

NZ Forecast Update: Farmgate milk price

30 November 2021



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Contact

Susan Kilsby for more details.

Farmgate milk price forecast revised up

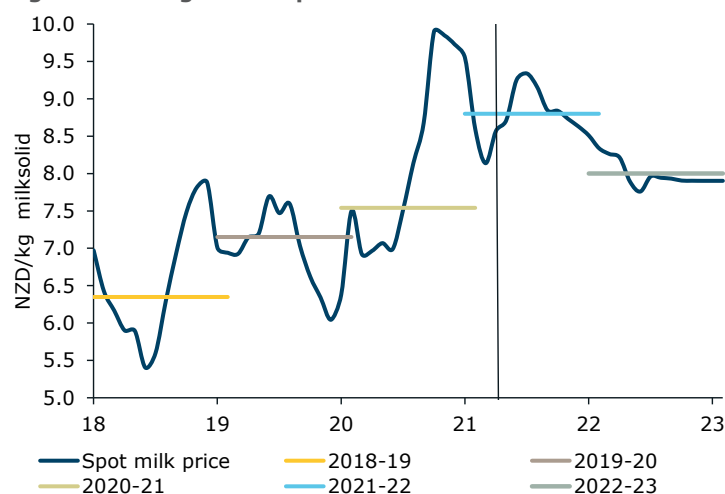
Key points

- We have revised our farmgate milk price forecast for the 2021-22 season up 60c to \$8.80/kg milksolid (MS).
- Our initial forecast for the 2022-23 season is at \$8.00/kg MS. A reduction in demand from China is a key risk to next season's forecast.
- The NZD is assumed to appreciate a little further, but to be relatively stable across our forecast period.

Prices become more certain as season progresses

We have revised up our farmgate milk price forecast for the 2021-22 season to \$8.80/kg MS (from \$8.20/kg MS). This puts our forecast just below the upper range of Fonterra's latest milk price guidance of \$7.90 - \$8.90/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 just above \$9.00/kg MS. There is potential for the farmgate milk price to reach this level, but this would require commodity prices to remain strong for the remainder of the season.

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

Commodity price basket	USD/t	NZD/USD effective				
		0.67	0.68	0.69	0.70	0.71
10%	4400	10.35	10.15	10.00	9.80	9.65
5%	4200	9.80	9.60	9.45	9.25	9.10
Base	4000	9.20	9.05	8.80	8.75	8.60
-5%	3800	8.65	8.50	8.35	8.20	8.05
-10%	3600	8.10	7.95	7.80	7.65	7.50
-15%	3400	7.50	7.35	7.25	7.10	6.95

Source: ANZ Research

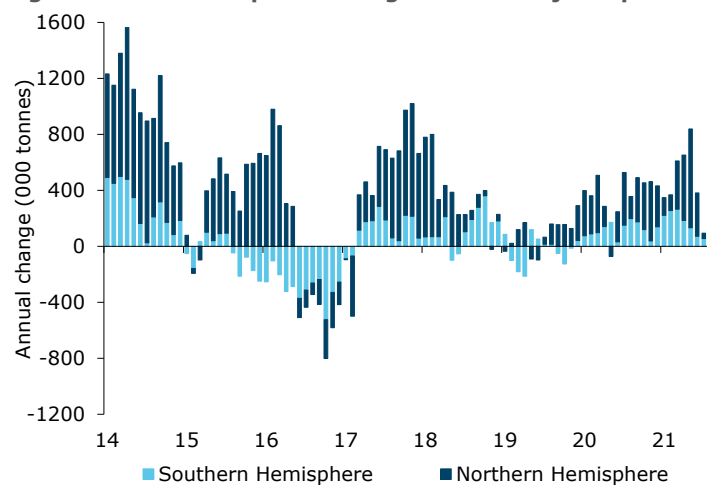
By this time of year normally a little over half the season's produce has been sold. Foreign exchange requirements for the current season will now be well hedged. This provides a greater degree of certainty for the current season milk price. Dairy commodity prices would need to drop about 20% for the 2021-22 milk price to fall below \$8/kg MS. We have allowed for some softening of commodity prices in our current forecast.

\$8 forecast for next season

Looking ahead, the 2022-23 season is also expected to deliver an above-average milk price. We are forecasting \$8/kg MS. While this may not be quite as strong as the current season's milk price, it is still a very high level.

One of the factors that is currently supporting global dairy commodity prices is the limited growth in global milk supplies. Milk output is only growing at modest rates in all of the main dairy-exporting countries.

Figure2. Global milk production growth for major exporters



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

Stronger growth is forecast in some of the developing nations that are large milk producers, but in these countries population growth or improving incomes is helping bolster demand for dairy products. Therefore any additional milk that is produced in countries such as India, Russia, Pakistan and China is expected to be readily absorbed by their domestic markets and therefore have only a limited impact on global markets.

The one large milk-exporting region out of which we may see extra growth is the US. So far this year growth rates have been subdued. Milk output in the first 10 months of the year was 2% greater than at the same period in 2020. However, this was due largely to comparatively strong growth in April and May, as some milk was not being collected at this time of the season in 2020 due to outbreaks of COVID-19 reducing factory capacity.

Another factor that is keeping milk growth in check in the US is very high grain prices, a factor that is reducing the profitability of producing extra milk. But grain costs could change next season, and it is possible we may see a surge in milk supply, which would put downward pressure on prices.

Likewise, a reduction in demand remains a real threat.

Thus far, demand for dairy has remained robust throughout the pandemic but this could also change. China continues to grow its presence in the global dairy market but economic growth is starting to wind back in this region, although growth still looks strong relative to other regions. But should Chinese consumer confidence be dented then we could see a reduction in demand for dairy produce, which would quickly flow through to lower prices.

At this point we don't expect that to occur, but we have factored in some easing of commodity prices into our 2022-23 forecast of \$8/kg MS. Milk price futures for next season are presently trading at \$8.65/kg MS. This contract has rocketed up in price from \$7/kg MS in June to peak at \$8.75/kg MS in mid-November. The high prices on offer have resulted in a flurry of farmers trading this contract to provide a degree of price certainty for next season.

Table 2. Farmgate milk price sensitivity table (2022-23 season)

		NZD/USD effective					
		USD/t	0.68	0.70	0.72	0.74	0.76
Commodity price basket	20%	4800	11.35	10.95	10.60	10.25	9.90
	10%	4400	10.20	9.65	9.55	9.20	8.90
	Base	3800	8.55	8.25	8.00	7.65	7.40
	-10%	3600	7.95	7.70	7.40	7.15	6.90
	-20%	3200	6.85	6.60	6.35	6.10	5.90
	-30%	2800	5.70	5.50	5.30	5.10	4.90

Source: ANZ Research

Stability in New Zealand dollar forecast

Despite the huge level of uncertainty in global financial markets the NZD has traded in a relatively tight band against the USD over the past year. A continuation of this stability is reflected in our forecast, which incorporates a small lift in the NZD to USD0.72 where it is then assumed to hold throughout the forecast period.

Figure 3. NZD/USD



Source: RBNZ, ANZ Research

Most central banks have now signalled tighter monetary policy is on its way. Therefore the fact that the RBNZ started its tightened cycle ahead of many other banks hasn't actually had a large impact on the NZD.

Overall the outlook for the farmgate milk price remains robust in the near term.



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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



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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