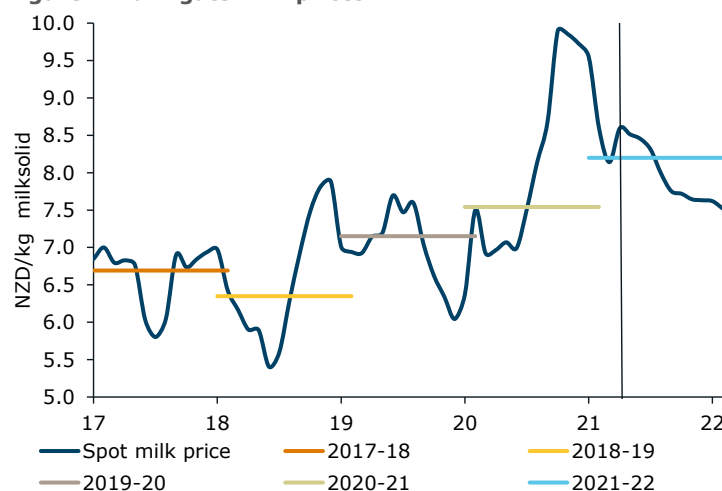
Key points

- We have revised up our farmgate milk price forecast for the 2021-22 season by 50c to \$8.20/kg MS.
- Dairy commodity prices have generally improved as the season has progressed and are now holding at elevated levels, but we do anticipate some softening of prices later in the season.
- The NZD has not appreciated quite as quickly as we initially expected, and a relatively large portion of currency requirements will now be hedged for the current season, reducing the risk of a stronger NZD significantly eroding farmgate returns.

Milk price risks reduce as season progresses

We have revised up our farmgate milk price forecast for the 2021-22 season to \$8.20/kg MS (from \$7.70/kg MS). This puts our forecast 20c above the mid-point of Fonterra's latest milk price guidance of \$7.25 - \$8.75/kg MS.

Figure 1. Farmgate milk prices



Source: Fonterra, ANZ Research

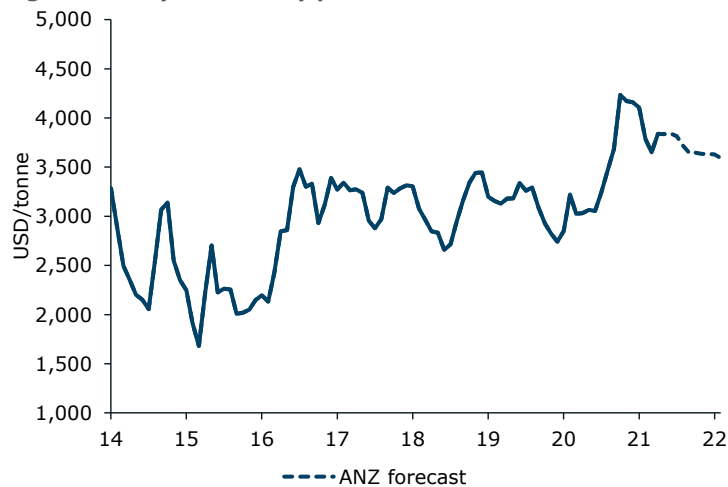
Milk price futures for the current season (ie the Sep 22 contract) are currently trading at \$8.50/kg MS, having lifted 60c since early September. Even the contract for next season (2022-23 season) bounced above \$8 in early October but last settled at \$7.95/kg MS.

Commodity prices holding at elevated levels

Dairy commodity prices have trended higher as the season has progressed. Often prices weaken at this time of the season, but this season prices have instead firmed. While we don't see further upside in these prices in the immediate term, they are now at a level that delivers a healthy return back to our farmers.

Dairy commodity markets are relatively balanced at present, explaining the stability we are currently seeing in prices. But global dairy demand is fragile. Asian economies continue to suffer from the global pandemic and contagion spreading from the impending slowdown in China's property development sector.

Figure2. Dairy commodity price basket



Source: GDT, NZX, ANZ Research

Global milk supplies are however only expanding slowly, so this is compensating for the somewhat patchy demand. High grain costs are limiting profits for Northern Hemisphere producers and therefore there is little incentive to expand production. Whatever supply growth that is occurring is generally being absorbed within the country of production, meaning we are not seeing an increase in the volume of dairy product on offer in the global markets.

This situation is unlikely to change anytime soon.

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

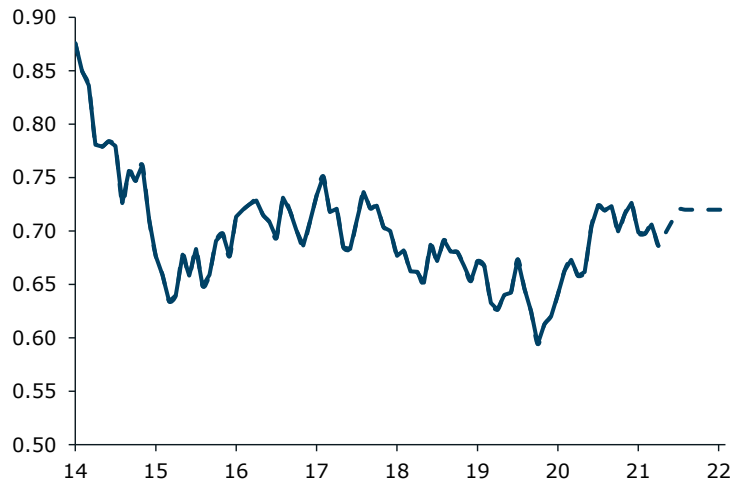
		NZD/USD effective					
		USD/t	0.67	0.68	0.69	0.70	0.71
Commodity price basket	20%	4130	9.60	9.45	9.25	9.10	8.95
	10%	3940	9.05	8.90	8.75	8.60	8.45
	Base	3750	8.50	8.35	8.20	8.05	7.90
	-10%	3560	8.00	7.85	7.70	7.55	7.40
	-20%	3380	7.45	7.35	7.20	7.05	6.95
	-30%	3190	6.95	6.80	6.65	6.55	6.40

Source: ANZ Research

New Zealand dollar remains in check

The NZD has not appreciated as quickly as we expected it might. This is positive for the farmgate milk price as a lower NZD results in higher returns in local currency terms.

Figure 3. NZD/USD



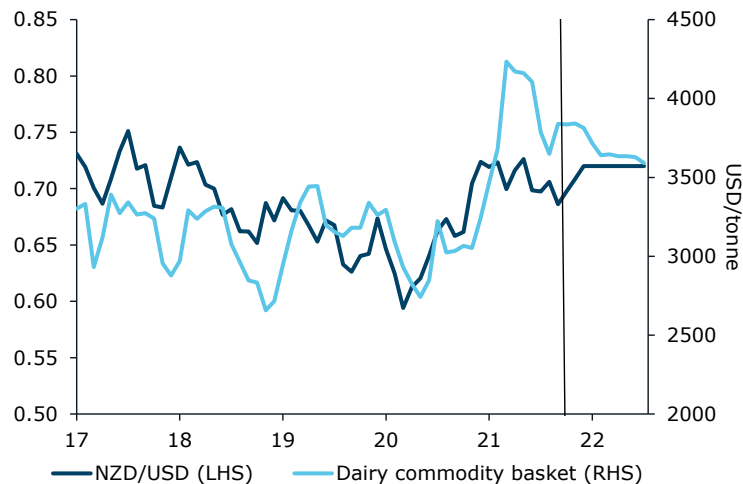
Source: RBNZ, ANZ Research

Even with monetary policy tightening quicker here than other parts of the world this has not put a lot of pressure on our currency. The October OCR lift was well anticipated by markets, so the impact of the actual announcement was relatively muted.

Weighing on the NZD are the ongoing global uncertainties associated with the pandemic. This is reducing the appetite to invest in riskier assets, which includes the NZD.

The NZ dollar is expected to firm a little further as the season progresses. We anticipate the NZD will be worth USD0.72 by December. However, a relatively large portion of FX requirements for next season will have already been locked in, so we anticipate the effective NZD/USD rate for the 2021-22 season will be just over USD0.69.

Figure 4. NZD vs dairy prices



Source: RBNZ, GDT, NZX, ANZ Research



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Sharon Zollner
Chief Economist

Follow Sharon on Twitter
[@sharon_zollner](#)

Telephone: +64 27 664 3554
Email: sharon.zollner@anz.com

General enquiries:
research@anz.com

Follow ANZ Research
[@ANZ_Research](#) (global)



David Croy
Senior Strategist

Market developments, interest rates, FX, unconventional monetary policy, liaison with market participants.

Telephone: +64 4 576 1022
Email: david.croy@anz.com



Susan Kilsby
Agricultural Economist

Primary industry developments and outlook, structural change and regulation, liaison with industry.

Telephone: +64 21 633 469
Email: susan.kilsby@anz.com



Liz Kendall (maternity leave)
Senior Economist

Research co-ordinator, publication strategy, property market analysis, monetary and prudential policy.

Telephone: +64 27 240 9969
Email: elizabeth.kendall@anz.com



Miles Workman
Senior Economist

Macroeconomic forecast co-ordinator, fiscal policy, economic risk assessment and credit developments.

Telephone: +64 21 661 792
Email: miles.workman@anz.com



Finn Robinson
Economist

Macroeconomic forecasting, economic developments, labour market dynamics, inflation and monetary policy.

Telephone: +64 21 629 553
Email: finn.robinson@anz.com



Kyle Uerata
Economic Statistician

Economic statistics, ANZ proprietary data (including ANZ Business Outlook), data capability and infrastructure.

Telephone: +64 21 633 894
Email: kyle.uerata@anz.com



Natalie Denne
PA / Desktop Publisher

Business management, general enquiries, mailing lists, publications, chief economist's diary.

Telephone: +64 21 253 6808
Email: natalie.denne@anz.com



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