The dairy industry

Turning sour

As boom turns to bust, global milk prices slump

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LITTLE over a year ago, New Zealanders were still talking about a “white-gold rush”. Strong prices for milk were prompting sheep and cattle farmers to convert to dairy, and Chinese firms were coming in to buy up agricultural land and milk processors. Inevitably, influx has led to glut. Prices have fallen to their lowest in more than ten years (see chart). Farmers in France, Britain and Belgium have recently been staging protests against low milk prices, but few places are as badly affected as New Zealand, whose dairy industry produces a quarter of its export earnings.

On August 7th Fonterra, a co-operative owned by New Zealand farmers which is the world’s largest dairy-export firm, said it expected to pay its members NZ$3.85 ($2.55) per kilogram of milk solids in the current season, ending in May 2016. That is less than half the record price of NZ$8.40 it was paying two years ago, and well below breakeven for many farmers.

There are three main reasons why the milk trade has turned sour. One is the economic slowdown in China, a giant market where demand for dairy produce had hitherto been growing strongly. Another is the abolition of the European Union’s dairy-production quotas earlier this year, which is encouraging big producers in Germany, the Netherlands and elsewhere to boost their output and exports. A third is Russia’s ban on EU produce, in retaliation for European sanctions, which is forcing those European farmers that had been selling to Russia to seek other markets.

Andrew Little, the leader of New Zealand’s opposition Labour Party, says he fears prices will stay low, and that the industry’s bankers will lose patience. If this leads to a lot of indebted farms being put on the market, many may fall into foreign hands, especially Chinese and American ones—something New Zealanders would not welcome. As a stopgap, Fonterra is
offering farmers a loan of 50 cents for each kilogram of solids they sell to the firm between June and December. The loan will be interest-free for the first two years, and the farmers have to pay it back only if and when the price recovers to NZ$6.

There have also been calls for Fonterra to suspend the twice-monthly online auctions of GlobalDairyTrade, a trading system it owns, which is used to set benchmark prices, until prices pick up. Fonterra’s boss, Theo Spierings, has said he would like New Zealand to have something like Europe’s price-intervention scheme, in which the EU buys farmers’ stock when prices of milk powder, butter and other produce hit certain levels.

Some think Fonterra itself is the problem. Jacqueline Rowarth, professor of agribusiness at Waikato University, argues that it has concentrated too much on trying to be big and to dominate the dairy trade, instead of paying attention to consumer demand. Its market
intelligence seems to have been weak: it appears to have underestimated the effects of China’s slowdown on milk-powder stocks there, and the impact of ending EU quotas on European farms’ exports. If it had given farmers more warning of the impending downturn, they might not be in such trouble now.

Both Fonterra and the government are urging farmers not to panic, and assuring them that demand for dairy produce will bounce back in a year or so. However, China is continuing to boost its domestic milk production, while taking advantage of Western sanctions to sell more produce to the Russians. For example, a huge farm with 100,000 cows is being set up in Mudanjian, a Chinese city near the border with Russia. With China’s farms expanding, at a time of subdued domestic demand, and with European ones freed from production quotas, milk prices could slip further. That could make it impossible for some farmers in New Zealand and elsewhere to carry on.

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