

NZ Forecast Update: Farmgate milk price

8 February 2023



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Contact

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Milk price forecasts revised down

Key points

- We have revised down our farmgate milk price forecast for the 2022-23 season by 25c to \$8.50/kg milksolid.
- Our forecast for the 2023-24 season has also been revised down 25c to \$8.75/kg milksolid.
- The NZD has appreciated more quickly than forecast, and we now expect it to reach USD0.66 by September 2023 (USD0.63 currently).
- Dairy commodities are poised to rebound, but the lower prices achieved in recent months has put downward pressure on farmgate returns.

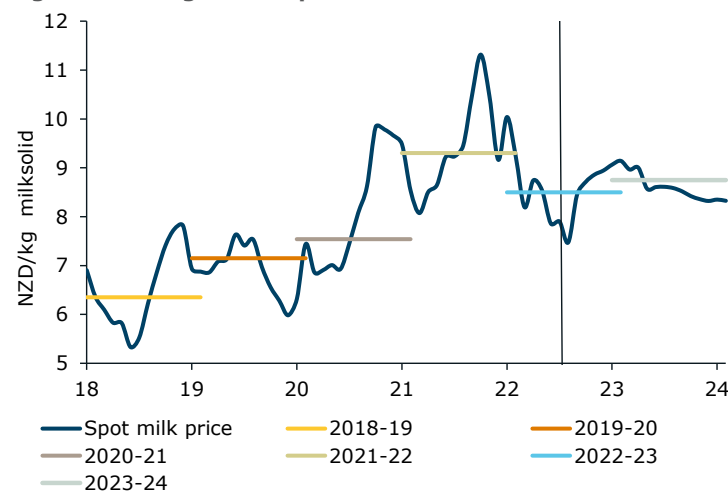
Milk price drops to lower end of Fonterra forecast

Our \$8.50/kg milksolid (MS) forecast for the 2022-23 season is at the lower end of Fonterra's latest price guidance of \$8.50-\$9.50/kg MS.

Milk price futures have also retreated quite sharply. The milk price futures contract for the 2022-23 season peaked at \$10.30 in September but more recently this contract has traded at or near \$8.50/kg MS.

Despite the lift at this week's auction, recent movements in both dairy commodity prices and the exchange rate have been largely unfavourable for farmgate prices. While we expect dairy commodity prices to gradually recover, we also expect the NZD to appreciate further.

Figure 1. Farmgate milk prices



Source: Fonterra, ANZ Research

The NZD has been relatively weak over the past year, which has helped offset a period of lower dairy commodity prices. The NZD is now trending higher, but dairy farmers will still benefit both this season and next season from processors' FX hedging positions.

This lower effective NZD will help returns next season. We have revised down our initial milk price forecast for the 2023-24 season by 25c to \$8.75/kg MS.

At present, \$9 is looking like a bit of a stretch for next season, although forecasting this far in advance does carry a high degree of uncertainty.

Milk price futures for the 2023-24 season have recently traded at \$8.75/kg MS. This is well down from the lofty heights of \$10.35/kg MS they reached in October.

While most of the interest in futures contracts remains in the current season contract (2022-23 season) there have been some trades in the 2024-25 contract.

Dairy commodity prices expected to improve

Dairy commodity prices have been quite weak this summer, compared to recent years, but we do anticipate prices will steadily improve from here. The positive result from the early February Global Dairy Trade event will help to instil some confidence in the market.

We are forecasting a modest improvement in dairy prices across the remainder of the 2022-23 season.

Whole milk powder (WMP) prices are highly dependent on demand from China. While demand from the Chinese market appears to be improving, it does not appear that this market is short of stock at present. Additional domestic production of WMP is also expected to bolster stocks, but many Chinese companies still prefer to use imported milk powders due to the consistent quality of the product.

WMP pricing is improving, but skim milk powder (SMP) prices are being kept in check by additional volumes becoming available from Europe and the United States.

New Zealand does have some flexibility in its product choice, and for now WMP looks a better option than SMP production, although with milkfat products still delivering good results there is not a lot in it based on current prices. However, with extra European SMP being offered to the market, WMP is expected to be a less risky product choice.

Demand for milkfat products remains robust. Butter and anhydrous milkfat products are still selling well, despite these products being more aligned with higher-priced food products such as bakery goods. This demand is mainly being driven by improvements in demand from Asia, which is the main destination for NZ dairy products.

Currency continues to firm

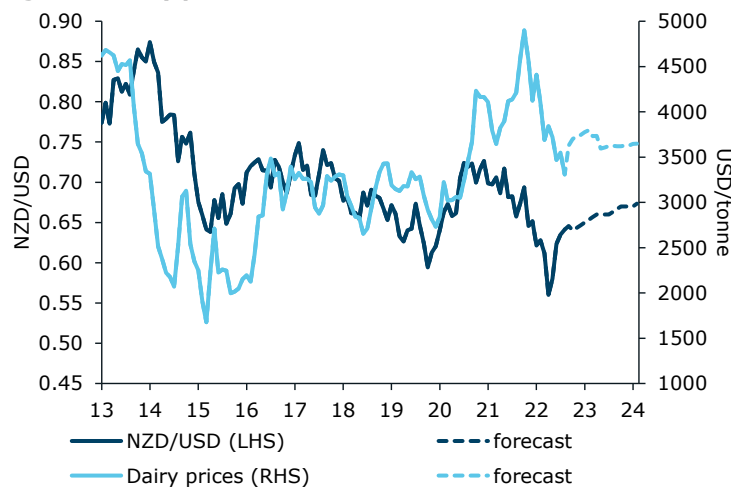
The NZD has steadily appreciated in recent months. We now anticipate the NZD will be trading at USD0.66 by September and lift to USD0.67 by March 2024. Any increase in the NZD does erode returns at the farmgate level, but effective exchange rates are still expected to be lower next season due to processors' hedging policies.

Table 1: NZD/USD forecast

	Mar 23	Jun 23	Sep 23	Dec 23	Mar 24
Forecast	0.64	0.65	0.66	0.66	0.67

The recent lift in NZ interest rates is putting some upward pressure on the currency as it attracts additional inflows of capital. However, global risks are still elevated and this tends to result in investment in the safe-haven currencies such as the USD. We expect this will limit how far the NZD appreciates. No doubt there will be volatility in the NZD, and this will have a direct impact on the milk price, particularly for the 2023-24 season.

Figure 2. Dairy prices vs NZD



Source: GDT, NZX, RBNZ, ANZ Research

Summary

Global dairy markets are starting to improve but elevated stock levels will curb the speed of the recovery. The reopening of China is positive but at present a lot of the incremental demand is coming from other markets.

The NZD is steady climbing which will erode returns. However, currency hedges already in place will slow the impact on farmgate prices.

Overall the dairy commodity market is expected to improve a little and this is factored into our current milk price forecasts.

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

		NZD/USD effective					
Commodity price basket		USD/t	0.655	0.660	0.665	0.670	0.675
	10%	4065	9.70	9.60	9.55	9.45	9.35
	5%	3885	9.20	9.10	9.00	8.95	8.85
	Base	3700	8.65	8.55	8.50	8.40	8.35
	-5%	3510	8.10	8.00	7.95	7.85	7.80
	-10%	3330	7.55	7.50	7.40	7.35	7.30
	-15%	3150	7.05	7.00	6.90	6.85	6.75

Source: ANZ Research

Table 3. Farmgate milk price sensitivity table (2023-24 season)

		NZD/USD effective					
Commodity price basket		USD/t	0.62	0.63	0.64	0.65	0.66
	15%	4200	10.80	10.60	10.40	10.20	10.00
	5%	3840	9.70	9.50	9.30	9.15	8.95
	Base	3650	9.10	8.95	8.75	8.60	8.40
	-5%	3465	8.55	8.35	8.20	8.05	7.90
	-10%	3285	8.00	7.80	7.65	7.50	7.35
	-20%	2925	6.85	6.75	6.60	6.45	6.30

Source: ANZ Research



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