What influences farmgate milk prices?

Overview
Dairy farmers are always dealing with uncertainty in nearly all aspects of their farming business. The weather, cost of inputs and prices of outputs are continually changing. These all impact the bottom line.

Milk prices in particular have a major influence on profitability. Generally, farmers are price takers and have limited control on the price received. No one can predict the future, but the more informed farmers are on price trends, the better prepared they will be for planning and decision-making.

On-farm influences
Some factors that determine milk prices are within a farmer’s control. These include:

- Milk quality: influenced by cow health and mastitis control to minimise bulk milk cell counts, as well as adequate dairy cleaning programs and milk cooling capacity.
- Milk supply pattern: flat line production will attract higher milk prices. Farmers need to assess the impacts to the cost of production when chasing flat line production price premiums to ensure the additional price will justify the increased cost and risk.
- Milk composition: breeding and feeding strategies can influence the fat and protein composition.
- Milk volume: larger volumes will attract higher prices.

Some of the above factors are set (e.g. milk composition based on dairy breed), while some can be varied from season to season and within season (e.g. milk volume).

Because of on-farm factors, milk prices will vary between farms even when supplying the same milk processor. The final price can vary 10 to 15 per cent or even more.

Milk pricing takes into account the factors above and is complex. Farmers should seek income projections from their milk processor to get a price estimate specific to their business. To properly compare prices with other processors, dairy farmers should also seek farm income projections from those processors.

Key points
- There are a range of factors that influence the milk price a dairy farmer receives—on-farm, processor-specific and global. Some of these factors farmers can control, others they can’t.
- Every farm will have a different milk price due to its own unique supply characteristics and milk processor they supply.
- Prices will vary between processors.
- Export prices provide an insight into future farmgate prices.
- Milk pricing is complex—to get a true indication of milk price, farmers should seek income projections from their processor.
Processor-specific influences

Although on-farm factors play a part, off-farm influences are more important in determining milk prices. Different processors will pay different prices depending on:

- **Region of supply**
- **Product mix and the returns derived from that product mix**
  - export versus domestic—supplying the domestic fresh market requires consistent supply all year round. Flat line milk production costs more to produce, hence a need to pay a premium price to secure that supply.
  - commodity products vs value added products
- **Pricing strategies**
  - local competition for milk supply
  - incentives for production and supply patterns
  - quality incentives/penalties
  - loyalty payments
- **Company performance**
  - processing costs
  - supply contracts and currency hedging policies
  - overall company profitability
  - milk payment strategies (how much profit is retained for shareholders versus paid for milk to secure supply).

The above factors influence milk prices offered to farmers. Every company is different, hence the range of milk prices within and between dairy regions.

While milk prices do vary between processors, price variation is limited by competition between processors. Milk processors compete with each other for milk supply. If a processor offers a low price it will lose supply to its competitors. Even in regions with limited competition, the milk price needs to be sufficient for farmers to make a profit, or else dairy farms will go out of business and processors will lose milk. Milk processors need to offer a competitive milk price to maintain milk supply and remain profitable.

Global influences

Global influences explain much of the variation in milk prices from season to season. Milk processors, like farmers, are price takers for the products they produce. They might have more negotiation capacity compared to a farmer, but they are still operating in a competitive market irrespective if they are focused on the domestic or export markets.

Milk processors have different exposures to domestic and export markets. Therefore, what happens with world dairy prices will have different impacts on processors. However, even a domestic-focused company is not immune to the world market as there is an impact on prices in the form of competition from dairy imports. The domestic fresh market does not have as much exposure to imports and therefore is not as volatile, but it is still highly competitive.

Changes in global prices will come several months before changes in milk prices. Monitoring world dairy markets does provide some insight to likely price movements. Farmers can use this information to further inform their decision-making.

Further information and references

See agriculture.gov.au/milkpriceindex

This factsheet has been prepared by: RM Consulting Group Pty Ltd trading as RMCG.