

17 November 2021



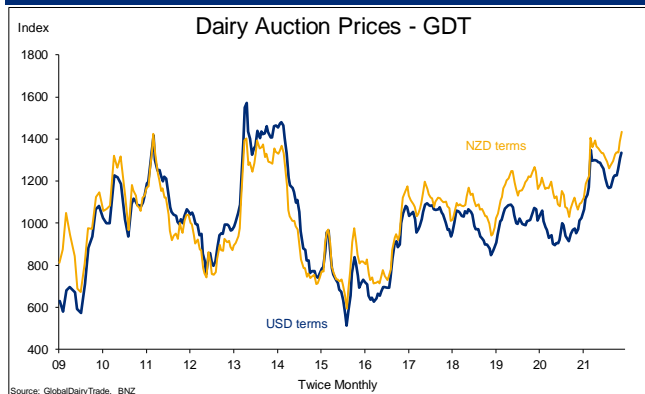
## Milk Price Record Beckons, But Mind Costs

- Dairy prices continue to push higher
- As decent demand runs into sluggish supply
- Milk price looks set to hit record, but not in real terms
- We lift our 2021/22 milk price forecast to \$8.90
- Production costs are rising, globally
- Likely to limit supply response to high milk prices

We noted a couple of months ago that the balance of risks to domestic milk prices had swung upwards. Since then dairy product price outcomes have added to the case. This includes the latest GDT auction overnight where prices rose 1.9%, with gains across all major product groups.

The cumulative gain since the recent low in August is 14.4% and lifts prices to more than 37% above a year ago. This is not just a bounce off a low base. Prices are around 28% above their five-year average and can be deemed outright strong.

### Dairy Prices Strong



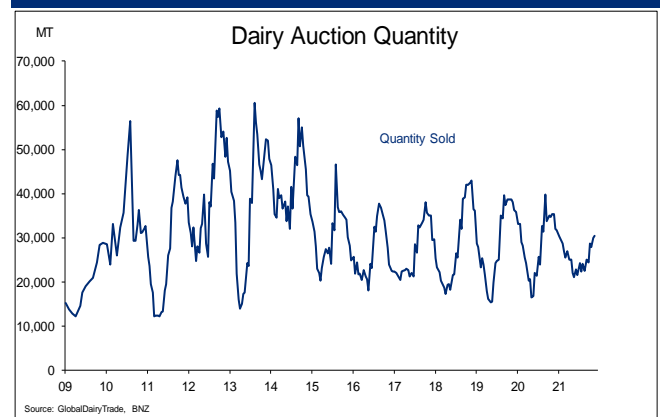
Price supportive factors include:

- Positive global risk appetite
- Some economic reopening
- Robust demand, with the number of unsatisfied bidders at the regular auctions consistently above average
- Global supply bottlenecks and troubled global logistics
- Tight global milk supply

Tight supply includes some disappointing NZ milk production figures, with both August and September outcomes around 4% below the corresponding months a year ago. This sets up the season overall to be lower than the prior year (especially with La Nina risks brewing and

late season production facing into tough year-earlier comparators). Volumes sold through the GDT platform continue to significantly lag year earlier levels. The near 30,400MT of product sold at the auction overnight was about 14% lower than for the same event a year ago. In addition to lower milk production, recently lower GDT volumes also reflect Fonterra removing a substantial amount of product from the auction platform and selling via other sales channels. Importantly, relatively low GDT sales are not a sign of soft demand.

### Seasonal Peak Stunted

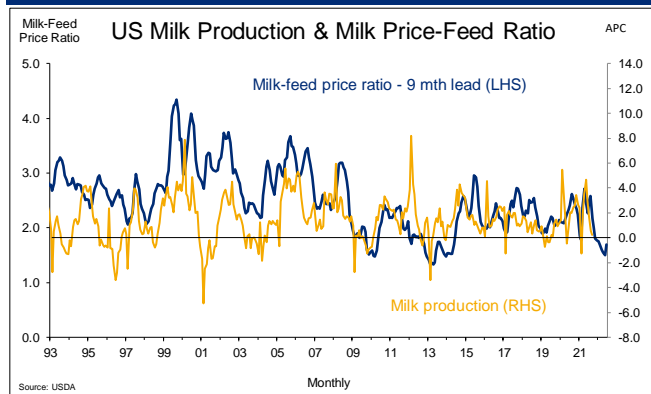


A lack of NZ milk through the first part of the season has reinforced limited supplies from elsewhere. Milk production growth in the EU has been subdued with output in many key EU countries slipping below year earlier levels. Australian milk output is down more than 3% year to date. And in the US, September milk production was a mere 0.2% higher than a year earlier.

We have long been sceptical that global milk supply would respond meaningfully to elevated dairy prices. In part, this is because we saw limited milk supply as a key factor behind higher prices in the first place on rising costs.

Take the US for example. The US milk price to feed ratio has been significantly below average all year raising the risk that US milk production dips below year earlier levels over coming months. US cow numbers are already falling (down 0.9%, or some 85,000 head, since May). The USDA has recently lowered milk production forecasts for both 2021 and 2022.

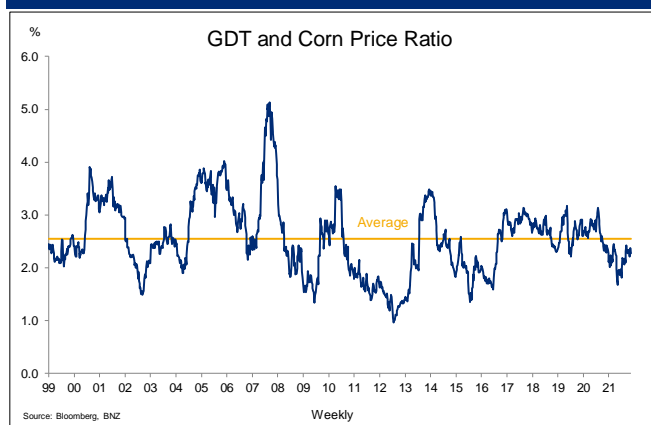
**Might US Milk Production Fall?**



More generally, costs have continued to escalate crimping even further the potential for an aggressive global milk supply response. This suggests current dairy product price strength can persist for longer than we had previously anticipated. We still don't expect a big global milk supply response to strong dairy prices, at least not until dairy prices are strong relative to some reference to underlying production costs.

Dairy prices relative to the likes of grain prices offshore are not out of line. Dairy prices even look cheap relative to a very sharp run up in global fertiliser prices over recent months. Movements in these costs will be important to monitor, relative to dairy prices, as a guide to potential changes in milk supply ahead.

**Not Out Of Line**

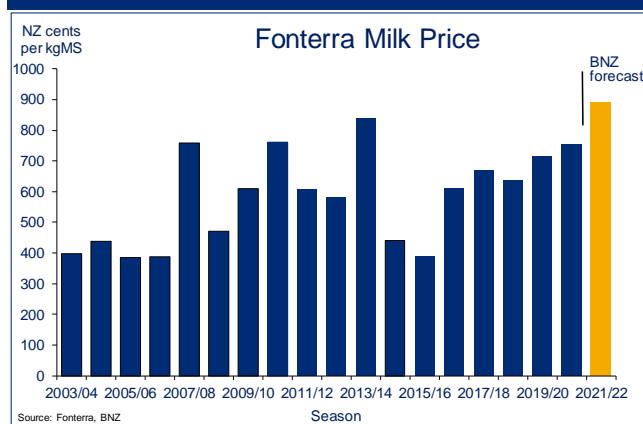


All this suggests dairy product prices will be stronger for longer than we had previously anticipated. Coupled with a contained NZD, this adds more support to domestic milk prices. And, already, GDT prices expressed in NZ dollars have lifted to their highest level since the auction platform began more than 13 years ago.

Factoring all the above in, we lift our 2021/22 milk price forecast to \$8.90 (from \$8.30 previously). This is similar to current NZX futures pricing of around \$9.00. Nonetheless, there remains a fair way to go in the season with risks on both sides. Our new forecast builds in near-term strength

before some easing in product prices by the end of the season. If product prices were not to ease, or push higher, a milk price of \$9 or more appears possible.

**Record Beckons**

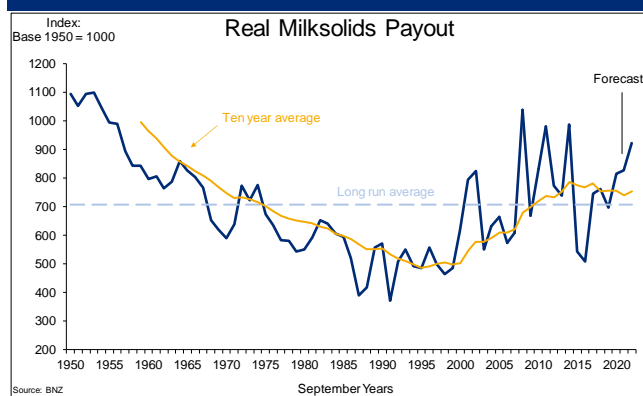


Anything around these sorts of levels would be a record milk price, surpassing the previous high of \$8.40 in 2013/14. This is clearly a very strong milk price outlook.

But we are quick to point out that local farmers are also facing rising costs, in what is a significantly more inflationary environment. For example, the latest producer inflation data show dairy farm input costs have lifted around 8% over the past year. Costs have accelerated over recent quarters and this is before the recent lifts in interest rates have entered the official data.

Furthermore, on our calculations, even a \$9 milk price this season would not generate a record high payout in inflation-adjusted terms (although it would be well above average).

**But Not In Real Terms**



We look forward to Fonterra's latest take on the ever-changing dairy market. Recent GDT results and a contained NZD suggests the milk price outlook is testing the top end of the co-op's current \$7.90 to \$8.90 forecast range. As things stand, some lift in the \$8.40 mid-point seems likely – perhaps at its Q1 Business Update on 3 December.

Farmers will also be looking ahead to next season. To the extent that global milk supply remains sluggish due to cost pressures, world dairy prices are likely to remain higher than otherwise. This brings the prospect of a second consecutive season with a milk price above \$8. But, let's face it, forecasting in the current environment is fraught with difficulty. We have pencilled in \$8.30 for the 2022/23 season but acknowledge very wide error bounds around any forecast for that season at this stage.

Any further shocks to global milk supply (think weather event in a major exporting country) could see prices higher than described above. The evolution of current supply bottlenecks and logistic issues will also be important for prices ahead.

We are also wary of possible changes in demand. There is potential for slower than expected economic growth, particularly in China as it contends with Covid, property market issues, and energy shortages. Some industrial commodity prices have already seen a decent pullback from recent highs. More broadly, there are dairy demand risks from generally higher inflation sapping purchasing power of potential buyers and the related prospect of tighter monetary conditions globally with the potential to dent income growth. As always, there is much to monitor.

[doug\\_steel@bnz.co.nz](mailto:doug_steel@bnz.co.nz)

## Contact Details

### BNZ Research

**Stephen Toplis**  
Head of Research  
+64 4 474 6905

**Craig Ebert**  
Senior Economist  
+64 4 474 6799

**Doug Steel**  
Senior Economist  
+64 4 474 6923

**Jason Wong**  
Senior Markets Strategist  
+64 4 924 7652

**Nick Smyth**  
Senior Interest Rates Strategist  
+64 4 924 7653

### Main Offices

#### Wellington

Level 4, Spark Central  
42-52 Willis Street  
Private Bag 39806  
Wellington Mail Centre  
Lower Hutt 5045  
New Zealand  
Toll Free: 0800 283 269

#### Auckland

80 Queen Street  
Private Bag 92208  
Auckland 1142  
New Zealand  
Toll Free: 0800 283 269

#### Christchurch

111 Cashel Street  
Christchurch 8011  
New Zealand  
Toll Free: 0800 854 854

### National Australia Bank

**Ivan Colhoun**  
Global Head of Research  
+61 2 9237 1836

**Alan Oster**  
Group Chief Economist  
+61 3 8634 2927

**Ray Attrill**  
Head of FX Strategy  
+61 2 9237 1848

**Skye Masters**  
Head of Fixed Income Research  
+61 2 9295 1196

#### Wellington

Foreign Exchange +800 642 222  
Fixed Income/Derivatives +800 283 269

#### New York

Foreign Exchange +1 212 916 9631  
Fixed Income/Derivatives +1 212 916 9677

#### Sydney

Foreign Exchange +61 2 9295 1100  
Fixed Income/Derivatives +61 2 9295 1166

#### Hong Kong

Foreign Exchange +85 2 2526 5891  
Fixed Income/Derivatives +85 2 2526 5891

#### London

Foreign Exchange +44 20 7796 3091  
Fixed Income/Derivatives +44 20 7796 4761

This document has been produced by Bank of New Zealand (BNZ). BNZ is a registered bank in New Zealand and is only authorised to offer products and services to customers in New Zealand.

**Analyst Disclaimer:** The Information accurately reflects the personal views of the author(s) about the securities, issuers and other subject matters discussed, and is based upon sources reasonably believed to be reliable and accurate. The views of the author(s) do not necessarily reflect the views of the NAB Group. No part of the compensation of the author(s) was, is, or will be, directly or indirectly, related to any specific recommendations or views expressed. Research analysts responsible for this report receive compensation based upon, among other factors, the overall profitability of the Global Markets Division of NAB.

NAB maintains an effective information barrier between the research analysts and its private side operations. Private side functions are physically segregated from the research analysts and have no control over their remuneration or budget. The research functions do not report directly or indirectly to any private side function. The Research analyst might have received help from the issuer subject in the research report.

New Zealand: The information in this publication is provided for general information purposes only, and is a summary based on selective information which may not be complete for your purposes. This publication does not constitute any advice or recommendation with respect to any matter discussed in it, and its contents should not be relied on or used as a basis for entering into any products described in it. Bank of New Zealand recommends recipients seek independent advice prior to acting in relation to any of the matters discussed in this publication.

Any statements as to past performance do not represent future performance, and no statements as to future matters are guaranteed to be accurate or reliable.

Neither Bank of New Zealand nor any person involved in this publication accepts any liability for any loss or damage whatsoever which may directly or indirectly result from any advice, opinion, information, representation or omission, whether negligent or otherwise, contained in this publication.

USA: If this document is distributed in the United States, such distribution is by nabSecurities, LLC. This document is not intended as an offer or solicitation for the purchase or sale of any securities, financial instrument or product or to provide financial services. It is not the intention of nabSecurities to create legal relations on the basis of information provided herein.