ANZ Research

NZ Forecast Update: Farmgate milk price

9 March 2022

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Contact

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Farmgate milk price forecast revised up

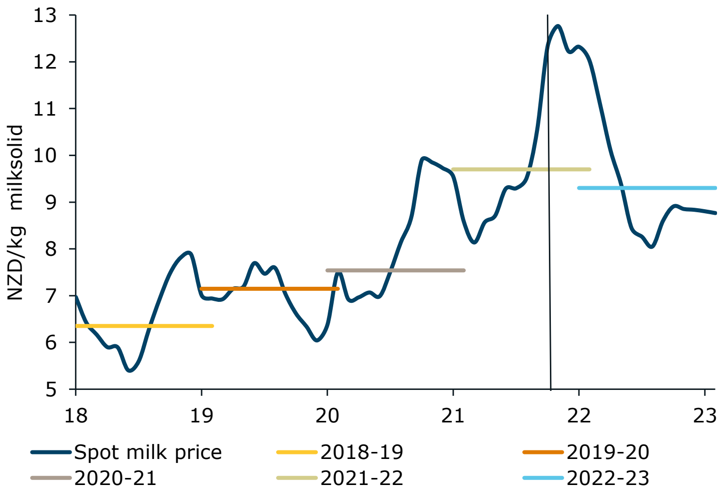
Key points

- We have revised our farmgate milk price forecast for the 2021-22 season up another 40c to $9.70/kg milksolid (MS).
- Our forecast for the 2022-23 season has also lifted significantly from $8.40/kg to $9.30/kg MS. Inflationary pressures will temper supply, keeping dairy commodity prices elevated for longer.
- The NZD is assumed to appreciate steadily across our forecast period to reach USD0.70 by the end of the 2022 calendar year.

Prices become more certain as the season progresses

The risk of a sharp downwards correction in dairy commodity prices in the near-term is very low and as much of this season's product is already sold we can be more confident in forecasting this season's milk price. We have now revised up our farmgate milk price forecast up to $9.70/kg MS (from $9.30/kg MS). This puts our forecast slightly above the mid-point of Fonterra's latest milk price guidance of $9.30 - $9.90/kg MS.

Figure 1. Farmgate milk prices



Source: Fonterra, ANZ Research

The sharp rise in dairy commodity prices over the past couple of months has set a much more bullish tone for commodity prices in the shorter term. We are also seeing strong upward pressure in commodity prices more broadly on supply concerns. Despite the high milk prices being paid across the globe we are not seeing any major increase in global milk supplies, which means we are unlikely to see dairy commodity prices drop sharply before the end of the milk production season.

The NZ dollar is trending up which generally puts downward pressure on farmgate prices. If the RBNZ increases the Official Cash Rate as quickly as we are forecasting, to curb inflation, that may put further upwards pressure on our currency. But our dairy companies will have already hedged most of their currency requirements for the 2021-22 season leaving very little exposure to movements in the NZD.

Demand intact despite high prices

Dairy products are now becoming extremely expensive for consumers, particularly those in developing nations, who spend a large portion of their income on food. Eventually this will impact demand, but for now we are still seeing solid demand for dairy commodities despite the excessively high prices.

This means we are not likely to see a sharp correction in dairy commodity prices soon enough to significantly negatively impact farmgate returns this season. On the flip-side dairy commodity prices would need to be about 15% higher than current futures prices for the rest of the season to break the $10 barrier, which seems unlikely.

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

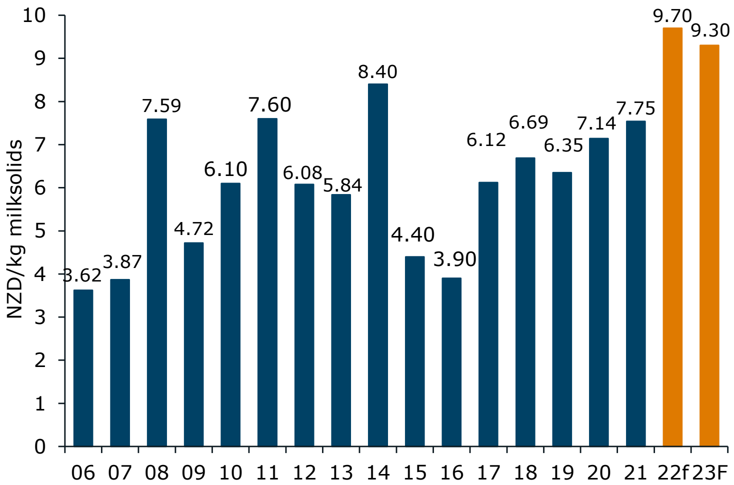
			NZD/USD effective				
		USD/t	0.680	0.685	0.690	0.695	0.700
Commodity price basket	10%	4695	11.05	10.95	10.85	10.75	10.65
	5%	4485	10.45	10.35	10.30	10.20	10.10
	Base	4270	9.85	9.75	**9.70**	9.60	9.50
	-5%	4050	9.25	9.15	9.05	9.00	8.90
	-10%	3840	8.65	8.55	8.50	8.40	8.35
	-15%	3630	8.05	8.00	7.90	7.85	7.75

Source: ANZ Research

Looking out to 2022-23

Looking forward, we expect milk prices to remain at elevated levels next season. We have increased our forecast to $9.30/kg MS (from $8.40/kg MS). We expect dairy commodity prices to remain at high levels at the beginning of the season but think it is unlikely prices will stay at such lofty levels as the season wears on.

Figure 2. Farmgate milk price



Source: Fonterra, ANZ Research

Global risks are highly elevated at present, which is driving uncertainty. The Ukraine situation is adding fuel to what is already an overheated commodity market. Oil prices have skyrocketed but continue to seesaw on headlines on how the war is progressing. Energy commodities were in tight supply before the invasion and the supply situation is now at least a lot less certain.

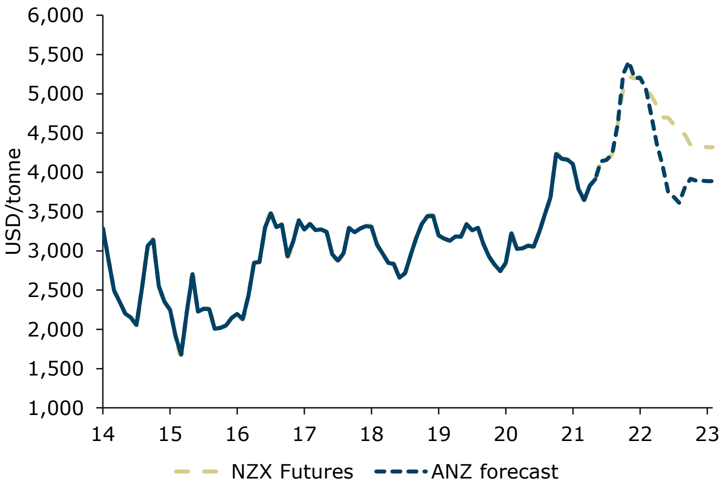
High gas prices are pushing up fertiliser prices, which in turn is pushing up the prices of grain and food in general. The cost of producing milk is rising, particularly in the Northern Hemisphere, where indoor farming systems mean much greater exposure to high prices for fertiliser, grain and fuel.

The lift in the price of producing milk has already resulted in a reduction in production in some of the main dairy-exporting regions, including the United States. It now seems very unlikely that there will be a meaningful increase in production anywhere in the world over the next six months.

This eliminates much of the downside risk for dairy commodity prices in the short-term. However dairy commodity export prices are nearing record levels and when you add expensive freight into the equation, combined with relatively subdued economic conditions, it appears only a matter of time before we start to see some reduction in dairy demand.

At this point it does look like we will be commencing the 2022-23 season with dairy commodity prices at a very strong level. It is debatable how long prices will hold at such elevated levels but there is certainly nothing obvious on the horizon to derail prices immediately. But we are operating in a highly unusual environment where economic risks are certainly high and markets are not always behaving as they have in the past. Therefore we have factored in a sharper decline in dairy commodity prices than is currently showing on the NZX futures market (figure 3).

Figure 3. Dairy commodity price basket

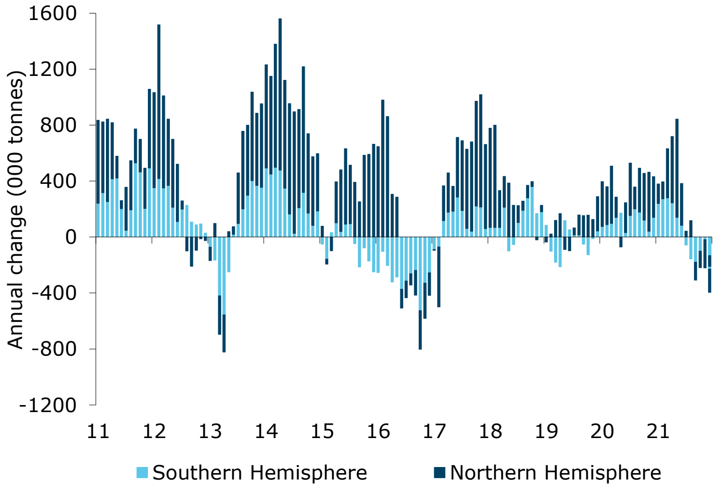


Source: NZX, ANZ Research

Dairy commodity prices and the NZ dollar tend to trend in opposite the same direction which provides a natural hedge for farmgate returns. However, at present we are operating in an environment where the NZD is low and commodity prices are high. Eventually this situation may well correct itself. Likely hikes in the cost of inputs (such as fertiliser), as well as limited resources more generally, are now being reflected in food prices. Environmental limits may be starting to curb food production. Tougher environmental rules are certainly a factor which is limiting growth in global milk supply.

Indeed, global milk supply has been tracking behind the same time last season since August (figure 4). This is the first major slowing of milk production since 2017 and this is supporting global dairy prices.

Figure 4. Global milk production growth for major exporters



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

Operating costs are also rising sharply for our own farmers, but running a pasture-based system does help mitigate some of our exposure to expenses that are rising. Nevertheless, some of the major costs NZ farmers face are racing upwards at a rate which is even outpacing the rapid general lift in inflation. We now expect inflation in NZ to top 7% in second quarter of this year.

The on-farm costs that are rising the quickest include some large costs for most dairy farms: labour, fuel and fertiliser. Interest rates are also rising rapidly, increasing the incentive to reduce debt as quickly as is feasible.

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

			NZD/USD effective				
		USD/t	0.64	0.66	0.68	0.70	0.72
Commodity price basket	20%	4890	12.45	12.00	11.60	11.20	10.85
	10%	4485	11.25	10.85	10.45	10.10	9.75
	Base	4080	10.05	9.65	**9.30**	9.00	8.70
	-10%	3675	8.85	8.50	8.20	7.90	7.60
	-20%	3270	7.60	7.30	7.05	6.80	6.55
	-30%	2850	6.35	6.10	5.85	5.65	5.40

Source: ANZ Research

Summary

The farmgate milk prices for this season is now certainly going to be a record price. Returns are also expected to remain elevated next season, but there is a much higher degree of risk in next season’s milk price. Not just because it is a whole season later, but also because of the global uncertainty we are seeing at present.

Additionally, while high milk prices are generating higher income levels costs are also rising rapidly – particularly fertiliser, labour and feed costs.

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