Quarterly Update

Interesting times ahead for 2024/25

11 June 2024

Heading into 2024-25, non-operational costs such as interest are going to have a significant sway on the ability for dairy farmers to generate a cash surplus.

As we enter the 2024/25 season, New Zealand dairy farmers are expecting the fifth season in a row of farm-gate milk prices higher than $7.00 per kilogram of milksolids (kg MS). Fonterra's 2024-25 opening milk price forecast sits between $7.25 - $8.75 per kg MS, while the banking sector is indicating forecasts of up to $8.40 per kg MS. Despite these strong prices, inflationary pressures on many of the expenses incurred in dairy farming are continuing to erode farmers' financial position. From 2020/21 to 2022-23 the DairyNZ Econ Tracker reported an increase in operating expenses per kg MS of 21% while gross farm revenue per kg MS increased by 16%.

This increase in expenses is accompanied by an increase in non-operational costs, which are expenses associated with the farm business but not directly tied to milk production. These expenses include interest, rent (excluding support blocks), tax, net drawings, net capital transactions, and debt repayments. Looking ahead these are forecast to account for 38% of total expenditure in 2023-24 and 39% in 2024-25. Even for farmers who can bring on farm expense under control, non-operational expenses at these levels require strong milk prices for farmers to breakeven.

Figure 1 illustrates the amount of debt per kg MS. The three vertical lines indicate thresholds at which farms would pay $1, $2 or $3 per kg MS in interest costs, based on an 8.25% interest rate.

Figure 1: 2022-23 Closing term liabilities ($ / kg MS)

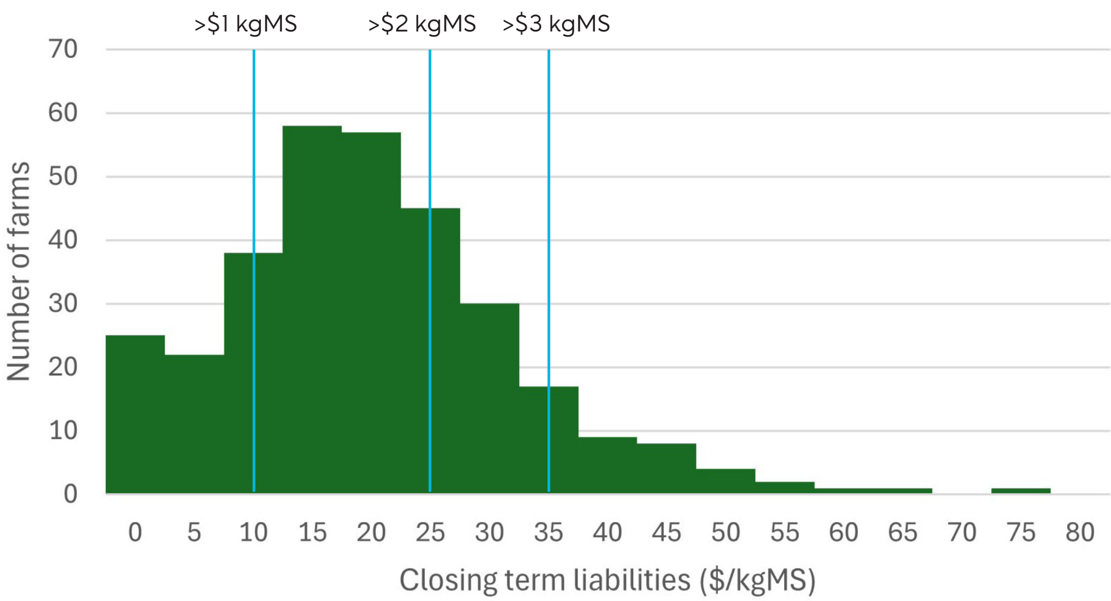

Figure 1 highlights the diverse nature of dairy farm debt and the impact of high interest rates. Approximately 39% of farms would pay more than $2 per kg MS in interest. Given the forecast operating expenses of $6.44 per kg MS in 2024-25, an additional interest expense of $2 per kg MS means that farms would need to generate gross farm revenue higher than $8.44 per kg MS before even considering other non-operational expenses (drawings, taxes, rent and capital expenditures).

The Reserve Bank has recently chosen to hold the Official Cash Rate (OCR) at 5.5%, with commentators suggesting that it will remain at this level until at least the end of this year. In this context, farmers will be anticipating a scenario where the average interest rate for the sector sits between 8 - 8.5% and overdraft rates remain above 10%. With no adaption of the farm's cost structure, strong milk prices are not guaranteed to generate a cash surplus in this environment as demonstrated by the previous example.

In summary, non-operational costs are forecast to account for approximately 40% of total expenditure this season and next. This highlights that focusing on operating profit alone does not adequately describe farmers' financial position. In the current environment, farmers will need to manage both operating and non-operating expenses.

DairyBase is also a great tool for famers to track financial health metrics amongst others, and its detailed tables can guide you through how these metrics are calculated.

Visit the Econ Tracker tool

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