Rabobank

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Global dairy markets "teetering on the edge"- Rabobank

Robust Chinese milk powder demand and waning milk production growth across key export regions has left global dairy markets "teetering" at commodity price levels not seen since 2014, Rabobank says in its just-released Q4 Global Dairy Quarterly report.

The agribusiness banking specialist says weather-related issues have afflicted peak milk production in New Zealand and Australia, while supply growth has also been stymied in the US and Europe by squeezed profit margins for producers.

This has resulted in a year-on-year global milk production deficit that is too deep for favourable milk production gains seen in South America to offset, it says.

The report says – after nine consecutive quarterly increases – combined global milk supply growth in the major dairy exporting regions has ground to a halt in quarter three this year and will trail behind last year's milk production in quarter four.

Report co-author, Rabobank senior agricultural analyst Emma Higgins said combined quarter four milk production in the big seven dairy exporting regions – New Zealand, Brazil, Argentina, Uruguay, EU, US and Australia – is expected to decline by 0.3 per cent compared with the prior year. This will be the first quarterly year-on-year decrease since 2019.

Despite the elevated milk prices, the report notes that it will be challenging to turn these supply settings around quickly.

"High feed prices and general input cost inflation are common themes across the major milk-producing regions," Ms Higgins said.

"Rising input costs, lack of labour, unfavourable weather, and questionable feed quality will limit the ability by farmers to quickly turn the milk taps on around the globe."

The report says the ability to withstand the rising cost pressures is highly dependent on the milk price. Much of the world is experiencing adequate milk prices to offset higher costs – but not high enough to facilitate expansion.

It's this set of circumstances – less milk being produced from key regions to meet steady demand – which are now driving global dairy markets. In light of these fundamentals, Rabobank has increased its New Zealand forecast farmgate milk price for the 2021/22 dairy season to NZD $8.80/kgMS.

"Chinese demand remains the critical swing factor in the farmgate milk price forecast for

New Zealand farmers," Ms Higgins said.

"We remain extremely wary of high inventory levels – albeit unevenly distributed – combined with growing local milk supply in China. Our view is that Chinese buyers are torn between the bullish sentiment outside China and the current weak fundamentals within China to decide whether, when, and at what price levels they should return to the market.

"Our base case scenario is that demand from other regions continues to hold as import demand from China slows down over coming months."

New Zealand update

The report says New Zealand export volumes for the three months to October 2021 dropped by two per cent on the same period last year.

"While exports to China were exceptionally strong over this period, it wasn't enough to offset a significant decline in volumes to Sri Lanka and, to a lesser extent, Algeria, the Philippines, Korea and Saudi Arabia," the report says.

Ms Higgins said New Zealand milk production was now benefitting from the recent sunshine and warmth across the country.

"Unfortunately, the change to more favourable weather was too late for the peak milk month of October, where collections dropped by 3.3 per cent year-on-year, and there have now been three consecutive months of milk supply slipping backward against 2020 since August 2021," she said.

"Rabobank's milk production forecast for the entire 2021/22 season is minus one per cent year-on-year but we are not ruling out a late run in the second half of the season, especially in a high milk price environment. Still, our base case assumes the weaker peak will be hard to recoup across the season — given lingering challenges to milk production in parts of Canterbury — in addition to high comparables to match from February onwards."

Ms Higgins said cash flows for New Zealand farmers remain sound and have been further boosted by the recent lift in the mid-point of Fonterra's Farmgate Milk Price range which now sits at $8.70/kgMS.

"Margins range from profitable to very profitable for farmers at this level, depending on cost structures. Farmers are making the most of available cashflow directed towards shoring up balance sheets, more automation, preparing for environmental regulation changes, alongside usual repairs and maintenance," she said.

Ms Higgins said a particular pain point for New Zealand dairy producers at present is labour availability.

"Farms with scale and more staff appear to be faring better in the competitive labour market, compared to mid-to-small-sized operators with less staffing flexibility when it comes to rosters," she said.

"A particular watching point is how resourcing scarcity might further compound over the coming six months as the Delta variant of Covid-19 spreads throughout New Zealand."

The report says despite higher cost structures and resourcing issues, farm sales have recently kicked back into life.

"Dairy farm sales prices are firming up, reflecting higher confidence in the industry and intense competition for alternative land uses," Ms Higgins said.

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Rabobank New Zealand is a part of the global Rabobank Group, the world's leading specialist in food and agribusiness banking. Rabobank has more than 120 years' experience providing customized banking and finance solutions to businesses involved in all aspects of food and agribusiness. Rabobank is structured as a cooperative and operates in 38 countries, servicing the needs of about 8.6 million clients worldwide through a network of close to 1000 offices and branches. Rabobank New Zealand is one of the country's leading agricultural lenders and a significant provider of business and corporate banking and financial services to the New Zealand food and agribusiness sector. The bank has 31 branches throughout New Zealand.

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