

# NZ Forecast Update: Farmgate milk price

6 May 2022



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## Contact

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## Farmgate milk price forecasts revised down

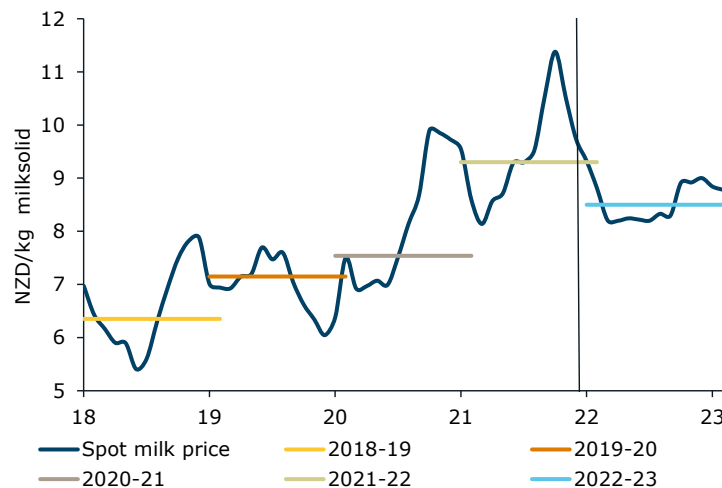
### Key points

- We have revised our farmgate milk price forecast for the 2021-22 season down 40c to \$9.30/kg milksolid (MS). This is the bottom end of Fonterra's current forecast range of \$9.30-\$9.90/kg MS.
- Our forecast for the 2022-23 season has dropped 80c to \$8.50/kg MS as commodity prices are anticipated to keep falling in the coming months.
- The NZD is assumed to appreciate steadily across our forecast period to reach USD0.69 by the end of the 2022 calendar year.

### Global risks impact dairy prices

Dairy commodity prices have dropped sharply over the past couple of months as demand across Asia has been eroded by the wider economic implications of the Shanghai lockdowns and broader challenges to China's economic momentum. We have revised down our farmgate milk price forecast to \$9.30/kg MS (from \$9.70). This puts our forecast at the bottom end of Fonterra's current milk price guidance of \$9.30-\$9.90/kg MS.

Figure 1. Farmgate milk prices

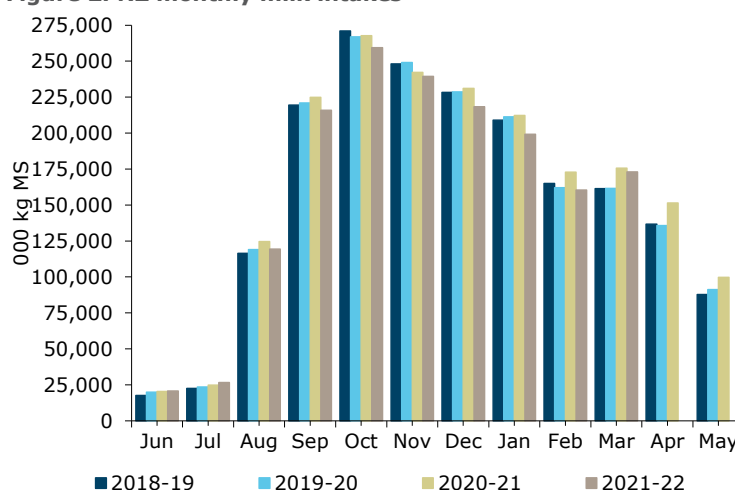


Source: Fonterra, ANZ Research

Global dairy markets have been impacted by the economic consequences of the Shanghai lockdowns, which is being felt throughout Asia. The near-term economic outlook in China generally is looking more clouded as global demand for manufactured goods starts to wane. The high prices buyers have been required to pay to secure dairy products in recent months have also had some impact on demand, particularly from poorer countries.

Fonterra has also increased the volume of current-season product that it is offering on Global Dairy Trade at present, and short-term changes in offer volumes can have a considerable impact on prices. NZ is having a strong finish to its milk production season. Intakes aren't quite on par with last season, but they are well above the norm for this time of the season. This won't make up for the earlier lack of production but it does mean exporters now have a little more product to sell than previously expected.

**Figure 2. NZ monthly milk intakes**



Source: DCANZ

Also at this time of the year, milk intakes in the Northern Hemisphere milk-producing regions are at their seasonal peak. This can also affect prices, but this impact is not usually noticed until later in the winter when NZ exporters begin more actively selling the new season's produce.

These factors are all combining to weigh on the milk price for the 2021-22 season.

**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%	4545	10.65	10.55	10.45	10.35	10.25
	5%	4335	10.05	9.95	9.85	9.75	9.70
	<b>Base</b>	4130	9.45	9.40	<b>9.30</b>	9.20	9.15
	-5%	3930	8.90	8.80	8.75	8.65	8.60
	-10%	3720	8.30	8.25	8.15	8.10	8.00
	-15%	3510	7.70	7.65	7.60	7.50	7.45

Source: ANZ Research

### Looking ahead to 2022-23

Looking forward, we expect milk prices to remain at elevated levels next season, but we have revised down our forecast 80c to \$8.50/kg MS (from \$9.30/kg MS). We expect dairy commodity prices will continue to fall in the coming months, but relatively low global milk supplies are expected to put a floor under prices later in the year.

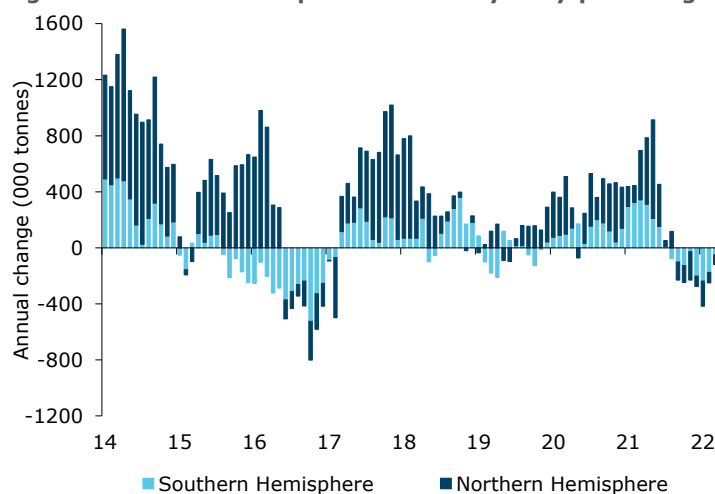
Global risks are highly elevated at present, which is driving uncertainty. The Ukraine situation is adding pressure to what is already an overheated commodity market. Oil prices have skyrocketed but continue to seesaw on headlines on how the war is progressing. Energy commodities were already in tight 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.

We have seen some increases in global milk supplies in response to the high prices, but these are expected to be modest throughout the rest of 2022 as high input costs take the shine off strong milk prices. In the current environment where demand is weakening, any increase in output can put

downward pressure on prices. For now we remain relatively confident the supply response will not be excessive, but it is much harder to forecast demand.

**Figure 3. Growth in milk production in key dairy-producing regions**



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

At this stage we anticipate dairy commodity prices will continue to fall for the next three to six months before stabilising. There is considerable uncertainty about how supply constraints and waning demand will balance out in terms of price movements. NZ milk price futures are currently trading at considerably higher prices than our updated forecasts.

**Figure 4. Dairy commodity price basket**



Source: NZX, ANZ Research

**Table 2. NZX future prices and open interest (as at 4 May)**

Contract period	Daily settlement price (4 May 22) \$/kg MS	Open interest* (million kg MS equivalent)
Sep 22 (2021-22 season)	9.30	80.0
Sep 23 (2022-23 season)	9.46	54.2
Sep 24 (2023-24 season)	8.40	4.8

Source: NZX

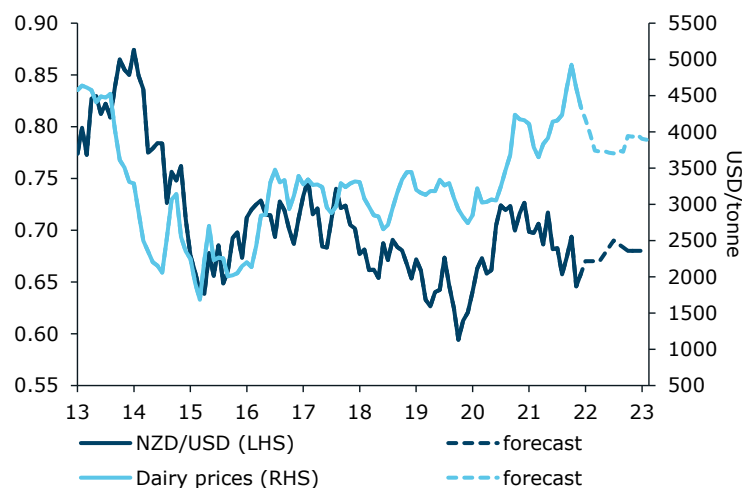
Note units can only be traded in lots of 6,000 kg MS

The high milk prices available on the NZX derivatives market have certainly attracted some additional attention from farmers in recent months. However, the use of the products still remains relatively low overall. The number of open contracts (known as open interest) in the Sep 22 contract equates to about 4% of New Zealand's total milk supply.

### Lower NZD provides some relief

Farmgate prices have certainly benefitted from the low NZD relative to dairy prices (as shown on figure 5).

**Figure 5. Dairy prices vs NZD**



Source: GDT, NZX, RBNZ, ANZ Research

There has been some relief provided by the recent easing of the NZ dollar, although this will have more impact on next season's milk price than the current season. The NZ dollar has weakened a little as central banks in other regions start to tighten monetary conditions. Recently the Reserve Bank of Australia increased its cash rate by 25bp to 0.35%, while the US Federal Reserve lifted its cash rate 50bp as expected. These central bank movements have weighed a little on the NZD, but our currency is still expected to strengthen as the year progresses. By the end of the 2022 calendar year we anticipate the NZD will reach USD0.69.

**Table 3. 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%	4530	11.40	10.95	10.60	10.20	9.90
	10%	4155	10.25	9.90	9.55	9.20	8.90
	<b>Base</b>	3780	9.15	8.80	<b>8.50</b>	8.15	7.90
	-10%	3405	8.00	7.70	7.40	7.15	6.90
	-20%	3030	6.90	6.65	6.35	6.15	5.90
	-30%	2640	5.75	5.50	5.30	5.05	4.85

Source: ANZ Research

### Summary

Global risks to demand are now outweighing relatively subdued global milk supplies. On balance we anticipate further downwards pressure on commodity prices and farmgate prices.

However, the overall tight supplies in the global food production system, along with muted incentives to increase milk production, mean prices are not expected to slide too far. This will help keep farmgate prices above their long-run average next season.



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