Rabobank

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Dairy prices expected to remain elevated in the near term, but longer-term outlook less certain — global report

Dwindling world milk production looks set to support buoyant global dairy commodity prices over coming months, but with the Russia-Ukraine conflict creating a wave of uncertainty in markets, the longer-term pricing outlook remains much less clear, Rabobank says in a recently-released report.

In its **"*Global Dairy Quarterly Q1 2022: How high for how long*?"**, the agribusiness banking specialist says weather-related issues, high or rising production costs and lingering disruptions from Covid-19 resulted in milk production growth faring worse than previously anticipated in the final quarter of 2021.

"These challenges have impacted dairy farmers from all the key production regions around the world, and among the "Big 7" dairy exporters – New Zealand, Australia, the EU, the US, Uruguay, Brazil and Argentina — production is now expected to fall by 0.7 per cent year-on-year in the first half of 2022," Rabobank senior agricultural analyst Emma Higgins said.

"This has further increased the global milk supply deficit and led to soaring dairy commodity prices and significantly higher farmgate milk prices across the major export regions. And potential further upside in milk price remains, with the recent strength in global commodity prices yet to be transferred through to farmgate milk prices in some regions."

The report says rising milk prices are failing to induce greater production and the supply deficit is unlikely to go away in the near term.

"Poor forage quality is negatively impacting milk yields in the EU and the US. In some cases, dairy producers are maximising profit, not production, as they consider escalating feed costs," Ms Higgins said.

"After growing by four per cent in 2021 despite a host of supply chain challenges, we now anticipate global dairy exports will slow in 2022 as the supply shortfall significantly impacts the exportable surplus from key dairy exporting regions."

In light of these circumstances, the report says, Rabobank has increased its New Zealand **forecast farmgate milk price for the 2021/22 dairy season to NZD $9.70/kgMS**.

"The lower-than-expected milk production both within New Zealand and globally supports a milk price forecast around the mid-point of Fonterra's current range of NZD 9.30/kgMS to NZD 9.90/kgMS," Ms Higgins said.

How high for how long?

Looking towards the new 2022/23 season, Ms Higgins said the pricing outlook was much less certain, hinging upon consumer behavior and normalised market conditions — both of which are very unpredictable within a setting of the escalating Russia-Ukraine conflict.

"We expect global dairy commodities to stay elevated through to the middle of the year amid the constrained global supply. But with inflationary pressure running rampant around the world, and expectations for global economic growth beginning to slow, this begs the question 'how high will dairy prices go and for how long will they stay there?'," she said.

"High-priced dairy commodities could take a bite out of some importers' appetites, but on the flip side, we have seen rising oil prices support Whole Milk Powder (WMP) prices in the past."

Ms Higgins said one of the key initial impacts of Russia's invasion of Ukraine was increased global food security concerns.

"These concerns have played a role in lifting dairy prices higher. And we do see these concerns remaining to the fore with buyers over coming months, adding upside weight to dairy commodity prices for the new season." she said.

"However, the situation is evolving rapidly and we also need to consider the possibility that China could support Russia and expose itself to sanctions, which in turn could be applied to 25 per cent of global dairy product. Should this eventuate, it would create a dire situation for China and its trading partners, with New Zealand hardest hit given it would need to find alternative markets for nearly 40 per cent of its dairy exports.

"The Russia-Ukraine conflict also escalates an already high cost situation. Russia and Ukraine are major players in global trade of grains, energy and metals and we anticipate more upside to come for farm inputs like grain, oil, natural gas and fertiliser over time," Ms Higgins said.

New Zealand update

The report says New Zealand milk production over the summer months has been at the mercy of the weather.

"January 2022 was extremely hot across New Zealand, limiting pasture growth. The Waikato – home to over 20 per cent of the New Zealand dairy herd – was particularly dry, with farmers tapping into supplementary feed from the spring or reducing milking hours to help maintain milk flows into autumn," Ms Higgins said.

"Welcome rainfall was received over most of the country in February, easing fears of a very steep decline in collections and an early end to the season for some farmers. However, parts of Southland remain thirsty, while Canterbury is still suffering impacts from a poor spring and less sunshine."

Ms Higgins said the bank was anticipating New Zealand milk production for the 2021/22 season would be four per cent lower than the previous year.

"Lower volumes of milk collected over the peak period, combined with fickle summer weather, have resulted in a year-on-year gap that is likely too wide to bridge over the shoulder," she said.

"Feed reserves may be tight in some parts of the country through the winter months due to the negative weather impacts on the grain harvest and the use of feed over summer and autumn."

Despite high input costs and stretched labour availability due to the spread of Omicron, the report says cash flows on New Zealand dairy farms remain positive.

"With more input cost pressure expected, particularly for fertiliser and fuel, the recent lift in farmgate milk price forecasts has been warmly welcomed and margins for farmers remain profitable to very profitable, depending on the operation," 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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