AGRI UPDATE

Milk price forecast update.

11 Feb 2025 | **Michael Gordon**, Senior Economist | +64 9 336 5670 | +64 21 749 506 | michael.gordon@westpac.co.nz

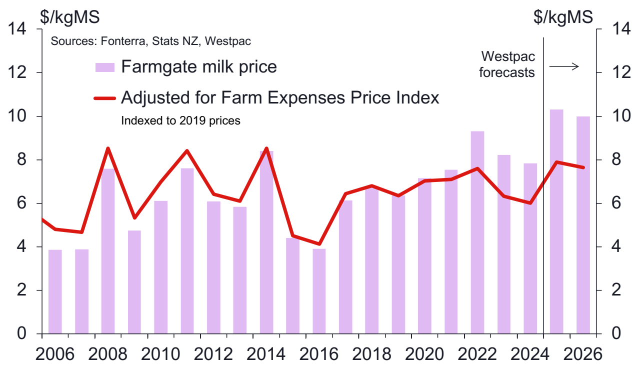
Starter for ten

- **We have revised up our farmgate milk price forecast for this season by 30 cents to $10.30/kg.**
- **Resilience in world dairy prices and a lower New Zealand dollar have strengthened the outlook for the remainder of the season.**
- **Our opening forecast for the 2025/26 season is $10/kg.**
- **While we expect world prices to ease from their current levels as the rebuilding of Chinese inventories runs its course, this is partly offset by a sustained lower exchange rate over the season.**
- **With the start of the next season still months away, there is significant uncertainty around both of these factors, and we'd put an appropriately wide range around our forecast.**

Farmgate milk price forecasts

	2024/25		2025/26
	Westpac	Fonterra	Westpac
Milk price	$10.30	$9.50-$10.50	$10.00

Farmgate milk price forecasts



Current season forecast revised up to $10.30/kg.

We have revised up our farmgate milk price forecast for this season to $10.30 per kilo of milksolids, from a previous forecast of $10.00/kg. Global dairy prices have generally held their ground, and the lower New Zealand dollar is helping to boost local returns.

The last two GlobalDairyTrade auctions have seen a solid lift in dairy prices, although that followed declines in the two previous auctions. Overall, though, they've held up better than we expected – our previous $10/kg forecast assumed that prices would gradually edge down over the remainder of the season.

Chinese buyers have been much more prominent in recent months, with reports that they are needing to restock after letting their inventories run down to extremely low levels. Whole milk powder (WMP) has been particularly in demand, as there are few countries other than New Zealand that export it in significant amounts. WMP prices have reached their highest since April 2022; other products such as skim milk powder and butter have also gained recently but have not exceeded last year's highs.

Our view remains that dairy prices will ease back as this restocking phase runs its course and Chinese demand returns to business-as-usual levels. However, there's still some uncertainty around how far they might bid up prices in the meantime.

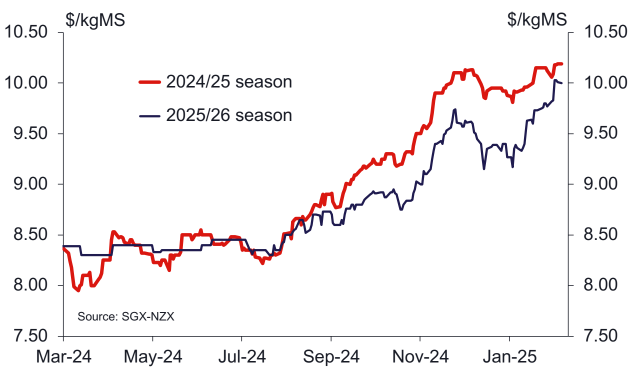
The exchange rate is also proving to be more favourable than expected for exporters. In its last monthly update, Fonterra said that by early December it had covered 86% of its foreign currency exposure for the season and assumed that the remainder would be hedged at around 0.5860, the spot rate at the time. However, the exchange rate has generally been lower than that since.

Much of this season's production has already been priced, so any further revisions to the milk price forecast will be relatively small. However, developments in the next few months could have a major bearing on the outlook for next season.

$10/kg forecast for the 2025/26 season.

Our first forecast of next season's milk price is $10.00/kg. Note that this is our estimate of the final milk price – not where we're expecting Fonterra to set its own opening forecast, which may be more conservative (this will likely be announced in late May). Our forecast is right in line with the futures market at the moment, which jumped up to $10/kg after last week's GDT auction.

Futures pricing for farmgate milk prices



As noted above, we expect world dairy prices to ease over the year ahead as Chinese buying returns to more normal levels. On the supply side, the current high prices provide a strong incentive for the world's major dairy exporters to ramp up production. However, they may still be constrained by other factors – in particular, how well the US and Europe deal with their respective disease outbreaks (avian flu and bluetongue virus) will have an impact on their herd sizes and hence their output over the next season.

Overall, we've assumed that world prices will be 6% lower on average compared to the current season. However, this is partly offset by a lower expected exchange rate over the season. As we discussed yesterday in **our Weekly Economic Commentary**, the New Zealand dollar has fallen significantly since the US election, and the Trump administration's policies are likely to mean higher US interest rates and a sustained higher US dollar.

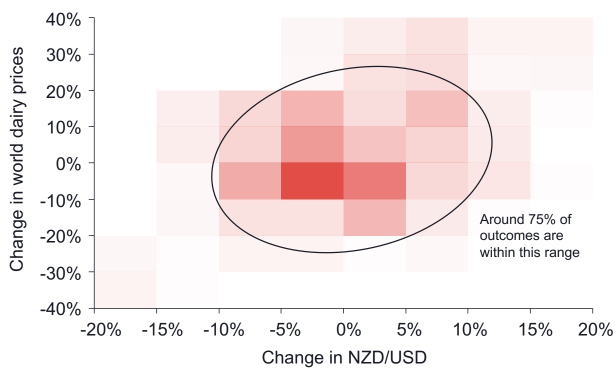
While a second season of farmgate prices at $10/kg or more sounds extremely optimistic, it's necessary to look at this in 'real' terms. The bout of high inflation in the years following the Covid shock means that both consumer prices and farmers' production costs have taken a permanent step higher. In that respect, double-digit milk prices are likely to be a frequent occurrence in the years ahead.

What are the risks?

Given that we're still a few months away from the start of the next season, it's appropriate to place a wide margin of uncertainty around our milk price forecast. Global economic conditions, trade policies, and other geopolitical risks mean that both dairy prices and the exchange rate could end up a long way from our forecasts in the year ahead.

In the chart below we plot the history of changes in world dairy prices and the New Zealand dollar, going back to 1987. Both of them have been highly variable – even on a 12-month average basis, dairy prices can vary by as much as 40% from one year to the next, while the exchange rate can vary by as much as 20%. However, we can also see a tendency for them to move in the same direction, which means that the exchange rate tends to provide a partial buffer for New Zealand exporters against global price shocks.

Heatmap of annual changes in dairy prices and NZD



Even with the buffering effect of the New Zealand dollar, the potential variation in local currency returns over the next year is substantial. We estimate that a range of $1.50 either side of our $10 forecast (that is, a range of $8.50 to $11.50) would cover around 75% of historic outcomes. This is double the range that Fonterra has tended to place around its opening forecast.

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