WESTPAC DAIRY UPDATE

Milk price forecast update.

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Recovery delayed; milk price forecast lowered to $7.80/kg.

- We have lowered our 2023/24 milk price forecast to $7.80/kg.
- The chief catalyst for the revision is the ongoing sluggishness in the economy of our key market, China.
- For many farmers, this would put the milk price below their break-even point.
- That said, farm balance sheets are generally strong and given previous experiences of downturns, we expect that farmers are well-placed to manage through this milk price cycle.

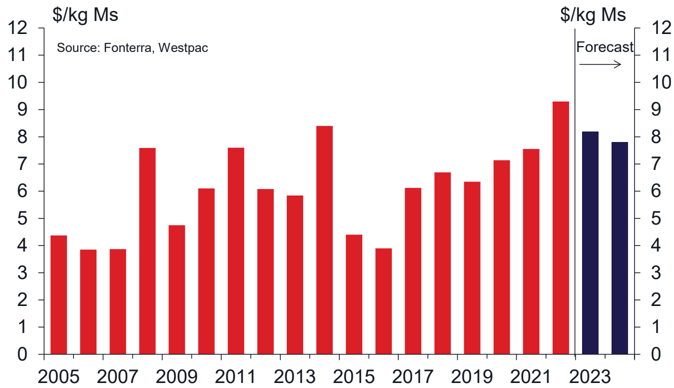
Farmgate milk price forecasts

	2022/23		2023/24	
	Westpac	Fonterra	Westpac	Fonterra
Milk price	$8.20	$8.10-$8.30	$7.80	$7.25-$8.75

Milk price forecast lowered to $7.80/kg.

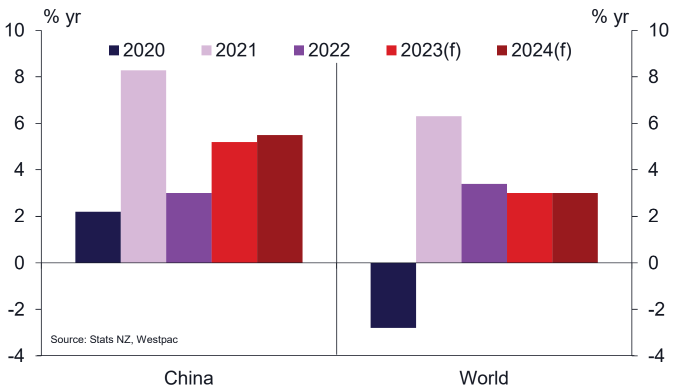
We have lowered our 2023/24 milk price forecast to $7.80/kg, from $8.90/kg previously.

Farmgate milk prices



The chief catalyst for the forecast revision is the (unexpectedly) sluggish Chinese economy. We have made significant downward revisions to our forecasts for Chinese economic growth this year. As recently as last month, we expected economic growth for 2023 of 6.2%. Since then, we have made consecutive downward revisions to 5.7%, and now 5.2%.

Global economic growth



As a result (chiefly) of weak Chinese demand, the downward price trend in global dairy prices has been sustained much longer than we expected. Prices have fallen at 10 of the 14 auctions held this year, with prices down 22% in annual change terms. In contrast, we had expected that prices would have bottomed by now, if not begun to turn higher.

While continued soft Chinese demand accounts for most of the price weakness, other factors are playing a role. Firstly, a bumper autumn for New Zealand has boosted global dairy supply temporarily. Indeed, April and May production was up a combined 7.7% compared to the same period a year ago – both months set record highs. This late autumn surprise was enough offset the very weak spring and thus lift production for the entire season above last season's level. Secondly, and as discussed in a previous report, New Zealand has not been well-placed to benefit from relatively high cheese prices. New Zealand dairy companies have limited (factory) capacity to produce more cheese. And while cheese production has expanded where possible, in the short term, these companies are stuck producing other less profitable products like whole milk powder. Indeed, a more optimal production mix, if it were possible, would result in a higher milk price.

We still expect global dairy prices to eventually recover late this year (if not early next year). However, that means prices will remain low through the peak spring months of production and thus while prices will recover, it's now likely that the price recovery comes too late in the season to prevent a lower milk price.

Meanwhile, we also note that the global production outlook is generally soft, if not weak. We expect flat or very low production growth in the US or EU over calendar 2023 and for New Zealand production to grow by around a modest 0.7% this season (June to May). Meanwhile, in Australia and Argentina, production continues to fall. This soft overall supply picture will put a floor under prices later in the year and into 2024.

We note that it's still early days in the season and a wide range of milk prices are possible. In that sense, Fonterra's forecast range is a useful tool. Using their \$1.50/kg range and our forecast as the midpoint, would give a range of \$7.05/kg to \$8.55/kg (Fonterra's current range is \$7.25/kg to \$8.75/kg). With that in mind, Fonterra is likely to lower their forecast range at their next announcement. If anything, we suspect that Fonterra might lower their range a touch below what we have indicated above. Note Fonterra is due to update its forecast range by the end of next month.

Doing it tough.

For many farmers, this season's milk price is likely to be below their break-even point. A back of the envelope calculation, with total operating expenses of \$6.80/kg and debt servicing costs of \$1.50/kg would put farmers total outgoings at \$8.30/kg i.e. \$0.50/kg above our milk price forecast. Note that break-even estimates vary widely by farm (and also in the calculation method), so that some farms may have larger deficits, while some may still even be in surplus.

That said, farm balance sheets are generally strong. With that in mind, plus the experience gained during previous downturns, we expect that farmers are well-placed to manage through this milk price cycle.

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