

# Research Economy Watch

21 August 2024

## Milk Price Outlook Improves

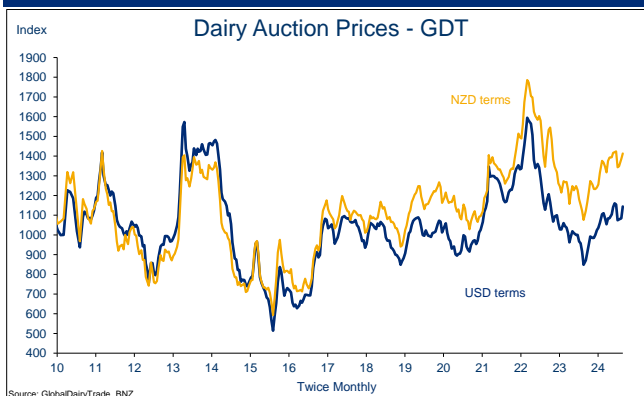
- **Global dairy prices firm**
- **On stronger demand, supply concerns, and a lower USD**
- **Supportive of higher milk price in NZ**
- **We nudge our 2024/25 milk price forecast up to \$8.50**
- **Many risks remain**

This morning's GDT dairy auction was positive. Dairy prices posted a strong lift, with the GDT price index gaining 5.5%. It is the largest gain in a single auction since March 2021, although should be seen in the context of a large drop early last month. The price index is not far from recovering all that decline.

Price gains were widespread. Wholemilk powder rose a hefty 7.2%, skim milk rose 4.0%, butter increased 3.7%, and AMF was up 4.8%. Cheddar prices bucked the trend, easing 0.2%.

The overall result is certainly miles better than the extreme weakness seen at this time last year. Compared to that low, the GDT price index is up nearly 35%.

### Dairy prices firm



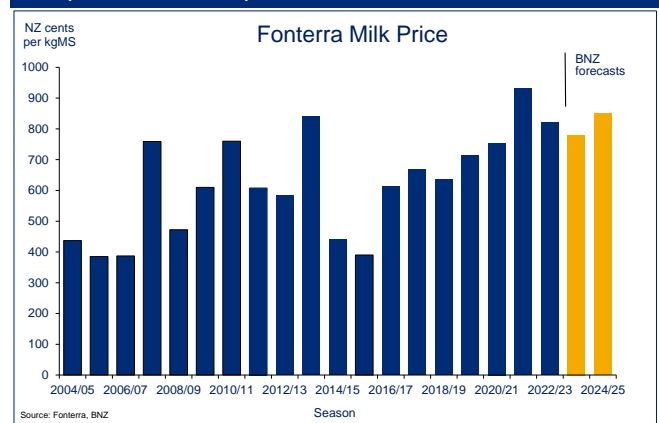
We thought prices might lift at this event, although the gain was a bit bigger than we imagined. And given the supportive details, regards both demand and supply, it is enough for us to nudge up our point forecast for Fonterra's 2024/25 milk price to \$8.50 (from our pre-season forecast of \$8.20).

This suggests a bit more upside risk to the co-op's current \$8 forecast midpoint for the 2024/25 season. Eyes turn to the various dairy processors to see if they see sufficient

reason to nudge up forecasts for their own milk price, some of which already differ from Fonterra.

An \$8.50 outcome for the 2024/25 season would be a decent improvement on the \$7.80 midpoint currently expected for the 2023/24 season.

### Milk price outlook improves



Demand for dairy appears to have strengthened, with strong bidder participation over recent auctions. Overnight, there is strong buying from North Asia (read China) – especially across major products like both milk powders and butter, and the number of unsatisfied bidders lifted adding to the sense of a firming underbelly to dairy demand.

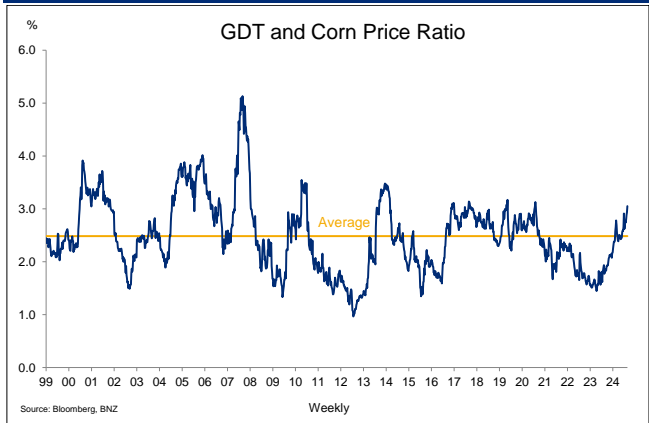
However, questions remain around what lies ahead. It is difficult to know how much of the current demand is due to restocking and/or potential concern around global milk supply. Demand driven by those factors may not be sustained.

Economic indicators in China, including around real estate and consumer spending, have been subdued. We have seen this elsewhere in the likes of soft lamb, iron ore, and oil prices – albeit with many other factors in play across those products.

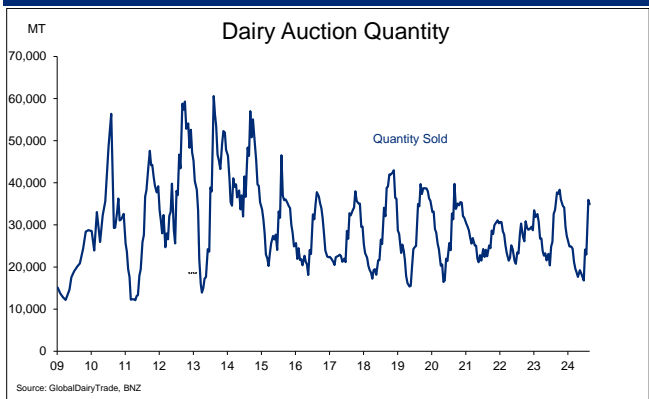
We are also conscious of dairy prices pushing ahead of the likes of international grain prices, which often elicits a supply response in time. Something to bear in mind if dairy prices continue to squeeze higher in the near term.

For now, a further positive feature of today’s auction was the fact that prices increased despite more volume. The amount of product sold at this event was up 4% y/y. And there looks to be more coming from NZ, with yesterday’s report of milk production increasing by 9.2% y/y in July. Of course, mid-winter is low-production in NZ and that rate of growth will slow into the season proper, but there are signs that output through the peak of the season will be up a bit on year ago levels.

**Dairy prices outperforming global grain**



**GDT volumes lift**



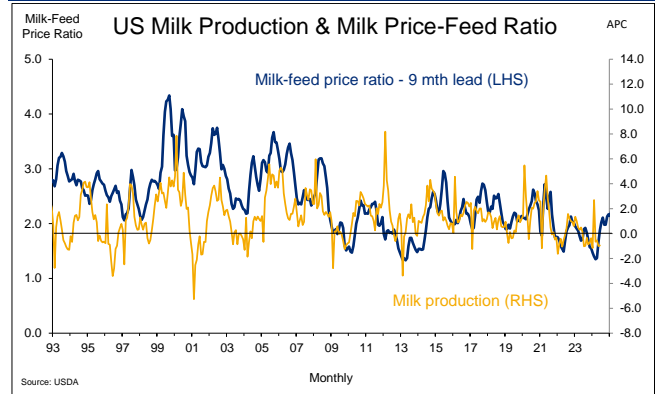
In contrast to NZ, supply risks appear to be increasing elsewhere including in the EU given an expanding outbreak of Bluetongue disease across various countries.<sup>1</sup> This has the potential to limit milk production. EU prices for SMP have pushed above NZ prices over recent auctions. And milk production in the US has already been trailing previous year levels for some time. The EU and US make a lot more milk than NZ does, so changes there can have an outsized influence on international pricing.

A lower USD also seemed to offer support to the USD-denominated GDT prices at the auction overnight. And even global monetary policy easing, and expectations of more ahead, might have helped at the margin and may well continue doing so ahead.

<sup>1</sup> Bluetongue is an acute viral disease of ruminants spread by midges. It can cause a reduction in milk production in cows.

Of course, any support to GDT dairy prices from a softening US dollar needs to be considered alongside the flipside being a stronger NZD against the greenback. The NZD/USD has lifted around 3.4% since the previous auction, seeing a much smaller lift in GDT prices when expressed in NZ dollars.

**US milk supply currently contracting, but more next year?**



While we have nudged our milk price forecast for the current season upwards, many risks remain: from the trajectory of growth and dairy demand in China, to tension in the Middle East, the US election, global monetary conditions, and the outlook for global milk supply (including NZ’s). All have the potential to change the outlook for dairy prices. Price volatility over the past two months alone suggests you can’t even rule out something under \$8.

Our \$8.50 milk price view builds in some easing in product prices toward the end of this calendar year (and higher costs and NZD), which is as much recognition of the downside risks as anything else. But risks are on both sides. For example, if the upside risks, including potential additional tightening in competitor milk supply, come to fruition then further upside to milk price than that forecast is possible. It is not our current forecast, but if current GDT prices and currency levels were to persist for the remainder of the season, it would suggest conditions consistent with a milk price approaching \$9.

There is a long way to go in the NZ dairy season. But as milk flow is starting to ramp up, there is much to monitor in international markets to see what the season’s output will be worth.

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