

WESTPAC DAIRY UPDATE

GlobalDairyTrade auction results.

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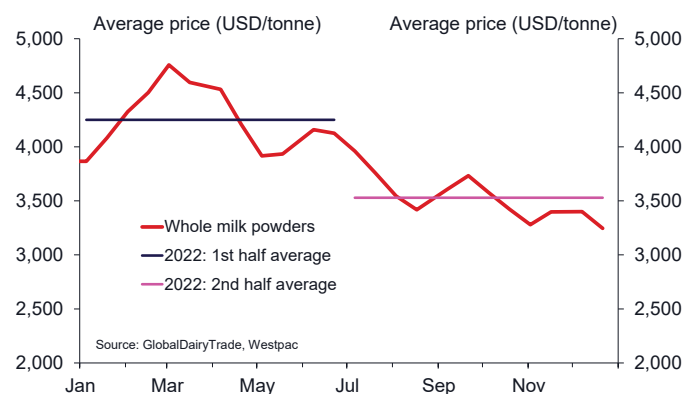
2022: A year of two halves.

- 2022 was a year of two halves for global dairy markets.
- Very tight global supply saw prices starting 2022 with a hiss and a roar.
- However, that gave way to a steady decline in prices through the second half of the year, dragged down by weak Chinese dairy demand even as global supply remained weak.
- Looking to 2023, we expect the weak patch for prices to continue in the first half of the year.
- However, as Chinese Covid restrictions are eased further, we expect global demand and prices to improve from around mid-2023.

A hiss and a roar.

Global dairy markets started 2022 with a hiss and a roar. Whole milk powder (WMP) prices surged by around 23% over January, February and then early March. In fact, the global dairy price index hit a record high in March.

2022: Whole milk powder prices



The catalyst for the price surge was very tight global supply. New Zealand dairy supply ended the 2021/22 season a whopping 4% down on 2020/21, with drought and falling cow numbers (due to land use change) spurring the fall. That was a record fall for a season based on the data we have to hand. Dairy production in other key regions was also weak, albeit not as weak as in New Zealand.

The global dairy price surge culminated in a record farmgate milk price of \$9.30/kg. This price eclipsed the previous record

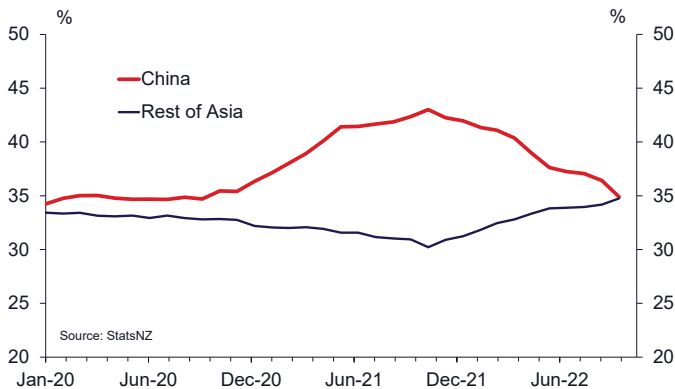
high of \$8.40/kg in the 2013/14 season. As a result, many dairy farmers went on to post record high farm profits.

Where China goes global dairy prices follow.

In the second half of the year, weak Chinese dairy demand pushed prices steadily lower even as global supply remained weak. Between the March peak and the end of the year, WMP prices have fallen by over a third.

The driver of weak Chinese dairy demand has been ongoing Covid restrictions which have caused the Chinese economy to effectively stall. In annual change terms, Chinese economic growth dipped to just 0.4% in the June quarter, down from over 4% in the three quarters prior. The chart below shows how the annual share of New Zealand dairy export volumes has fallen steadily over the year as Chinese demand has declined.

Share of New Zealand dairy export volumes



That price weakness has come despite continued global supply weakness. Indeed, to date this season, New Zealand production remains 3.5% down compared to the same stage of last season.

Surging on-farm inflation was another key feature of the second half of 2022. Dairy farm input inflation sky-rocketed to 17.5% in the September quarter versus the same quarter last year.

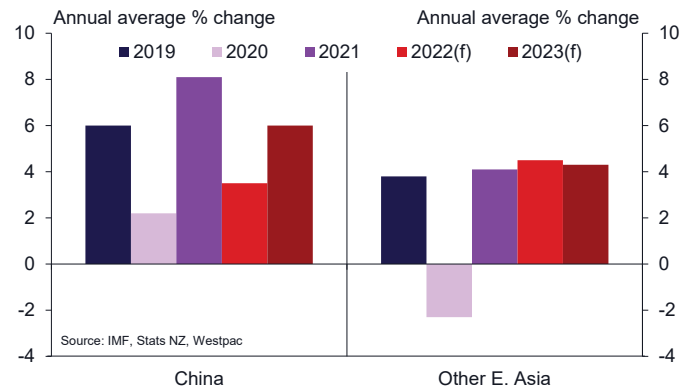
As a result, dairy farm profit margins have been squeezed over the second half of the year. However, we note that despite the cost surge and given the elevated starting point, the majority of farmers are still likely to remain profitable. Helping in this regard, we still expect a very healthy milk price of \$8.75/kg for the 2022/23 season.

2023: Chinese Covid hangover to linger; prices improving come mid-year.

Looking to 2023, we expect the hangover from Chinese Covid restrictions to linger over the first quarter or two. The Chinese authorities have already eased some Covid restrictions. However, these initial steps such as reducing isolation periods have been cautious. As a result, the restrictions are likely to constrict demand well into the new year.

However, as Chinese Covid restrictions are gradually eased further we expect global demand and prices to improve. Looking at the Chinese economy, for example, we expect Chinese growth to accelerate to 6% over calendar 2023, from just 3.5% over 2022.

Economic growth forecasts



In addition, the global dairy supply outlook remains soft. For example, we expect New Zealand dairy production to fall 1.5% over the 2022/23 season compared to last. Similarly, production remains weak in the EU and to a lesser degree in the US.

Our expectation for a stronger global dairy market from around mid-2023 sets up the 2023/24 season for a bumper milk price. Indeed, we recently set our opening estimate at \$10.00/kg.

Auction Results, 21 December.

Dairy auction prices dropped overnight. Overall prices fell 3.8%, while key whole milk powder (WMP) prices posted a 4.0% fall. Both overall and WMP prices ended the year 20.5% lower than where they started the year.

Prices were weak across the board. All five products that we monitor recorded price falls. Skim milk powder prices led the pack down, sliding 4.8%, with WMP posting the second largest decline of 4.0%. Butter and anhydrous milk fat prices posted falls in the 2% range, while cheddar prices posted the smallest fall of 0.7%.

This result was below our expectations. We had expected WMP prices to rise by 1%, and the market had priced in a similar rise.

It's hard to pin down a catalyst for the fall. There has been no market news to drive this fall. Possibly, some buyers may have taken an early holiday and thus been absent from the auction. The number of buyers from South-East Asia and the Middle East, for example, was down on the previous auction.

With that in mind, we are not reading too much into this result. We'll wait for the first auctions of 2023 to get a clear read on the state of the market.

Overall, the result remains consistent with our 2022/23 milk price forecast of \$8.75/kg. We note that our forecast stands 25 cents lower than the \$9.00/kg midpoint of Fonterra's updated range of \$8.50/kg to \$9.50/kg. In that sense, our

forecast clearly indicates where the risks lie relative to the midpoint of Fonterra's range.

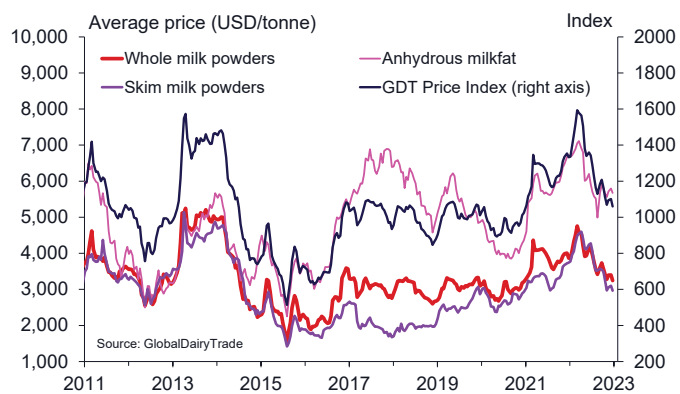
GlobalDairyTrade auction results

	Change since last auction	Prices USD/tonne
Whole Milk Powder (WMP)	-4.0%	\$3,246
Skim Milk Powder (SMP)	-4.8%	\$2,965
Anhydrous Milk Fat (AMF)	-2.2%	\$5,675
Butter	-2.6%	\$4,602
GDT Price Index	-3.8%	1060

Farmgate milk price forecasts

	2022/23		2023/24
	Westpac	Fonterra	Westpac
Milk price	\$8.75	\$8.50-\$9.50	\$10.00

Global dairy prices



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