

USDA Foreign Agricultural Service

# GAIN Report

Global Agricultural Information Network

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## New Zealand

Post: Wellington

### Low Farmgate Milk Prices Causing Financial Hardship for Farmers

**Report Categories:**

Agricultural Situation

Dairy and Products

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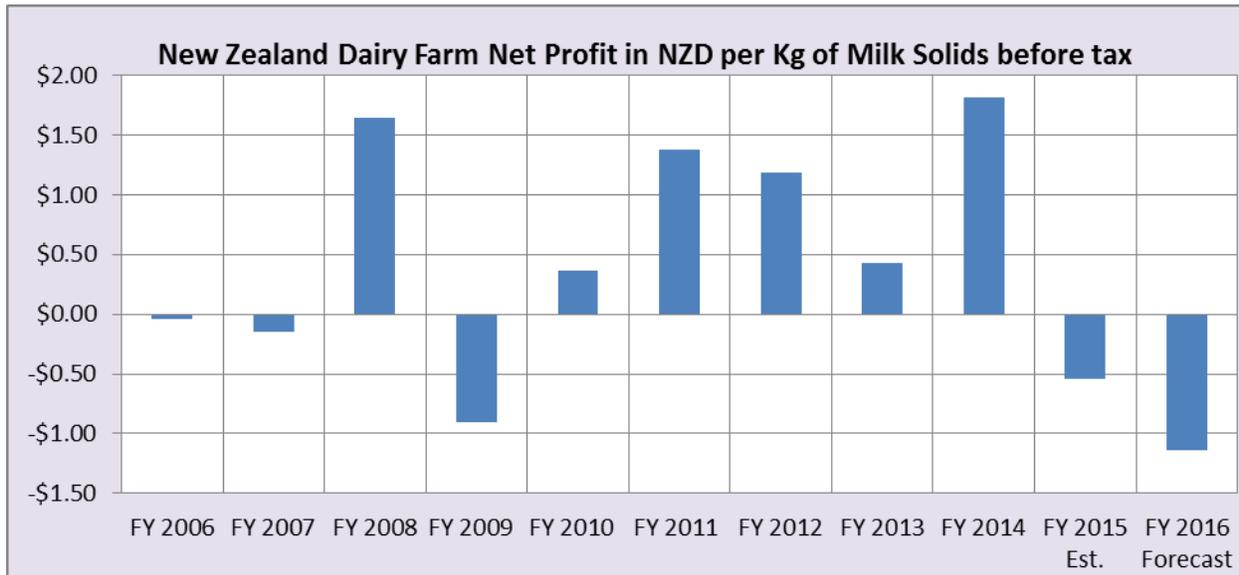
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**Report Highlights:**

Dairy commodity prices for New Zealand's major dairy exports have dropped 57% since February 2014. New Zealand dairy farmers are into the second year of very low farmgate milk prices now estimated at being 52% down from the peak milk price in 2014. The end to this price trough still looks to be some way off. Some commentators are saying it will be well into 2017 before commodity prices recover.

## Low New Zealand Farmgate Milk Prices Causing Most Dairy Farmers to Suffer Financial Losses

For the second year in a row, New Zealand dairy farmers will have to endure a low farmgate milk price which will mean most dairy farms will not achieve a breakeven financial outcome for the Financial Year (FY) 2016. Very low farmgate milk prices are likely to continue into FY2017 and could even stretch into FY2018, according to some industry participants.



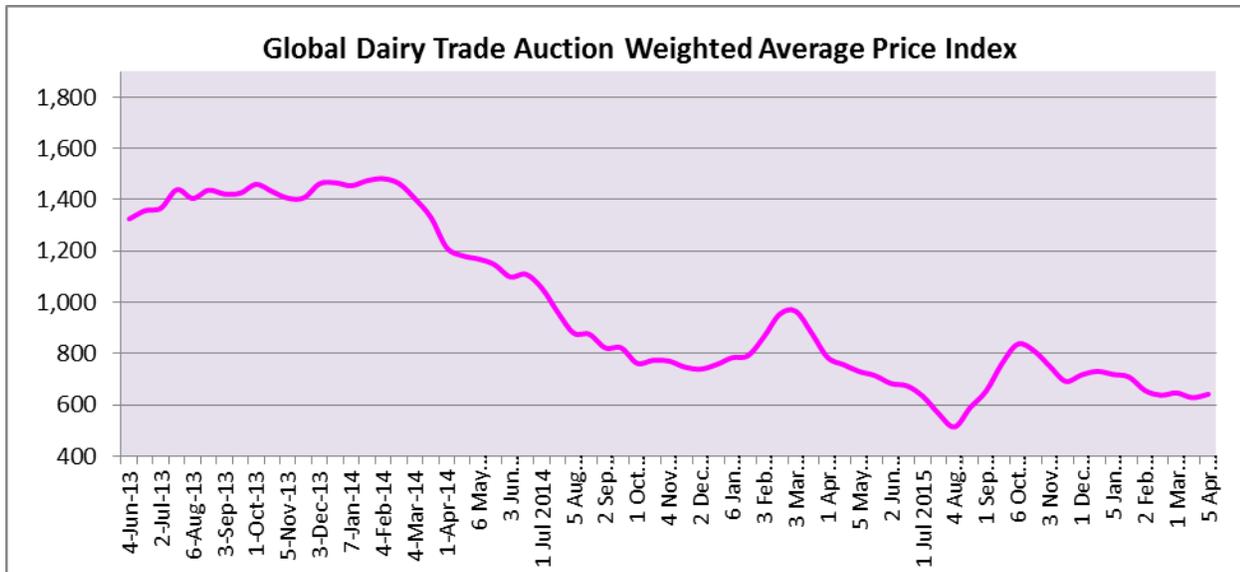
Source: DairyNZ, Post Estimates

The massive change in fortunes for New Zealand dairy farmers, who enjoyed their highest farmgate milk payout ever in FY2014, has its roots in the unique position of dairy in New Zealand, where the domestic market only consumes six to seven percent of the milk produced. The vast majority, around 93-94%, is processed into products for export such as whole milk powder, skim milk powder, anhydrous milkfat, butter, and cheese. This is in distinct contrast to most other countries where the milk produced is consumed domestically. Only approximately seven percent of global milk supply is traded across borders.

Not having a large relatively stable domestic market to buffer international price volatility means small changes in global supply that then enter international trade flows have big effects on commodity prices in New Zealand. Which is exactly what has happened since 2014: EU dairy farmers, who produce 30% of the world's supply of dairy products, increased their production in calendar year (CY) 2014 by 4.6% over CY2013. Nearly all of this additional output found its way onto the international market leading to an estimated 18% increase in globally traded supplies. A sizeable overhang in global supplies developed quickly, which has led to a significant reduction in dairy commodity prices.

Adding to this disruption, the Russian embargo on cheese imports from the EU, combined with a reduction in Chinese imports due to increased domestic production in that country, have only exacerbated the dairy commodity price trough.

The overall price index generated from the Global Dairy Trade Auction is a good proxy for the price movements in dairy commodities in the Pacific Rim and Oceania in particular. Since February 2014 the index has dropped by 57%.



Source: GDT website, The Global Dairy Trade Auction is a two weekly electronic auction of dairy products for delivery over the succeeding six months. It was started by Fonterra in 2008.

<b>New Zealand: Profitability of Dairy Farming</b> (in terms of NZ Dollars per kilogram of milk solids)										
Key Indicator or Category	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015 Est.	FY 2016 Forecast
Milk Sales	4.12	7.35	5.20	6.16	7.36	6.69	6.33	7.69	5.07	4.30
Livestock Sales & Sundry Income	0.31	0.45	0.45	0.37	0.44	0.40	0.44	0.42	0.54	0.45
Change in Value Livestock	0.16	0.15	0.02	0.00	0.07	0.14	0.08	0.16	0.00	0.00
<b>Total Gross Income</b>	<b>4.59</b>	<b>7.95</b>	<b>5.67</b>	<b>6.53</b>	<b>7.87</b>	<b>7.23</b>	<b>6.85</b>	<b>8.27</b>	<b>5.61</b>	<b>4.75</b>
Farm Working Expenses	3.63	4.91	4.88	4.51	4.95	4.73	5.03	5.17	4.90	4.55
<b>Operating Profit</b>	<b>0.96</b>	<b>3.04</b>	<b>0.79</b>	<b>2.02</b>	<b>2.92</b>	<b>2.50</b>	<b>1.82</b>	<b>3.10</b>	<b>0.71</b>	<b>0.20</b>
Debt Servicing	1.01	1.30	1.58	1.51	1.39	1.18	1.23	1.13	1.10	1.20

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Rent	0.10	0.09	0.12	0.15	0.15	0.13	0.16	0.15	0.15	0.14
<b>Net Profit</b>	<b>-0.15</b>	<b>1.65</b>	<b>-0.91</b>	<b>0.36</b>	<b>1.38</b>	<b>1.19</b>	<b>0.43</b>	<b>1.82</b>	<b>-0.54</b>	<b>-1.14</b>
Term Debt per kg MS	14.86	18.73	19.91	21.65	20.44	19.24	20.82	20.14	20.80	22.00

- Note
1. Sources: DairyNZ Economics Group, Post estimates
  2. Farm working expenses include depreciation; wages of management to the owner either real or adjusted; and other adjustments to standardize accounts
  3. Data has been collected from a sample of owner operated farms

Notwithstanding the effect of oversupply in the traded markets on dairy prices, and in turn on farm revenue, significant on-farm cost increases over the last ten years are another reason farmers are losing money. From FY2006 to FY2014, on-farm operating costs have risen by 46%, when analyzed on a per kilogram of milk solids basis, compared with the general consumer price index in New Zealand, which has inflated by 19%.

Most of the escalation in farm operating costs are in categories directly controlled by the farmers themselves such as: supplemental feed costs (up 178%); stock grazing off-farm (up 71%); repairs and maintenance (up 64%). Most of the extra inputs into farm systems from FY2008 through FY2014 were to increase production in the high milk price years when the marginal revenue was above the marginal cost of the inputs. Now the situation has changed and inputs such as supplemental feeds are often not economic anymore.

It is forecast that costs will be pruned back by 12% in FY2016 from the peak in FY2014. Along with this most farms are reducing cow numbers by three percent up to fifteen percent. Farmers are weathering the storm by adopting a combination of some of the measures shown below:

- Better on-farm management to achieve efficiencies and productivity gains;
- Rearing extra calves to sell as beef animals;
- Reviewing all costs frequently;
- Owing to good beef prices surplus stock sold for slaughter are achieving higher prices than in the past;
- Fortuitously interest rates are at historically low levels making debt servicing easier;
- Sources of off-farm income are sought, often one spouse is able to work off-farm;
- Reducing personal expenditure drawn from the farm; and
- Selling non-productive assets.

However most dairy farms will still need a farm-gate milk price of NZ\$5.30 to NZ\$5.60/kg of milksolids to breakeven unless they can sustainably reduce costs even further.

Forced sales of dairy farms by their creditors are on the increase but it is not expected to become a deluge.