

Milk Price Forecasts Update.

16 October 2019



We have revised up our forecast of Fonterra's farmgate milk price for this season, from \$6.50 to \$6.80 per kilo of milksolids. The change reflects the fact that world dairy prices have held up better than we expected at recent auctions. However, we remain cautious on the outlook for Chinese demand over the rest of this season. We also provide here our first forecast of the milk price for the 2020/21 season, where we expect a relatively healthy \$7.00/kg.

Our forecast of \$6.80/kg for the current season is still at the lower end of the range of market forecasts (though around the midpoint of Fonterra's forecast range of \$6.25 to \$7.25), which reflects our relatively downbeat view on China in the near term. China's economy has come under significant strain this year, as tensions with the US have escalated and both countries have slapped retaliatory tariffs on the other's exports. Recent negotiations have led to some tariff increases being delayed, but it's not clear whether this truce will be any more lasting than the previous ones.

As the trade war has escalated, we've seen a drop in output and a flattening-off in investment in China's manufacturing sector, and prices for hard commodities like steel and coal have fallen. While Chinese consumers haven't been directly in the firing line yet, we expect that there will be knock-on effects in terms of weak employment and wage prospects.

However, we have to acknowledge that Chinese demand for dairy products has held up well for the season to date. Prices at the GlobalDairyTrade auctions have risen by about 2% since we lowered our milk price forecast in August, against our view that they would fall further. Both the auction results and the overseas trade figures show that China has been the main source of growth in demand for dairy this year.

Our milk price forecast still assumes a pullback of around 10% in world dairy prices by the end of the season – a fairly conservative call given how far we've seen prices swing around in the past. If that call doesn't pan out, and Chinese consumers stay resilient to the ructions in their wider economy, the milk price would probably be even higher.

Milk supply is more of a neutral factor for our forecasts. Milk production among the major exporters has been about flat over the last year or so, with limited growth in the US and Europe and much weaker production in Australia. We're assuming only around 1% growth in New Zealand's milk production for this season. Normally an expected milk price as high as this would incentivise dairy farmers to look for ways

to ratchet up their output. But we think they will be more cautious about expanding this year, as they grapple with rising regulatory and environmental pressures.

Our opening forecast for next season's milk price is \$7.00/kg, which would be the highest since the 2013/14 season. World dairy prices are currently tracking around their long-term averages, and in the absence of any major demand or supply shocks, we would expect these prices to hold at similar levels over next season. However, we expect the farmgate milk price to be lifted by a lower effective exchange rate. Fonterra hedges a substantial amount of its foreign currency exposure in advance, so the recent declines in the New Zealand dollar will have more impact on next season's returns than on the current season.

Farmgate milk price forecasts

	2019/20		2020/21
	Westpac	Fonterra	Westpac
Milk Price	\$6.80	\$6.25-\$7.25	\$7.00

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