

Dairy Market Insights

First Quarter 2021

1. Summary

Complexity for global market outlook

- The global dairy market outlook is increasingly complex, with the varying pace of vaccine rollouts affecting prospects for foodservice outlets to re-open in key production and consumption markets in the US and UK.
- Layered on top of the COVID recovery issues are severe disruptions to supply chains that have the potential to slow trade and build inventories. Global shipping delays due to chronic container shortages and the effects of the recent Suez Canal accident may extend pressure on freight capacity.
- Weather remains dynamic – a mix of slow-moving factors and sudden changes. A big freeze is expected to extend the EU cold and slow spring lift-off, while drought creeps further across the west of the US. Changes in late-season NZ conditions can vary expectations week to week.
- The fundamentals in the EU market are likely to keep prices mostly firm with slow milk growth likely to remain a feature while retail markets will remain the dominant channel to households – which served dairy better than “normal life” in the past nine months. Delays in vaccines and extended lockdowns in some EU member countries has delayed changes in demand patterns, with foodservice recovery still some way off.
- Milk growth in the US will gradually slow with weaker margins. Meanwhile the reopening of eating out venues will push cheese output and demand away from cheddar, but also tighten butterfat supplies as cream use picks up. US cheddar prices should improve as heavy stocks ease.
- Regional US milk growth is important in this context. Government programs for relief buying and farmer assistance may further influence market behavior.
- Strong Oceania prices - driven up by China’s dominance at recent GDT events - are meeting resistance in WMP and butterfat markets. The late season improvements in New Zealand output and the better conditions in Australia won’t alter the market balance much in the short-term but may allow for some opportunities while logistics remain knotted.
- Demand elsewhere for WMP and fats remains patchy and price-sensitive while SMP is more affordable with the spread of values on offer.

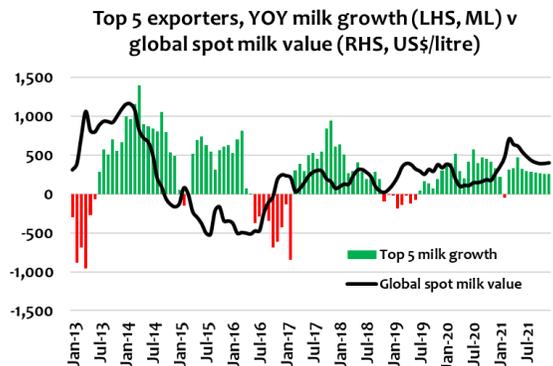
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What it means for Australian dairy farmers

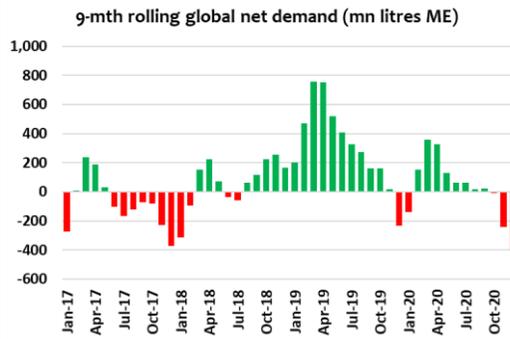
- The **Commodity Milk Value (CMV) has recovered strongly in recent months**, trading around \$7kgMS in late March, mostly on the back of stronger butter prices. This compares to an average CMV for the first quarter of the 2020/21 season of \$5.27kgMS.
- The recovery has had limited impact on current season returns, given there is limited product available to trade at these elevated prices. There were small step ups announced in the first quarter of 2021, bringing **average southern farmgate prices within a range of \$6.30 and \$6.50kgMS for the current season.**
- Stronger commodity price trends have improved expectations for the 2021/22 season, lifting the mid-range estimate for the commodity milk value to near \$6.00kgMS.
- This implies some weakening in commodity prices from current spot values as buyers in developing regions push back against high prices, and US competition increases in key cheese markets.
- This suggests **2021/22 farmgate milk prices for manufacturing use in southern regions** at this stage are likely to be comparable to the starting prices for the 2020/21 season - in the **range \$6.40 to \$6.60kgMS.**
- The range in forecast for the A\$ vs US\$ exchange rate is toward mid-2021, while the average consensus forecasts expects **US78c for 2021/22.** This has been used in our base scenario for the CMV outlook. There remain many variables in the macro and trade outlook which could potentially add to the volatility in currency in coming months.

2. Some key market indicators

Milk growth in the top 5 exporters is expected to gradually slow in the first half of 2021, expanding 1.6% on a like-for-like basis compared with 1.8% in H2-2020

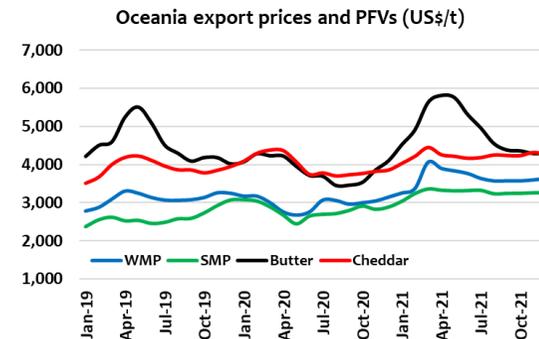


The global market continues to be in small over-supply – mostly reflecting US cheese stocks. This expected to continue into 2021

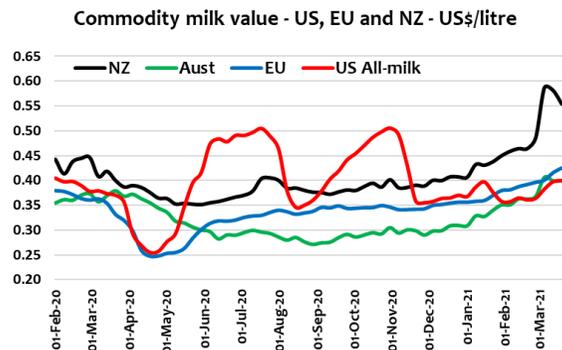


*MSE is a milk equivalents calculation based on the butterfat and protein used in commodity products.

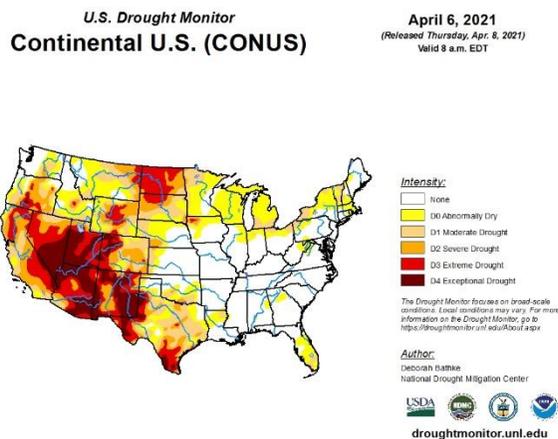
The resilience of import demand in China has strongly boosted Oceania product prices, taking WMP and butterfat beyond affordable levels for many buyers in other regions.



Global milk values are rising with tighter supplies. Constraints on production are likely to limit the milk supply response.

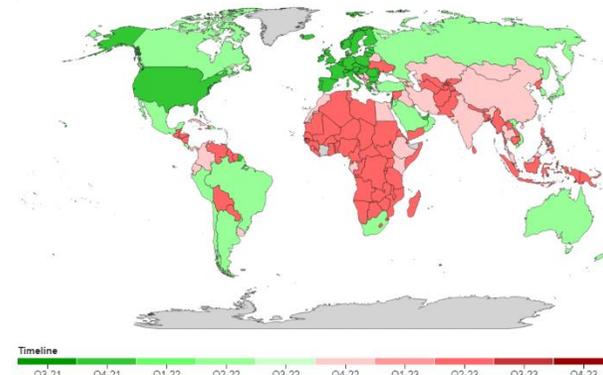


Worsening US drought conditions could affect 2021 crop yields, pushing feed prices higher and tightening dairy farm margins



Vaccine rollout timelines are rapidly changing, but the uneven distribution will bring staggered timelines for improved mobility, commuter travel and the reopening of foodservice channels. Many variables will continue to affect expectations for returning to “normal”.

The race to inoculate the world



3. Watch points

There are several policy and other wildcards that may significantly impact trade in the short to medium term.

Issue	Summary	Analysis/impact
COVID vaccine timelines	<ul style="list-style-type: none"> The timelines for sufficient vaccinations to reach “herd immunity” varies significantly from country to country. This will be staggered as our map on page 3 shows. The US rollout will probably improve, while the EU’s handling of vaccines has worsened. A return to “normal” won’t happen until well into 2022 in developing regions without major humanitarian efforts to get vaccines to people at risk and measures to manage risks from resumption of travel. 	<ul style="list-style-type: none"> The increased optimism is already having an effect in some commodity markets, but the unravelling of lockdown food patterns will alter the structure of demand in western economies. There will be ongoing concerns for the ability of vaccines to suppress more contagious variants.
Government policies	<ul style="list-style-type: none"> The US government continues to intervene in dairy markets. Details of the timing and product mix of later stages of USDA Food Box purchases, and the product focus of the US\$400m donations program, are still to come. Other policy changes – farmer subsidies, environmental and immigration policies impacting producers may slowly impact dairy. 	<ul style="list-style-type: none"> Remaining Food Box purchases are unlikely to cause major volatility in US cheese markets, but uncertainty remains for the impact of other measures on butter. Payments to producers may sustain the milk surplus for longer.
Macro outlook	<ul style="list-style-type: none"> The surge in money supply, recovery in consumer demand for resources and tightness in commodity supply has sustained fears of a rise in inflation, just as the world economy struggles back into growth mode. 	<ul style="list-style-type: none"> It’s early to tell. Previous “commodity supercycles” were driven by strong global demand but this time there will be a staggered restart to developed world activity depending on economic damage and the extent of disease control. Humanitarian action could alter that, but big nations with vaccine production will look after themselves first. Much of the lift in food commodities has been sparked by a combination of Chinese buying to improve food security and supply-side challenges.
Logistics	<ul style="list-style-type: none"> The chronic shortage of shipping containers driven by high-priority consumer goods trade into the US remains a significant short-term challenge for trade into developing markets. The Ever Given accident in Suez Canal (the effects of which will linger for weeks) adds to this pressure. 	<ul style="list-style-type: none"> These delays show the increasing fragility of global supply chains. This may increase pressure on some buyers to seek more coverage in ingredient sourcing. In the short-term demand for dairy ingredients is expected to increase to avoid shortages as activity in developing regions improves.
Trade disputes	<ul style="list-style-type: none"> Tensions between the US and China seems no better with the recent articulation of the position of the Biden administration. 	<ul style="list-style-type: none"> Official relations may remain strained but China’s access to food commodities (US corn, soybeans, whey powder) will continue to take priority in the foreseeable future as food security remains a priority.

4. Commodity overview

	What will support prices	What will weaken prices	Expected direction in 2021
SMP	<ul style="list-style-type: none"> • EU milk growing slowly, manufacturers prioritizing cheese • NZ limiting SMP output to avoid surplus butterfat surpluses • Slowly improving Mexican demand • Higher whey protein prices encouraging improving US domestic demand for SMP/NFDM 	<ul style="list-style-type: none"> • Stronger milk production growth in southwest of US meeting faltering cheese demand as weak employment and household income pressures take effect, likely to increase SMP/NFDM stocks • Freight delays adding to short-term inventory building • Competitive pressure from US exporters impacting EU/NZ prices 	Flat, with reducing NZ premium over competitors 
Butter	<ul style="list-style-type: none"> • Sustained growth in retail demand in EU • Slow growth in EU milk output and sustained cheese demand will minimise cream availability • Reduced NZ milk use for SMP/butter • Continued strong vegetable oil prices reflecting tight supplies 	<ul style="list-style-type: none"> • Rising US stocks and weaker cream multiples • EU butter stocks may build with cream surpluses • Cream demand in the US with faltering food service openings • Weak developing market demand with poor food service sales 	Current prices to weaken with reduced demand from developing regions 
Cheese	<ul style="list-style-type: none"> • Robust EU/UK retail demand for gouda and cheddar • Improved US foodservice sales • US manufacturers managing supply • Foodservice re-opening in Asian regions 	<ul style="list-style-type: none"> • Strong US milk output growth in cheese-rich processing regions • Intense competition in Asian markets • Improved scope for US exports at competitive prices 	Weaker with declining fat values, subject to competition in key markets 
WMP	<ul style="list-style-type: none"> • Persistent Chinese demand supported by cost advantage for imported product • Supply security concerns likely to sustain Chinese purchases with higher domestic fresh milk demand • Seasonally lower Latam WMP availability • Improved EU WMP output in 2021 	<ul style="list-style-type: none"> • Increased late season availability in New Zealand • Pushback from developing markets against rising prices • Reduced Algerian tenders likely at high prices • Slowing Brazilian import demand 	Weakening fundamentals as demand slows at higher prices 

6. Australian outlook

Critical issues

Milk production

- Seasonal conditions remain favorable in most regions. The outlook is for normal rainfall across most regions in Q2-2021 with better than average conditions in some southern dairy production regions.
- Irrigation storages levels in the Murray Darling Basin have steadied, allocations improved. Feed grain prices remain close to long-term averages but significantly cheaper than the same time in 2020, while there are abundant forage supplies.
- Sentiment remains a critical driver of the production intentions. Milk production will likely remain under pressure from farm exits despite conditions that are supportive for profitable milk production.
- Floods affected smaller, fresh milk regions in Queensland and NSW, which will put further pressure on milk supply in manufacturing regions while volumes recover. There are expected to be some small losses which will add to the volumes hauled from Northern Victorian into the NSW fresh milk market

Milk prices

- Expectations for the 2021/22 season have improved and our current outlook suggests full year milk prices for manufacturing use in southern regions to be similar to the starting prices for the 2020/21 season - in the range **\$6.40 to \$6.60kgMS**.
- There will be a large range of milk prices being paid across southern regions as in June 2020, with influence of domestic milk buyers on the terms of milk supply agreements.

Markets

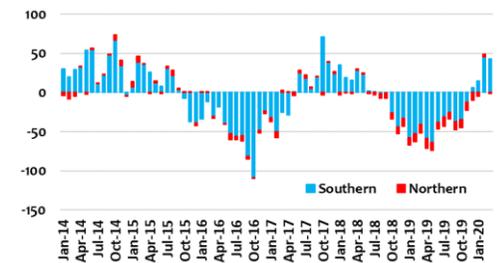
- Foodservice markets have returned towards normal with the removal of (most) COVID restrictions, but risks remain and short lockdowns will be implemented from time to time with leaks from quarantine and fears of variants. A slow vaccine rollout is impeding greater confidence.
- Imports of cheese are accordingly slightly lower on a rolling 6-month basis, while butterfat imports on this measure slowed 7% in the half year to Jan-2021.

Outlook factors

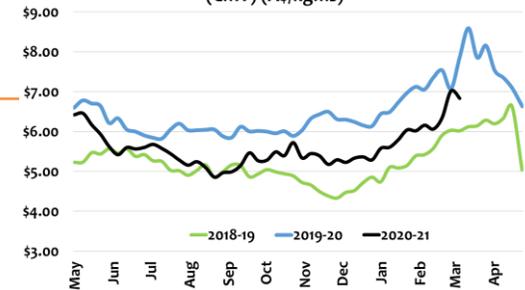
- We expect YOY decreases in milk production in H1-2021 due to the high comparatives in good pasture conditions in H1-2020. This will leave the full season output flat.

- Our mid-range estimate for the commodity milk value in 2021/22 has lifted to **near A\$6.00kgMS** using the base scenario in this outlook.
- Premiums paid by southern region manufacturers have typically ranged between \$0.40 and \$0.60kgMS in recent years and are likely to be similar in 2021/22.
- The range for the \$A vs US\$ exchange rate is widening in Q4-2021 and Q1-2022, while the average consensus forecast is **US78c for 2021/22**
- The pressure on cheese margins will continue to drive opportunistic imports of US product for processing requirements.

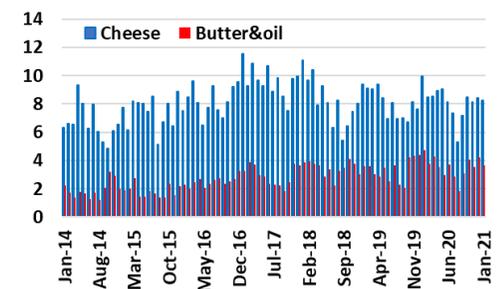
YOY growth, Australian milk output (mn litres)



Australian Spot Commodity Milk Value (CMV) (A\$/kgms)



Australian imports ('000t)



Glossary and explanation of key terms

Acronym		Explanation
AMF	Anhydrous Milk Fat	Removal of water from cream or butter yielding 99.8% milk fat product used in preparing reconstituted product and in food processing
CMV	Commodity Milk Value	The CMV calculation utilises actual or forecast spot prices for major commodities (SMP, WMP, cheese and butter) converted to local currency and the average industry product mix to generate revenue estimate. Direct conversion, overhead costs and allowance for profit retention to generate an estimate of returns available to the relevant milk pool. The CMV is used as a useful forward indicator of how the global market might affect the farmgate and is tracked weekly here .
EU	European Union	European trading bloc including 27 member states
FMP	Farmgate Milk Price	The average FGV that is paid by processors in the southern exporting region of Australia (including southern NSW, Victoria, Tasmania and South Australia) is made up of the underlying commodity value of milk (CMV) and a value-add or premium that depends on the product and market mix of each processor. This includes fresh and other retail dairy products as well as higher value specialised dairy ingredients.
MS	Milk Solids	The protein and fat content of milk which is the basis of payments from processors to farm suppliers. According to Australia in 2019/20 the average Australian litre of milk comprised 4.15gms of fat (4.15%) and 3.45gms of protein (3.45%) and therefore was 7.60gms of milk solids (7.6%).
NFDM	Non-Fat Dry Milk	Shelf-stable milk powder derived from the evaporation and spray drying of skimmed milk. NFDM is defined by the US Code of Federal Regulations and is similar in composition to the more widely produced and traded skimmed milk powder at 34% protein.
NZ	New Zealand	
LatAm	Latin America	Mainly focused on major dairy producing and importing countries Argentina, Uruguay and Brazil.
MENA	Middle East and North Africa	
SMP	Skimmed Milk Powder	Shelf-stable milk powder derived from the evaporation and spray drying of skimmed milk. SMP is defined by the globally recognized Codex Alimentarius as comprising 34% protein and 1.5% milkfat.
US	United States of America	
WMP	Whole Milk Powder	Shelf-stable milk powder derived from the evaporation and spray drying of whole milk. SMP is defined by the globally recognized Codex Alimentarius as comprising 34% protein and a minimum 26% and less than 42% milkfat.