

regional &
agribusiness



IN FOCUS: DAIRY

JANUARY 2019



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Photo Carl Davies, CSIRO

KEY POINTS

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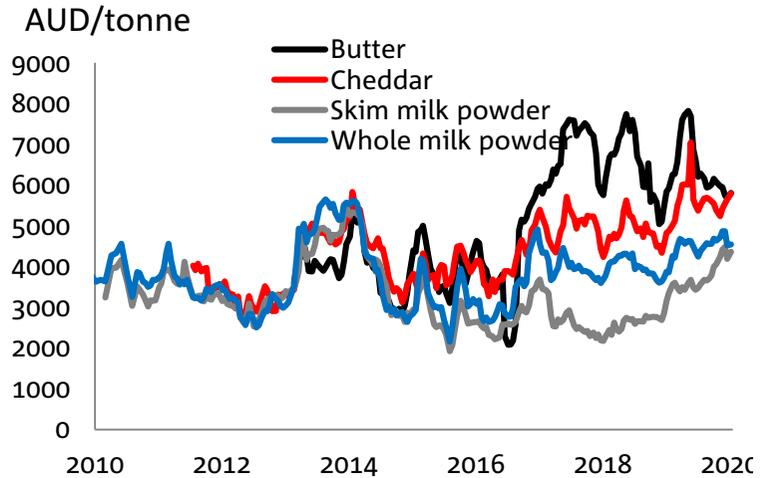
Australia's dairy sector faces a number of cross currents. Farmgate prices are very strong by historic standards, with Saputo and Fonterra having both stepped-up to \$6.95/kg – a level not seen since the heady days of 2013-14. There are, however, four key differences between now and 2013-14 that make for a *very* different experience for Australia's dairy farmers.

Firstly, input costs are much higher than in previous times. NAB's feedgrain price index for the season to date is around 23% higher than the 2013-14 average and temporary water in the Lower Goulburn over 5 times higher. These higher input costs reflect (and are worsened by), the second key difference – generally poorer seasonal conditions. 2019 was Australia's hottest and driest year on record, and while some dairy regions, such as western Victoria and parts of Tasmania, escaped the worst, others like northern Victoria, southern NSW and subtropical areas suffered heavily.

Thirdly, global prices are well below their 2013-14 peak, but this has been offset by a lower Australian dollar. The AUD averaged 91c in 2013-14 but only 68.5c so far this season. Our USD denominated dairy price outlook is essentially neutral and NAB's house view is that the AUD will only appreciate very modestly, reaching 75c by mid-2022. This should keep AUD dairy export prices elevated, although clearly a global demand or FX shock would upset this.

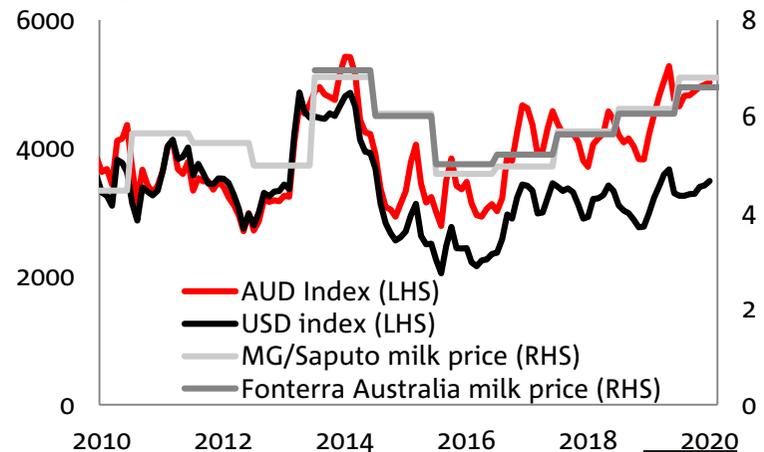
Lastly, suppliers are scrambling to offer premiums to maintain milk flow, which has been severely constrained by drought and high input costs. Thus far, high farmgate prices have failed to arrest the fall in Australian dairy production, which is now the lowest since the mid-1990s. In this environment, increased import competition is a serious risk.

GDT AUCTION RESULTS



NAB WEIGHTED DAIRY EXPORT PRICES

\$/tonne (export price, LHS), AUD/kg milk solids (farm gate price RHS)



Source: Australian Bureau of Statistics, Global Dairy Trade, Dairy Australia and NAB Group Economics



SEASONAL CONDITIONS



Ultimately, the less said about seasonal conditions in 2019, the better. Nationally, 2019 was rotten – the hottest and driest year on record with national average rainfall 40% below average.

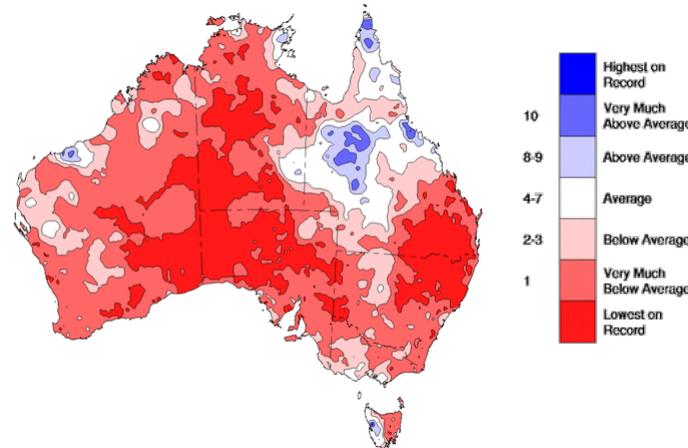
The impact of the season on the dairy industry has been very region specific. South-west Victoria, south-west Gippsland and parts of Tasmania enjoyed reasonable conditions for much of 2019. On the other hand, East Gippsland was very dry and is now contending with severe bushfires. Northern Victoria – which is largely dependent on irrigation – has faced an extended period of high water and feed prices, which has reduced competitiveness for the region.

The 2019-20 bushfire season is unprecedented and ongoing. Dairy properties have been lost and others are unable to deliver milk due to road closures. Bega – which operates in the south coast of NSW – announced to the ASX in early January that milk losses would not materially affect its operations.

The three month outlook coming into autumn is closer to average, although at this stage just getting through summer seems to be the biggest concern.

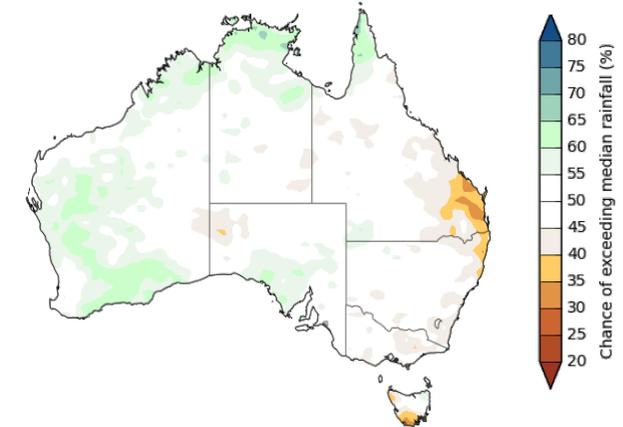
RAINFALL – 2019

Deciles



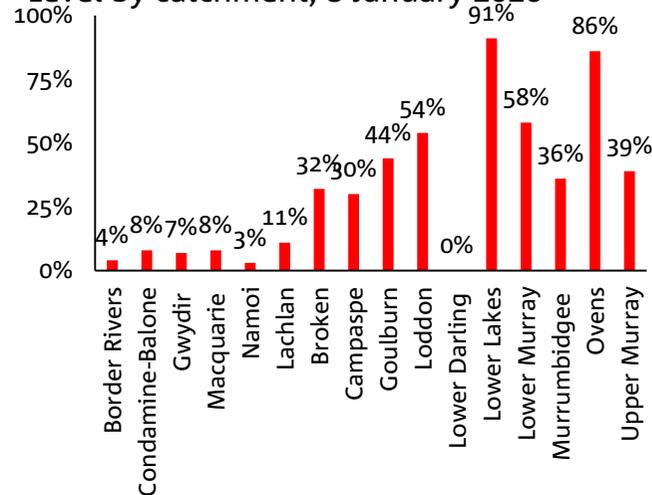
RAINFALL OUTLOOK

February to April



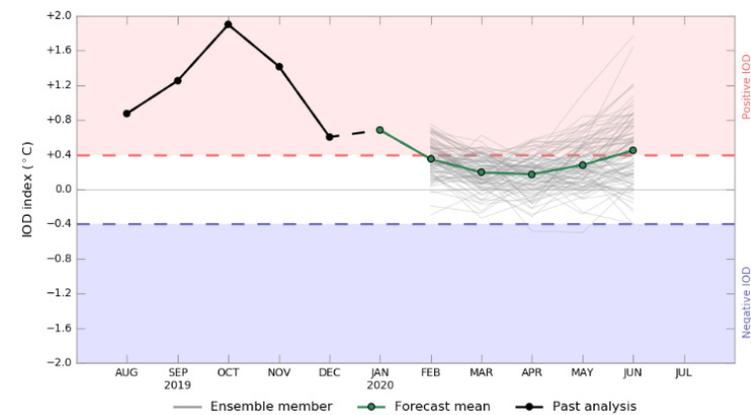
MURRAY DARLING BASIN STORAGE

Level by catchment, 8 January 2020



BOM INDIAN OCEAN DIPOLE

Monthly SST anomaly – IOD region



Source: Bureau of Meteorology, MDBA and NAB Group Economics

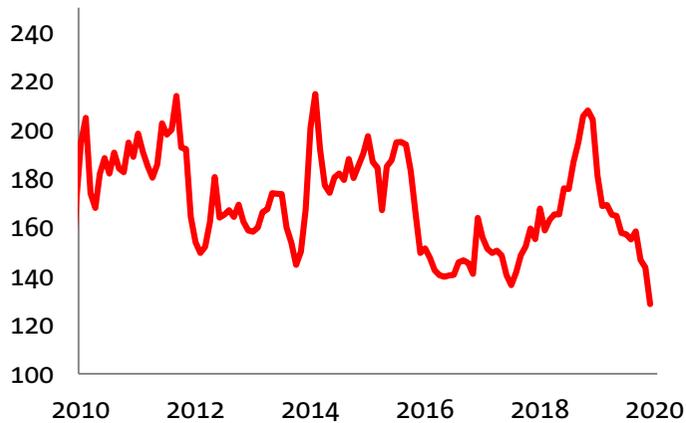


FARM INPUTS



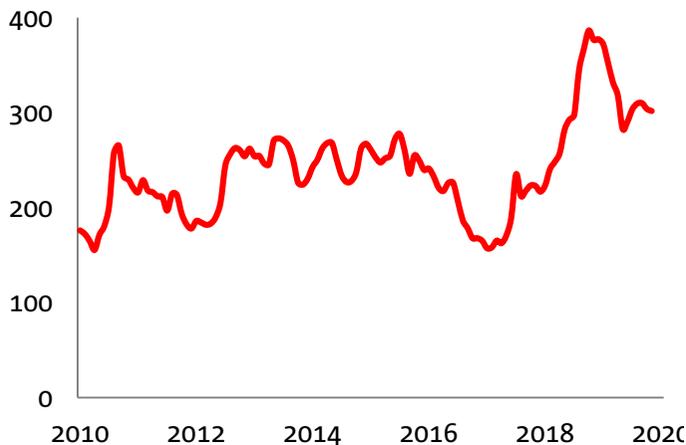
NAB FERTILISER INDEX

AUD index



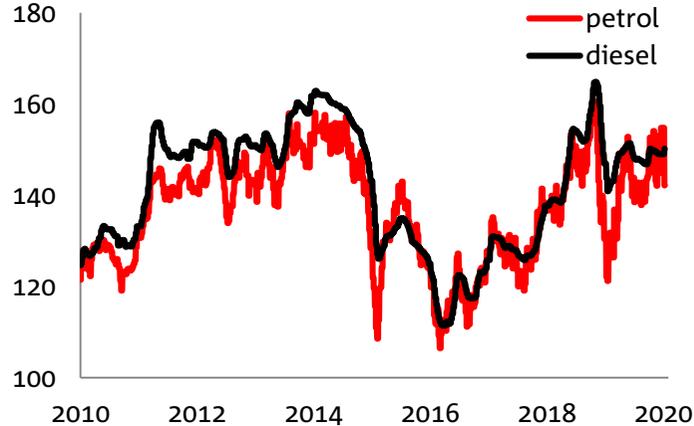
NAB WEIGHTED FEED GRAIN PRICE INDEX

AUD/t



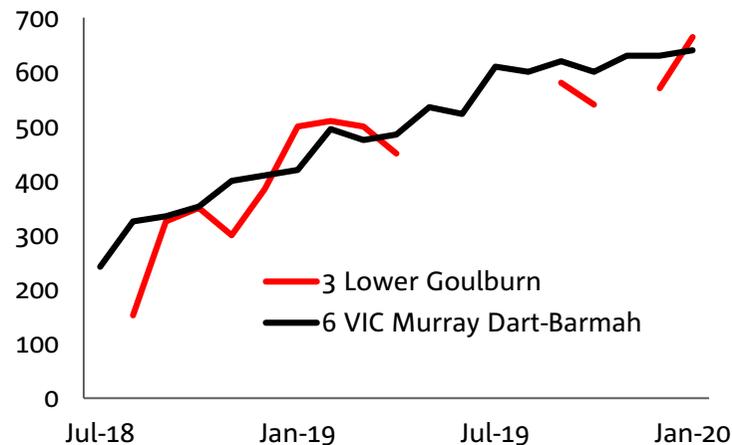
NATIONAL AVERAGE FUEL PRICES

AUc/litre



ENTITLEMENT TRADE PRICES

\$/ML, selected valleys



Farm input prices are unfavourable overall, although some inputs have provided relief since last year. Beyond prices, producers in drought-affected regions have been forced to increase volumes.

Irrigation-dependent farms in northern Victoria are forced to contend with extremely high temporary water prices. Zone 3 Lower Goulburn recorded an average temporary water price of \$664/ML for January 2020 to date. Prices at this level are a major challenge.

Fuel prices offer little excitement, with diesel hovering around \$1.50/l for much of the year. Crude oil prices surged earlier this month on Iran tensions, but this looks to have cooled, at least for now. Meanwhile, fertiliser prices have fallen substantially in the past year.

Feed prices remain high, with the NAB feed grain price index averaging \$316/t in January (to date), although this is a good deal below the high of \$386 in October 2018. Following miserable yields this season, we see it hard to see much downside until there is a good break.

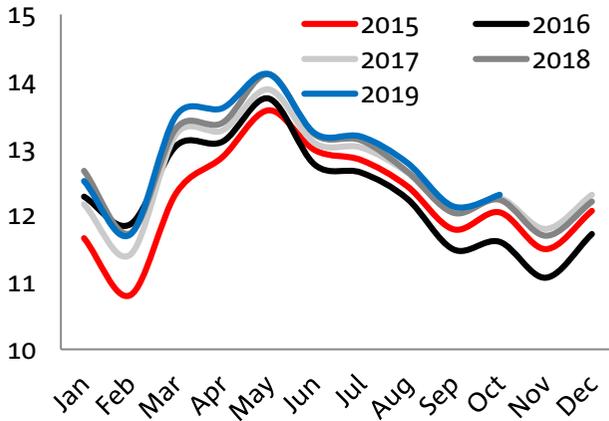
Source: Bloomberg, Profarmer, Department of Agriculture, NAB Group Economics

INTERNATIONAL PRODUCTION TRENDS



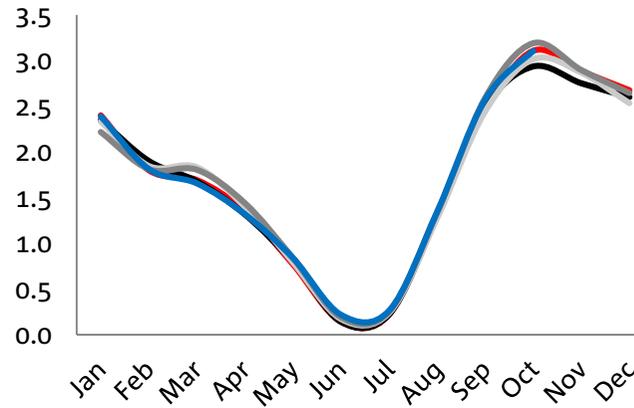
EU28 MILK PRODUCTION

Billion litres/month



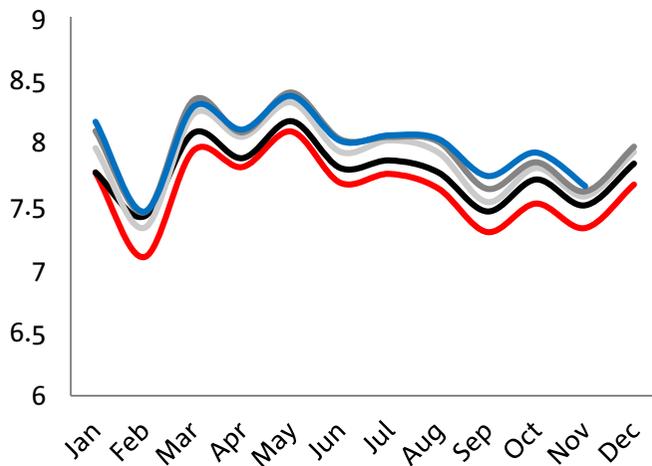
NEW ZEALAND MILK PRODUCTION

Billion litres/month



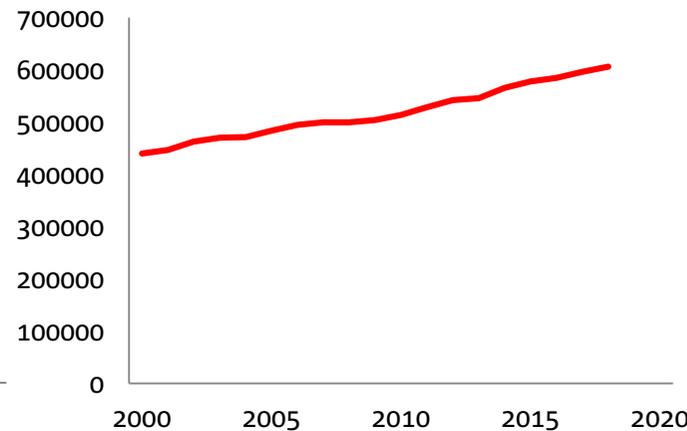
UNITED STATES MILK PRODUCTION

Billion litres/month



WORLD MILK PRODUCTION

KT



Milkflow for major international producers remains positive, although growth is perhaps slower some had expected. EU28 milk production is running at the top of its five year range, as is the United States.

New Zealand – the world’s largest dairy exporter – has seen recent monthly production a little below year-ago levels, although nowhere near enough to cause concern. New Zealand tends to exhibit very little volume risk year to year, with production increasing most of this century. New Zealand produced 71% more milk in 2018 than in 2000.

Fonterra New Zealand’s latest price update in December 2019 puts its 2019-20 farmgate milk price forecast at NZD7.00-7.60/kg milk solids. The low NZD – currently around 66 US cents – has been favourable to NZ dairy prices. Our forecasts point to the NZD reaching 70 US cents by mid-2022.

Global dairy demand growth has been supportive of prices and we see Chinese dairy demand growth as likely to continue.

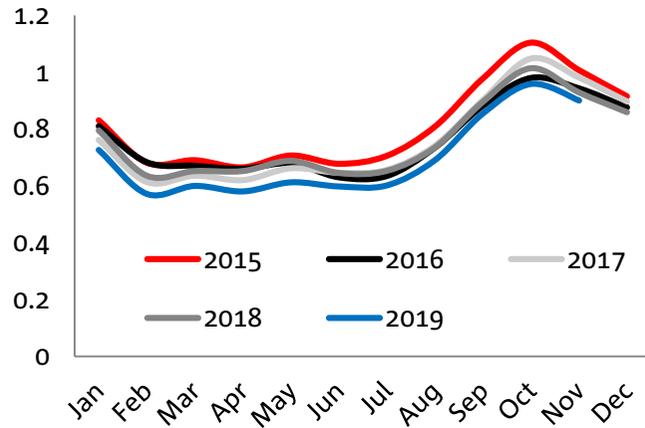
Source: European Union, Eurostat, ABARES, USDA, DCANZ and NAB Group Economics

AUSTRALIAN PRODUCTION TRENDS



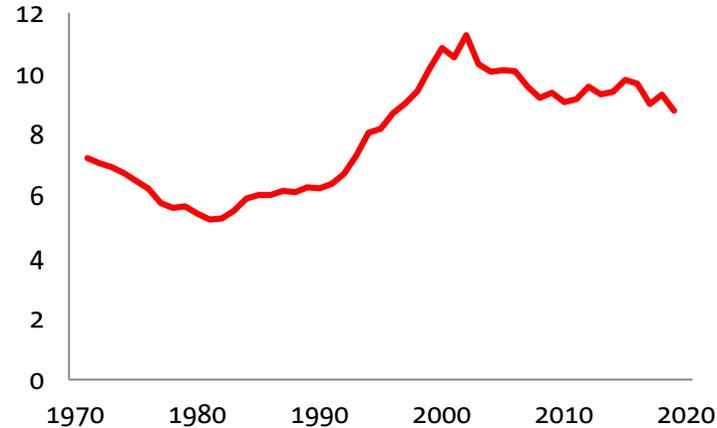
MONTHLY MILK PRODUCTION

Billion litres/month



ANNUAL MILK PRODUCTION

Billion litres/annum



Australian milk production continues to suffer following the 2016 farmgate price crunch, followed by a brief reprieve in 2017 and then two seasons of high feed and water costs.

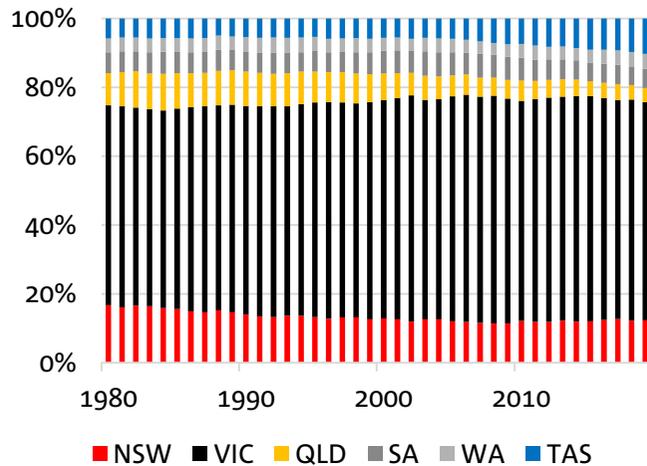
2018-19 milk production fell to just under 8.8 billion litres – the lowest since 1995-96. Dairy Australia’s latest forecasts point to production in the order of 8.3-8.5 billion litres this season.

What is needed to arrest falling production is a better season easing input costs, but our longer term concern is that an increase in permanent plantings (e.g. almonds) in the Murray Darling basin will structurally increase the price of water in northern Victoria. In the absence of lower water costs it is unlikely that northern Victorian production can grow.

Tasmania is an ongoing success story – the state’s share of national milk production has almost doubled to 10% over the last two decades. A mild climate combined with ample water availability has made dairy a compelling proposition in the state.

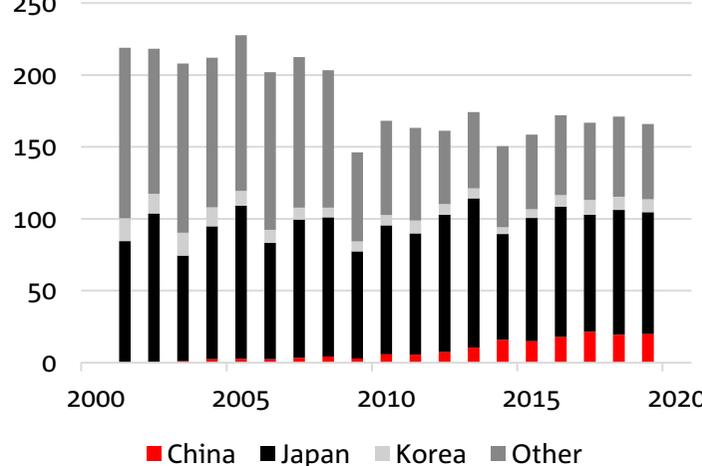
STATE SHARE OF AUST. PRODUCTION

% share



AUSTRALIAN DAIRY EXPORT VOLUME

KT by destination



Source: ABARES, European Union and NAB Group Economics





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