milkpriceoutlook

March 2018

The outlook for 2019/20 Southern Australian milk prices

A summary of the latest outlook for the value of milk at farmgate in the 2018/19 season.

Highlights

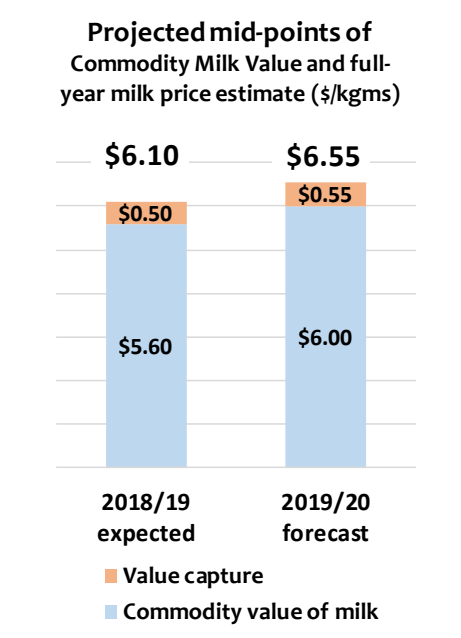
- **Slowing milk supply has tightened the world market**
- **This supports an improved price outlook for next season**
- **Some large trade and economic risks remain in the outlook**

About this outlook

This farmgate price outlook is drawn from Freshagenda's Global Dairy Directions analysis of global dairy supply and demand and the likely impact on commodity prices and other influences on milk prices in the southern Australian dairy market. We update our outlook when there are significant changes in market conditions. Our independent analysis is supplied to clients in processing, trading and ingredient buying around the dairy world.

The outlook for milk prices

The mid-points of the two elements of a price outlook outlined in this paper are:



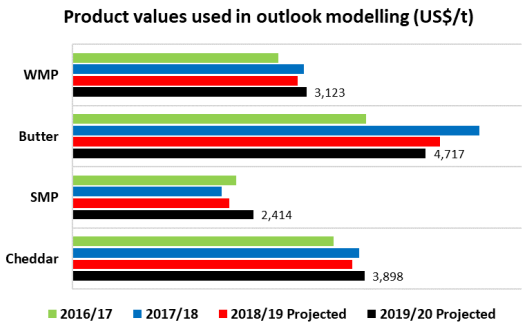
This outlook is sensitive to a number of variables affecting product prices and the value of the $A.

Key points

- Our outlook for milk prices identifies **two components of farmgate milk prices** paid by manufacturers in southern Australian regions, an estimated annual **commodity value of milk (CMV)*** and an additional **value-capture**.
- The rapid sell-down of the EU's SMP intervention stocks, the strong spring flush in NZ, and higher availability of cheap South American powders increased availability and weakened the market in late 2018.
- Slowing milk production growth, particularly in the EU and more recently in New Zealand, has limited export availability, while strong demand for low-priced milk powders from China and South East Asia has tighten the market and lifted prices. Butterfat and cheese prices have remained relatively high despite lukewarm demand. Given the flow-on effects for Oceania wholesale prices, we expect the CMV to average **$5.60-$5.70kgMS** for the 2017/18 season. The likely **value-capture** achievable by companies and paid to milk producers **above the underlying CMV** is expected to range between **45 and 55c per kg of milksolids**.
- Looking ahead over the next year, we expect commodity values to recede a little from current levels which will flow through to a commodity value of milk in the range **$5.80 to $6.20kgMS.** We expect the **value capture** to edge higher in 2019/20 given local milk supply shortages and scrutiny of retailers with respect to the dairy industry, to between **50 and 60c per kgMS.**
- **Companies may offer prices that differ from this forecast** (which is based on industry averages) due to differences in product mix and business models. Farmgate prices on offer in 2018/19 will reflect strong competition for milk supply. Saputo will aim to rebuild milk intakes to fill its ex-MG assets, while new facilities in North and West of Victoria will also be seeking additional supply. Stronger competition has the potential to lift prices above the fundamentals reflected in our outlook.

The assumptions

- Our outlook suggests projected fundamental values (PFV) will consolidate in 2019/20 with a modest milk growth outlook for northern hemisphere producers.
- Conversion, overhead and profit retentions are based on estimated industry averages. The $A is based on consensus forecasts by currency analysts, which **has weakened to US$0.72**.
- The conditions for value capture above commodity milk values are assumed to have improved slightly with the removal of a competitor in domestic cheese market, and retailers reducing their reliance on heavy discounting of food staples.



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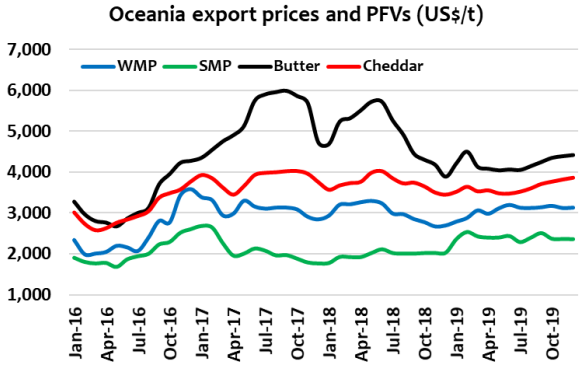
The global outlook

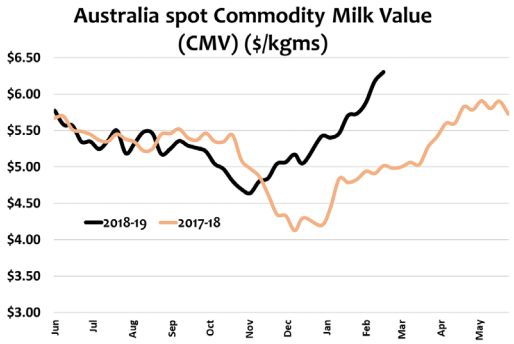
- The **EU's milk supply** has slipped behind prior year comparatives in recent months. The impacts of last year's hot dry summer conditions across Europe have slowed milk production growth, although a mild winter has made the effects less severe than expected. The extent of the spring flush will have a significant impact on availability of SMP, given there are still significant milk powder stocks within the sector.
- **New Zealand** is experiencing familiar dry conditions, particularly in the North Island, which has prompted early drying-off early to preserve cow condition for next season. Milk production will still be higher for the season, but far less than expected, and will support WMP prices which are now in tight supply until spring.
- **US milk production** has also slowed with increased pressure on farm margins and harsh weather conditions taking a toll. Trade policy squabbles with major trading partners Mexico and China have knee-capped US manufacturers who had increased trade in early 2018.



- On the demand side, **China** has been active in the market in late 2018 and early 2019 – despite escalating fears of an economic slowdown. Increased prices may slow demand from **SE Asia and North Africa** which took advantage of low prices in late 2018 to fill supply lines. The gradual sale of low-cost SMP from Europe may also keep a lid on prices in coming months.

The commodity milk value

- The spot CMV has rallied since a trough in November last year, adding $1.26kgMS. Values of all commodities have improved in the intervening period, particularly SMP, cheese and WMP. At the time of writing the CMV had reached $6.30, a level last achieved way back in March 2014.
- Looking forward, we are forecasting the CMV to consolidate in 2019, as product availability remains tight and supply needs are covered. This will be far more apparent in Australia as a sharp decline in milk supply will tighten supplies of cheese and butterfat.
- Positive farmgate price signals are then expected to drive a recovery in global milk production which will ease product shortages and place downward pressure on commodity prices.



Where are the risks?

- The outlook for the CMV is sensitive to changes commodity prices and exchange rates. The **table** shows the impact on the projected CMV from varying commodity prices (by 5% per column) and the $A in from our Australian milk returns model.
- We see the major market risks to this outlook as:
  - The fallout of Brexit which may result in significant trade disruption;
  - Resilience of cheese prices, with key Asian growth regions slowing their imports, while there is likely to be increased competition from Northern Hemisphere producers;
  - Demand from China and South East Asia given the threat of further economic slowdown and the as yet unresolved trade dispute with the US.

Sensitivity of 2019/20 CMV to changes in prices and currency

% changes to dairy commodity prices

% changes to $A value	5.96	-25%	-20%	-15%	-10%	-5%	0%	5%	10%	15%	20%	25%
	0.67	4.30	4.76	5.22	5.68	6.14	6.60	7.05	7.51	7.97	8.43	8.89
	0.68	4.20	4.65	5.11	5.56	6.01	6.46	6.91	7.37	7.82	8.27	8.72
	0.69	4.11	4.55	5.00	5.44	5.89	6.33	6.78	7.22	7.67	8.11	8.56
	0.70	4.01	4.45	4.89	5.33	5.77	6.21	6.64	7.08	7.52	7.96	8.40
	0.71	3.92	4.35	4.78	5.22	5.65	6.08	6.52	6.95	7.38	7.81	8.25
	0.72	3.83	4.26	4.68	5.11	5.54	5.96	6.39	6.82	7.24	7.67	8.10
	0.73	3.74	4.16	4.58	5.00	5.43	5.85	6.27	6.69	7.11	7.53	7.95
	0.74	3.66	4.07	4.49	4.90	5.32	5.73	6.15	6.56	6.98	7.39	7.81
	0.75	3.57	3.98	4.39	4.80	5.21	5.62	6.03	6.44	6.85	7.26	7.67
	0.76	3.49	3.90	4.30	4.71	5.11	5.52	5.92	6.32	6.73	7.13	7.54
	0.77	3.41	3.81	4.21	4.61	5.01	5.41	5.81	6.21	6.61	7.01	7.41

Further information

The outlook is intended as a planning input for farmers and other stakeholders and is freely distributed. **The commodity milk value (CMV) is an estimate of milk value based on spot prices for key commodities and the average industry product mix, net of costs. Between 2011/12 and 2017/18 the CMV has averaged over 80% of final farmgate returns – ranging between 70% and 95% of the final average price paid by manufacturers in southern Australia.* For more information on our approach to calculating the Commodity Milk Value, please go to our website. We track the CMV weekly here.