

8 September 2021



Milk Price Outlook Strong

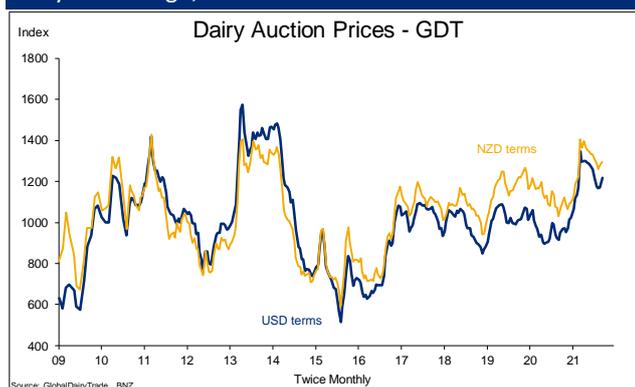
- Global dairy prices turn higher
- After 13% slide from March peak
- Prices at high level, outlook strong
- We lift our 2021/22 milk price forecast to \$8.30
- Reflects balance of risks we see, rather than a precise estimate
- There remains much to monitor

The balance of risks around domestic milk price forecasts has swung upwards. We have been detecting signs of such over recent weeks, with today's solid GDT auction result providing the latest evidence.

Expectations were positive going into the GDT event overnight and it didn't disappoint. The GDT Price Index rose 4.0%, with solid price gains across all major products. Indeed, the overall outcome was even a bit stronger than anticipated on the day and raises hopes for the rest of the season.

Today's price gains add to the tiny 0.3% gain at the previous auction that followed a run of 8 consecutive declines before that. Prices are at a high level, up nearly a third on a year ago and 18% above their 5-year average.

Dairy Prices High, Decline Arrested

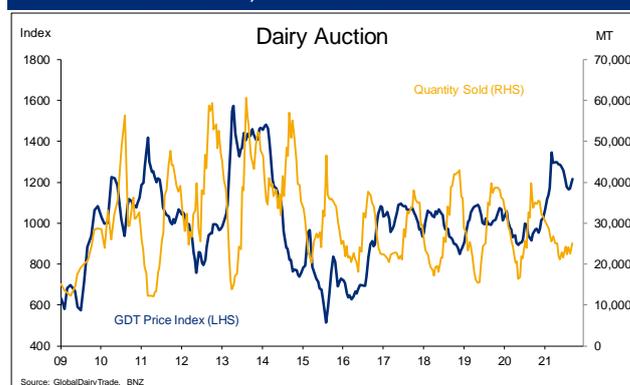


Skim milk powder prices led the charge higher, with a 7.3% gain. This follows recent moves we have seen for similar products in the US and EU, with a return of NZ product selling at a premium providing a further boost to GDT prices at this event. Most other product prices rose between 3% and 4%, reflecting broad based strength. Whole milk powder (WMP) prices rose 3.3%, with an average selling price at a strong US\$3,691/T.

The bounce in prices follows a general lift in global risk appetite over recent weeks helping underpin demand. The number of unsatisfied bidders was well above average overnight, suggesting a firm underbelly to demand and that the current price strength will have legs. Indeed, forward price curves show high price levels extending into next year.

Against buoyant demand, supply is on the tight side. The just over 25,000 MT of product sold at this auction was down around 37% on the same event a year ago. This reflects Fonterra removing a substantial amount of product from the auction platform over recent events (including 10,000 MT less WMP at this event) citing strong demand through other sales channels. Importantly, this suggests the relatively low GDT sales volumes is not a sign of soft demand.

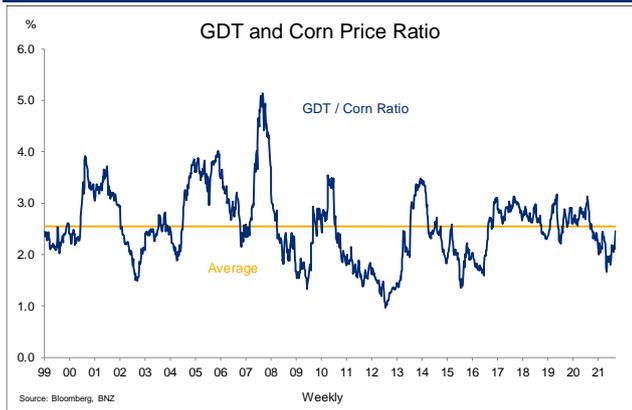
GDT Volume Subdued, Sold Elsewhere



More fundamentally, milk production growth in the EU has been subdued. Weather has played its part, but we have long been sceptical that global milk supply would respond aggressively to elevated dairy prices. This is because costs have also been ramping up. At least in the EU's case, the balance seems to be restricting output growth at this point.

More generally, we still don't expect a strong global milk supply response to strong dairy prices, at least not until they are strong relative to some reference of underlying costs. For example, dairy prices relative to the likes of grain prices offshore are not out of line, although it is worth watching offshore grain prices as they retreat from their recent peaks.

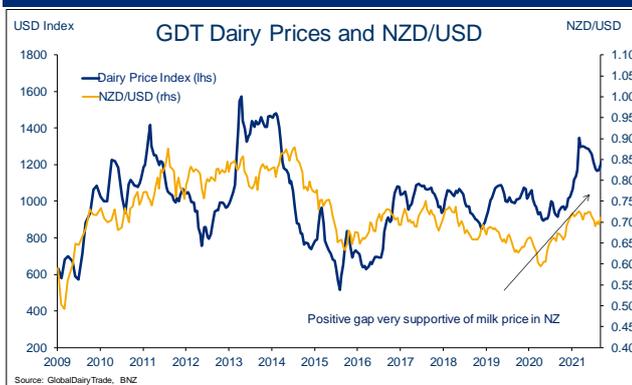
Dairy Prices Not Out Of Line



Meanwhile, all eyes remain on the NZ season as we head into October’s peak production. To date, conditions have been generally favourable for grass growth through large parts of the country. While this is encouraging, we do not anticipate much growth, if any, in NZ milk production for the season overall given strong output last season and a recent trend of fewer cow numbers. Through the pandemic, dairy farming has been deemed an essential industry so has continued operating through the various lockdowns. That is not to say there have not been any challenges. For example, the closed border has made finding appropriate staff all that much more difficult. As ever, actual milk production for the season will be heavily dependent on the weather.

Thinking about the implications for domestic milk prices, GDT price movements always need to be seen in the context of changes in the value of the NZD. So today’s lift needs to be viewed with regard to the recent bounce in the NZD (or the flipside of the recent drop in the USD). The NZD has lifted around 2.6% since the previous GDT auction. While that takes some of the gloss off the gains in world dairy prices from a domestic producer’s point of view, it still adds up to a net price gain in NZ dollar terms.

Dairy Prices Outpacing NZD

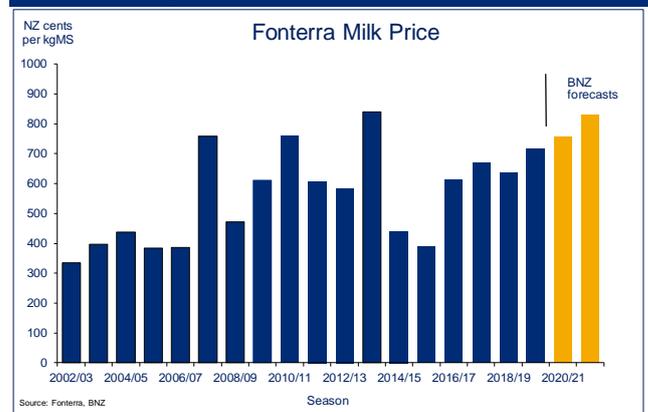


Pulling it all together, we think today’s price action and underlying dynamics provides even more support to the outlook for domestic milk prices. It equates to upside risk to the many 2021/22 milk price forecasts that have been

around the \$8.00 mark including our own \$7.80 view. We have had that view since before the season started in June. It is worth recalling that, at the time, that forecast built in a decent decline in offshore pricing. A lot of that has occurred, but not all. The GDT Price Index had fallen a cumulative 13.2% from its recent peak in March 2021, before today’s bounce.

More importantly, the dynamics and balance of risks appear to be changing with robust demand bumping up against subdued supply. It is as much that GDT prices have stopped falling as it is that they have bounced a bit. Factoring all that in, we lift our 2021/22 milk price forecast to \$8.30. Rather than any precise estimate of what Fonterra’s 2021/22 milk price might turn out to be, we think it should be read as we think the balance of risk is moving to something above \$8 rather than below it. Of course, something below \$8 can’t be ruled out.

Milk Price Buoyant



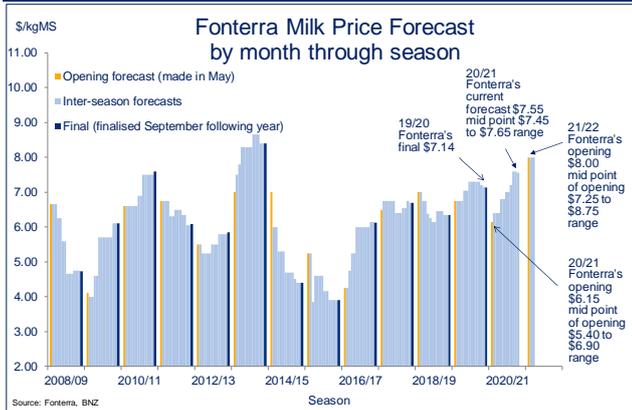
We think Fonterra will maintain a wide forecast range around its own milk price forecast when it provides its latest guidance at its annual results due on 23 September, if not separately beforehand. We expect the co-op’s forecast to remain in touch with its current view of \$7.25 to \$8.75. We will also get to see the final 2020/21 milk price. We can’t see any reason to think it will be outside of Fonterra’s latest \$7.45 to \$7.65 guidance range.

For the current season, there are still plenty of risks that have the potential to throw milk prices around with still a long way to go until season’s end next May.

The outlook for Chinese demand remains super important with the balance of current indicators positive. Elsewhere, we are watching rising inflation risks globally and the chance that global central banks start changing tack on monetary stimulus. That could quickly take the edge off risk appetite and become a headwind for dairy product prices. And, Covid hasn’t gone away. While it is a risk to demand, it can also cause havoc on the supply side especially around trade logistics and shipping. It will also pay to keep an eye on the NZD in case it appreciates more than anticipated.

From a big picture point of view, whatever the final 2020/21 milk price and latest mid-point forecast for 2021/22, both look odds-on to be materially above last year's (2019/20) \$7.14 milk price. And significantly above the 5-year average milk price of around \$6.00. For farmers, this is good news and strongly supports profitability. The challenge will be in managing costs given significant upwards pressure circulating from myriad sources.

Fonterra Update Due By 23 September



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