WESTPAC DAIRY UPDATE

Forecast update and GlobalDairyTrade auction results.

8 December 2021

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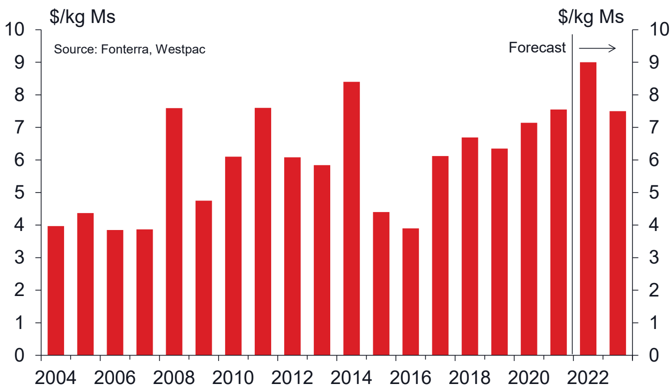
NZD booster shot.

- We have upgraded our 2021/22 farmgate milk price forecast to $9.00/kg and our 2022/23 forecast to $7.50/kg.
- The upgrades reflect a large downward revision to our NZD/USD forecasts.
- Effectively, the lower forecast NZD/USD is likely to prove a windfall gain for farmers over this season and next.

Farmgate milk prices



Farmgate milk price forecasts

	2021/22		2022/23
	Westpac	Fonterra	Westpac
Milk price	$9.00	$8.40-$9.00	$7.50

We have upgraded our 2021/22 farmgate milk price forecast by 10 cents to $9.00/kg. This revision puts our forecast at the top of Fonterra's updated forecast range of $8.40 to $9.00/kg.

We have also upgraded our 2022/23 farmgate milk price forecast by 60 cents to $7.50/kg. While not as low as our original opening forecast, this forecast still represents a $1.50/kg drop from our 2021/22 forecast. $7.50/kg is also where we expect the farmgate milk price to average over the next five years (in inflation-adjusted terms).

Lower NZD/USD is likely to prove a windfall gain for farmers.

The key catalyst for the forecast revisions is our lower forecast track for NZD/USD. We now expect NZD/USD to fall to US$0.66 by mid-2022. That's a whopping 8 cents lower than our previous expectation of it rising to US$0.74 at the same stage. Expectations of an earlier increase in interest rates in the US have put the US dollar on the front foot, and we expect that it will make further gains against currencies like the NZD over the next six months.

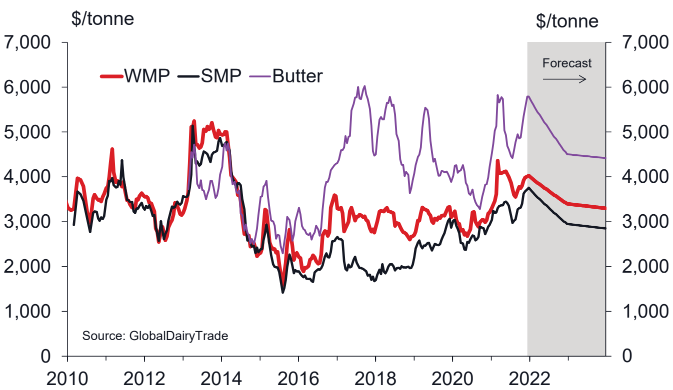
NZD/USD

The NZD/USD revision gives a small boost to the current season's milk price forecast, but a much larger boost to next season's. Fonterra hedges its NZD exposure well in advance. This means that much of this season's NZD exposure is already locked and thus the benefit of a lower NZD/USD is small. In contrast, Fonterra has plenty of time to take advantage of the lower NZD/USD for next season and hence we have lifted our forecast by 60 cents as a result.

Indeed, the lower NZD/USD is also likely to prove a windfall gain for farmers. Importantly, we expect the currencies in our key markets to remain firm against the USD, in contrast to the NZD. For example, we expect the Chinese yuan to remain flat against the USD over the next two to three quarters, before it gradually appreciates against the USD from later in 2022. It's a similar story for other currencies in our other key markets in South-East Asia. That means that Asian buyers will maintain their purchasing power in their local currencies and therefore their demand from this perspective should remain largely unchanged.

Nonetheless, we still expect global dairy prices to gradually fall from their peaks over 2022. As we mentioned in our previous update, we expect global dairy supply to rebound next year. And in turn, we expect this rebound will prove the main catalyst for the decline in global dairy prices.

Key dairy commodity prices and forecasts



All up, we expect the ducks to continue to line up for dairy farmers for longer. That's not to say there aren't risks. And on that front, we continue to highlight the cost pressures that farmers are facing. Keeping a lid on costs wherever possible, will remain key to making the most of this purple milk price patch. We also note that at this early stage, there is a wide range possible milk prices (of up to plus or minus $1.50/kg) around our 2022/23 forecast of $7.50/kg.

Auction results, 8 December.

Dairy auction prices posted modest gains overnight. Overall prices lifted by 1.4%, while key whole milk powder (WMP) prices lifted by a more modest 0.6%.

The lift in prices builds on gains over September, October and the first November auction. Overall prices and WMP prices have lifted by around 16% and 12%, respectively since August, and 26% and 34%, respectively above year ago levels. Taking a longer-term perspective, overall prices are around 30% above their five-year average.

The price strength overnight was broad based. All of the products that we monitor posted price gains. Butter prices led the price gains, rising 4.6%. Notably, cheddar prices continue to hold on to recent strong gains, rising another 1.0%.

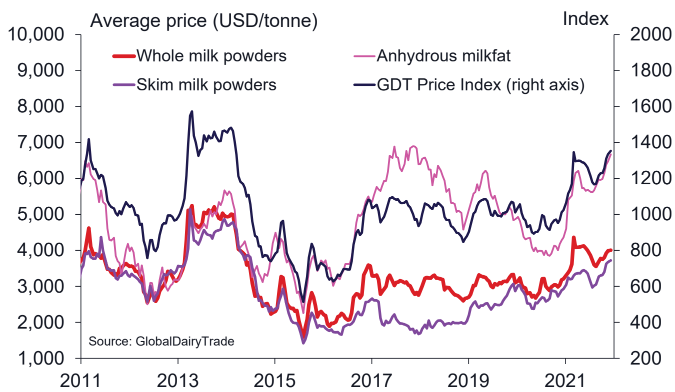
The result, however, was a little lower than our expectations. We had expected a 2% lift in WMP prices, while the futures market had expected a larger increase in the vicinity of 4%.

Heading into 2022, we expect global dairy production to start rebounding from its extended weak spot and for global dairy prices to begin gradually declining. Indeed, the last few months has seen weak global production across all key exporters, and this cannot continue indefinitely.

GlobalDairyTrade auction results

	Change since last auction	Prices USD/tonne
Whole Milk Powder (WMP)	0.6%	$4,008
Skim Milk Powder (SMP)	1.3%	$3,721
Anhydrous Milk Fat (AMF)	3.0%	$6,668
Butter	4.6%	$5,791
GDT Price Index	1.4%	1,354

Global dairy prices



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