Media release
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Slow rebalancing in global dairy markets weighs on prices, but turnaround beginning – Rabobank

Recent decreases in international dairy prices and the 2014/15 milk price payout projection reflect the slow pace of the rebalancing that is taking place in global dairy markets, agribusiness banking specialist Rabobank said today.

Rabobank New Zealand CEO Ben Russell said the current market price forecast will negatively impact New Zealand dairy farmer cash flow and profitability across this season and next, but a turnaround in global dairy markets was beginning, with Rabobank maintaining its expectation of a price recovery to commence during the 2015-2016 season.

Rabobank director of Dairy Research New Zealand and Asia, Hayley Moynihan said market indicators were emerging which would lead to reduced global dairy supply growth and ultimately a recovery in prices.

“What we are seeing reflected in the dairy prices now is the result of global dairy import demand softening in early 2014 due to high retail dairy prices impacting consumers, combined with lower income growth in many emerging markets and a sharp increase in global production during 2014 and 2015,” she said.

“Import growth has though returned in late 2014 and early 2015 and many import buyers, such those in South East Asia and the Middle East, have been taking the opportunity to replenish their inventories at the lower prices.”

However, Ms Moynihan said, global market rebalancing would take some time as milk production growth gradually slows and as normal buying patterns return.

“Our view is that global milk production growth will lift slightly again through to the end of the year, due primarily to low feed grain prices and with some increase in EU production following the earlier slow down to avoid paying quota penalties,” she said. “Production growth will, however, remain below the rapid growth levels experienced in early 2014.”

Ms Moynihan said in the important export market of China, demand for dairy was “still very subdued”, due to higher retail prices combined with slowing economic and income growth in that country.

“The dairy market in China is also still rebalancing, with higher domestic production and as it works through inventories from 2014 and generally adjusts to lower rates of demand growth,” she said. “For China, we expect a modest improvement in dairy demand in 2015 – in the vicinity of a 1.5 per cent increase on 2014 – but still well below five-year average growth rates.”

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Rabobank expects the benefits of a lower New Zealand/US dollar exchange rate to flow through into the 2015/16 season for New Zealand dairy farmers.

“Along with the expectation that dairy commodity prices will firm late this year and early next, this is likely to support an increase in the milk price for the 2015/16 season,” Ms Moynihan said.

“That said, farmer cash flows are unlikely to benefit from this until 2016 and more fully in 2017”

Mr Russell said this time frame and dairy price levels were in line with the expectations the bank had held for at least the past six months.

“We have always considered that the current trough in global dairy prices would be prolonged. As with so much in agriculture, it’s necessary to take a longer-term view of these periods and we’ve been working through cash flows with our clients at a lower milk price over the past six months and we will continue to do so,” he said.

“Our view is that farmers should prudently look to a 2015-16 milk price of approximately $5.50/kgMS for budgeting purposes, but also understand their financial position at a milk price of $5.00/kgMS.”

Mr Russell acknowledged the pressure this would put on dairy farmers.

“Many farmers will be in a loss-making position at these prices, and this can be a particularly stressful for them and their families. It is important for farmers to engage with their bank and professional advisers and develop plans to get through these difficult seasons. Banks have an important responsibility to support their clients and take a long-term view during difficult times,” he said

Mr Russell said ultimately rural communities and the wider New Zealand economy would feel the impact of lower dairy prices, with the reduction in income from the current dairy season compared to last year at around $7 billion.

But, he said, it was also important to understand that prices would improve, with Rabobank's medium-term forecast more positive.

“Our expectation is that growth in import demand through to 2020 – combined with supply growth constraints and cost pressures in key dairy export supply regions – will result in whole milk power prices averaging more than US$3500 a tonne over the next three to five years,” he said. “This would represent a lift of more than US$1000 a tonne, or 40 per cent, from current price levels to more sustainable prices for both dairy exporters and importers on an ongoing basis.”

However, he cautioned, high volatility would remain a feature of dairy market pricing into the future.

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