

NZ Forecast Update: Farmgate milk price

19 July 2023



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Milk price forecast drops sharply

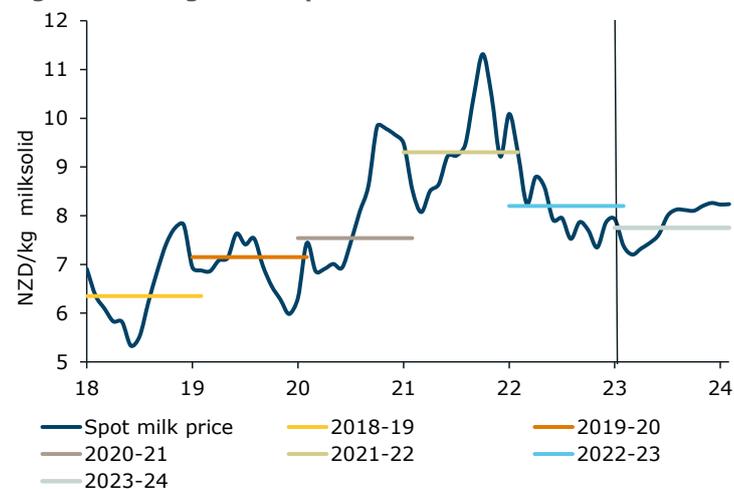
Key points

- We have revised down our farmgate milk price forecast for the 2023-24 season by 50c to \$7.75/kg milksolid.
- Our forecast for 2022-23 remains at \$8.20/kg milksolid.
- Global demand for dairy products has been impacted by deteriorating economic conditions affecting consumer demand, particularly in China.
- The relatively weak NZD remains supportive of the farmgate milk price but is not sufficient to offset the impact of lower returns for dairy commodities.

Milk price revised down

Dairy commodity prices have continued to decline in recent months, and it now appears that prices will not materially increase before a large proportion of the current season's supply is traded.

Figure 1. Farmgate milk prices



Source: Fonterra, ANZ Research

We now forecast a farmgate milk price of \$7.75/kg milksolid (MS) for the 2023-24 season, 50 cents lower than our previous guidance. Our forecast is now below the \$8.00 mid-point of Fonterra's latest price guidance of \$7.25-\$8.75/kg MS.

Milk price futures are currently priced at \$7.68/kg MS for the 2023-24 season, having retreated quickly over the past month.

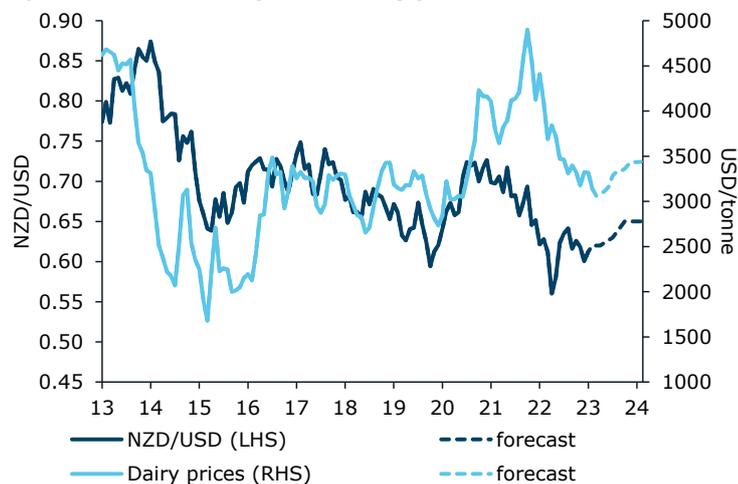
Dairy commodity prices still trending lower

Dairy commodity prices continue to soften and it is difficult to know exactly for how long prices will recede. Typically, such low prices stimulate demand. There has been a little extra demand from some buying regions recently, but this has been muted, as while prices are still falling buyers tend to hold off, looking to benefit from any further downward movement in pricing.

Clear signs that pricing has turned are likely to stimulate additional demand, as buyers scramble to secure supplies before prices trend even higher. But when this point might arrive remains unclear.

What is clear is that consumer demand is being impacted by weaker economic conditions in many regions. Most economies are still growing, albeit at a considerably slower pace than normal, which is taking a toll on dairy demand. The softer demand from China is having the largest impact, as China is by far the world's largest importer of dairy products. This market is expected to remain relatively weak for some time yet, but as milk supplies tighten prices are expected to improve later in the season.

Figure 2. NZD vs dairy commodity prices



Source: GDT, RBNZ, ANZ Research

We are also factoring in an increase in the value of the NZ dollar as the season progresses. But as hedging will already be in place for much of the current season's production, the effective exchange rate for the 2023-24 season is forecast to be considerably lower than the prior season. This is helping to offset some of the impact of the lower commodity prices but certainly not all of it.

Global milk supply is not really the problem

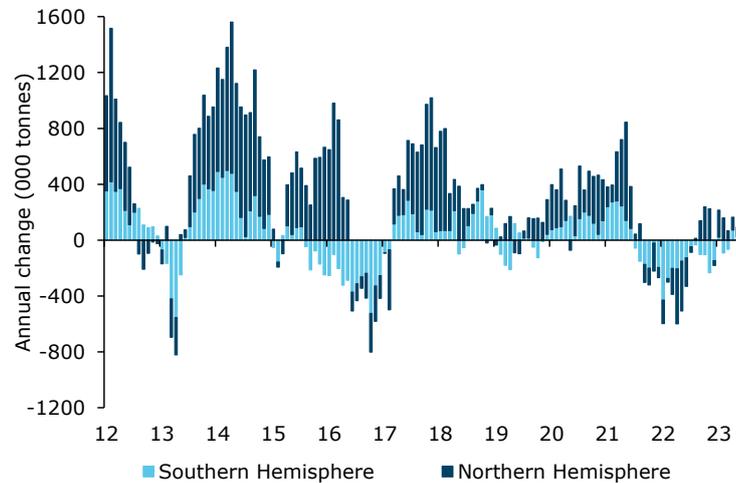
Global milk supplies have been growing at a very modest pace over the past 12 months, so additional milk has not been the catalyst for the weaker prices. Looking forward, global milk supplies are likely to tighten further as the low milk prices result in less feed inputs, particularly in countries where cows are housed and therefore feed is their major operating cost.

There are already anecdotal reports of smaller farms going out of business, particularly in regions where the cost of producing milk is very high, such as China. Therefore, over the next 12 months we could actually see a fall in global milk supplies.

New Zealand's milk output is generally trending lower. There will continue to be significant seasonal variations, given pasture production is largely determined by the weather. El Nino is forecast to occur this year, which could deliver a long, hot summer. That would curb dairy production, particularly in non-irrigated regions.

Thus far the winter has been relatively mild but wet conditions underfoot are resulting in some damage to pastures as calving gets underway and cows return from winter grazing. If soils are damaged this may limit pasture regrowth. This in turn could limit milk production, particularly if coupled with a dry summer.

Figure 3. Milk production growth in major dairy exporting countries



Source: DCANZ, Dairy Australia, EuroStat, USDA, CLAL.

Australia’s milk production dropped by approximately 5% last season, which reflected both poor weather and a lack of confidence in the industry. This season, weather conditions are assumed to be more favourable, but the confidence issue remains, which is why Dairy Australia is forecasting production to be flat to slightly lower in the year ahead.

The large dairy-producing regions of the Northern Hemisphere are expected to deliver modest growth in milk supplies. In the US milk production has been growing, but not excessively. Official USDA forecasts indicate growth of 0.8% in 2023 and just under 1% in 2024. However, in recent months the pace of growth has been nearer 0.5%. There are indications that cow numbers are decreasing and therefore it is most likely that growth in milk supplies will be more modest than forecast as feed costs are also rising relative to milk prices.

In Europe tighter margins for dairy producers are expected to result in less milk being produced in the second half of 2023, which is forecast to reduce milk intakes across the EU by 0.2% for the 2023 calendar year. Farmgate milk prices in Europe have fallen by more than 20% on average since the beginning of the year. Feed costs are easing but are still high relative to milk prices and environmental regulations are limiting cow numbers in some regions.

China’s milk production is always difficult to access accurately, but when dairy commodity prices are low it is typically cheaper to import dairy products than to produce them locally. Small farms in China continue to go out of business but this attrition is partially offset by ongoing growth in larger-scale farms, which have better access to government subsidies. These dynamics cloud the overall picture, but it is very unlikely that China’s milk production is growing significantly at present.

Summary

Global dairy markets have deteriorated at a quicker pace than anticipated. At this stage it is not clear when dairy commodity prices will lift but we have factored in a gradual increase. However, most of this won't occur before a large proportion of the new season's supply is already traded.

Milk output remains relatively subdued in most jurisdictions, which will eventually support higher prices.

The current weakness in the NZD is providing some assistance to farmgate pricing, but hasn't been sufficient to offset the sharper reduction in the price of milk powders and dairy fats such as butter and anhydrous milkfat.

Table 1. Farmgate milk price sensitivity table (2022-23 season)

		USD/t	NZD/USD effective				
			0.650	0.655	0.660	0.665	0.670
Commodity price basket	10%	3930	9.40	9.30	9.25	9.15	9.05
	5%	3750	8.90	8.80	8.70	8.65	8.55
	Base	3570	8.35	8.25	8.20	8.10	8.05
	-5%	3390	7.80	7.75	7.65	7.60	7.50
	-10%	3210	7.30	7.20	7.15	7.10	7.00
	-15%	3030	6.75	6.70	6.65	6.55	6.50

Source: ANZ Research

Table 2. Farmgate milk price sensitivity table (2023-24 season)

		USD/t	NZD/USD effective				
			0.60	0.61	0.62	0.63	0.64
Commodity price basket	15%	3700	9.60	9.40	9.20	9.05	8.85
	5%	3380	8.60	8.40	8.25	8.05	7.90
	Base	3220	8.10	7.90	7.75	7.60	7.45
	-5%	3060	7.55	7.40	7.25	7.10	6.95
	-10%	2900	7.05	6.90	6.75	6.60	6.50
	-20%	2580	6.05	5.90	5.80	5.65	5.55

Source: ANZ Research



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