

WESTPAC DAIRY UPDATE

Forecast update and Global Dairy Trade auction results.

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Boom and echo boom.

- This milk price cycle is different.
- Indeed, this cycle is shaping up as more boom and echo boom than the boom and bust of previous cycles.
- With this in mind, we have lifted our 2022/23 milk price forecast by 75 cents to \$9.25/kg. Meanwhile, we have tweaked our 2021/22 forecast up 10 cents to \$9.60/kg.

Farmgate milk price forecasts

	2021/22		2022/23
	Westpac	Fonterra	Westpac
Milk price	\$9.60	\$9.30-\$9.90	\$9.25

On the back of prolonged weak global dairy supply, we have upgraded our 2022/23 farmgate milk price forecast by 75 cents to \$9.25/kg. At the same time, we have tweaked our 2021/22 forecast up by 10 cents to \$9.60/kg. This latter move reflects fine-tuning of our forecast rather than any underlying change in dairy market view.

Farmgate milk prices



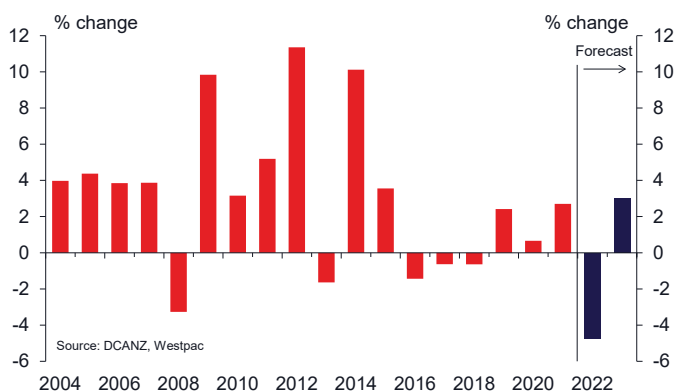
Dairy production is down for the count.

Global dairy production is staying weaker for longer. Indeed, we have recently revised down our forecast for New Zealand dairy production growth to -4.75% from -3% previously.

A drop of that magnitude would be the largest season-to-season fall on record. In fact, the drop, if we are correct, would

be around 1.2 percentage points larger than the previous record fall.

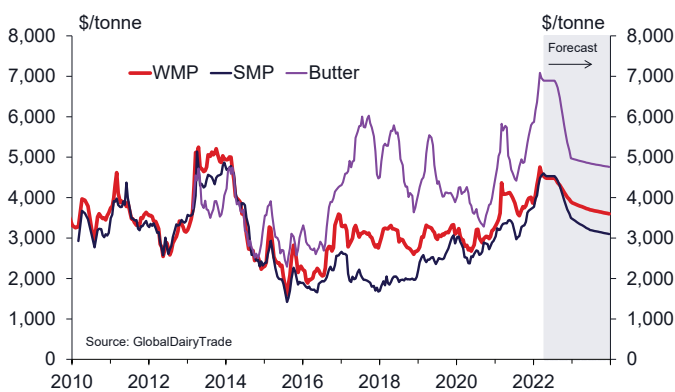
Dairy production growth (all NZ suppliers)



Meanwhile and as we have discussed previously, dairy production elsewhere is also weak. A similar combination of bad weather and high feed and other costs has hit production in other key exporters such as the EU and US. The Ukraine conflict has added additional supply issues to the mix. Indeed, due to rising feed grain and fuel costs, some Northern Hemisphere dairy producers are now running at a loss.

With the above in mind, we now expect global dairy prices to start the 2022/23 season firmly on the front foot. We still expect prices to eventually moderate over the season as global dairy supply eventually rebounds, nonetheless prices for the season as a whole are likely to average higher than we previously expected.

Key dairy commodity prices and forecasts



This milk price cycle is no bust.

This milk price cycle is different. If our 2022/23 forecast proves close to the money, then the milk price is likely to be the second highest on record after this season (2021/22).

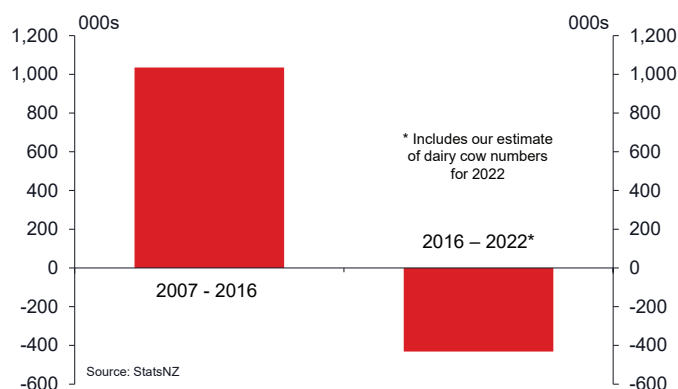
This is a marked departure from previous cycles. In the last milk price cycle, the price peaked at \$8.40/kg and then almost halved the following season to \$4.30/kg and then slumped further to \$3.90/kg the season after.

The reason for the massive price swing was the similarly massive swing in dairy production globally. Here in

New Zealand, production climbed around 11% in the season of the milk price boom, and then a further 4% or so the season after.

Dairy farm conversions underpinned the surge in production during this time. For example, between 2007 and 2016, dairy cow numbers jumped by over a million cows. And use of other inputs like land, feed and fertiliser also surged.

Change in New Zealand dairy herd



But over recent years, the dairy industry has consolidated to the point where the use of land and some other inputs has actually decreased. In fact, we project that the dairy herd has shrunk by around 400,000 cows between 2016 and 2022.

The reasons for the consolidation are varied. Regulations and compliance, competition for resources from other users, labour constraints and tight credit have all played a role. But essentially it is almost too hard to convert land to dairy use these days.

As a result, dairy production cannot respond quickly (or at a magnitude that it once could) to surging prices. We expect production to rebound just 3% next season, after the 4.75% slide this season. In other words, production is unlikely to recover to the level that it was back in 2020/21 for at least a few more seasons.

The upshot is that as it stands the boom bust milk price cycles are behind us. And unless there is a major unwinding in regulations and compliance around land use, in particular, the milk price has moved structurally higher. We expect it to average around \$8.00/kg in today's dollars over the long term from here.

Notably, costs have also lifted structurally as a result of the factors discussed above. But on balance, dairy farm business margins and thus profits have increased.

Auction results, 6 April.

Dairy auction prices dipped overnight. Overall prices fell 1.0%, while key whole milk powder (WMP) prices slid by 1.5%.

The price fall overnight was the second successive fall. Despite the fall, overall and WMP prices still sit 17% and 19% higher, respectively, than as at the end of 2021.

Prices were mixed by product; with four out of the six products we monitor posting price falls. Anhydrous milk fat led the price falls (down 2.5%), while butter prices also dipped by 0.6%. On the positive side of the ledger, cheddar and skim milk powder (SMP) continued their 2022 surge.

This result was weaker than expectations. Last week, we pencilled in no price change for WMP. Immediately prior to the auction, the futures market had indicated a circa 1% lift in WMP prices.

The Omicron outbreak and surging Covid case numbers in Shanghai and some other regions in China has led to a fall in dairy demand in the world's largest dairy market.

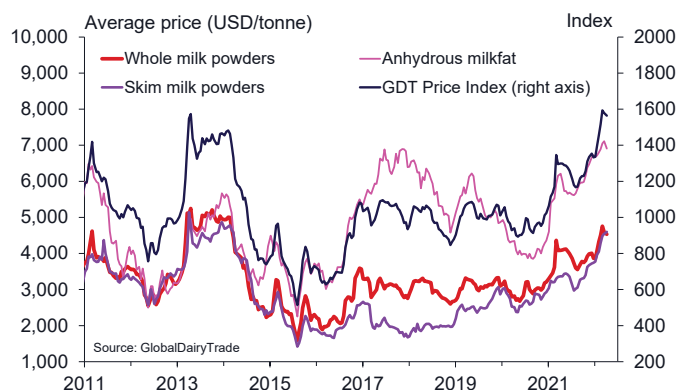
Indeed, the fact that WMP and butter have posted consecutive price falls points to conditions in China as being the key development for dairy markets. Recall that New Zealand is the largest exporter of WMP and butter to China, so any factors affecting demand there are soon reflected in these prices on the auction platform.

In contrast, SMP and cheddar prices continued their 2022 surge. SMP and cheddar prices up around 38% and 51% since this time last year, respectively. New Zealand is a smaller exporter of these products, with the EU the dominant exporter. As a result, the price rises for these products suggest that the Ukraine-Russia conflict and its impact on grain feed prices is continuing to put the squeeze on EU dairy production.

GlobalDairyTrade auction results

	Change since last auction	Prices USD/tonne
Whole Milk Powder (WMP)	-1.5%	\$4,532
Skim Milk Powder (SMP)	1.0%	\$4,599
Anhydrous Milk Fat (AMF)	-2.5%	\$6,908
Butter	-0.6%	\$6,891
GDT Price Index	-1.0%	1,564

Global dairy prices



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