

Dairy Market Insights

Second Quarter 2021

1. Summary

Complexity for global market outlook

- Global market fundamentals have weakened somewhat but remain mostly supportive of commodity prices. However, elevated commodity prices – driven by both the tightness of the domestic EU market, and China’s stronger demand which drove a higher involvement in GDT events – will continue to unwind.
- The expected continued slow growth in EU-27 milk production will be important in keeping fat and protein values relatively stable. Feed prices have eased a little and a more normal summer is forecast .
- In the US, milk production has ramped up in recent months, with increasing cow numbers and yields. US milk output will remain a factor for much of the second half of 2021 and will continue to affect global SMP and (possibly) cheese prices if domestic demand doesn’t recover quickly. The worsening drought in a number of western states could slow output more quickly. However, farm margins will get better and no sudden fall in cow numbers is on the radar.
- Progress in vaccination programs – particularly in the US and the UK - is driving a steady change in meal occasions in developed dairy markets. A large “bursting-out” phase will pass before the reality hits of lower household incomes and the risks of (still) living with COVID becomes apparent. The pushback from a far more price-sensitive market in both developed and developing regions is likely to continue to weaken butterfat prices, while tight protein balance sheets should remain supportive of SMP prices.
- The shifts in demand between retail and foodservice channels are well underway in many regions emerging from protracted lockdowns, but none are more seismic than in the US. The impact on the dairy market is overlaid with the complexity of regional milk and product output. A hot northern summer could help on both ends of the supply chain – dampening down milk growth and encouraging demand through ice cream consumption.
- China continues to hold the global dairy commodity market together, dominating recent growth in the trade. Its internal economic recovery and tight milk supplies don’t suggest that support will collapse any time soon. Even with a step up in WMP prices, imports remain competitive with local manufacture.

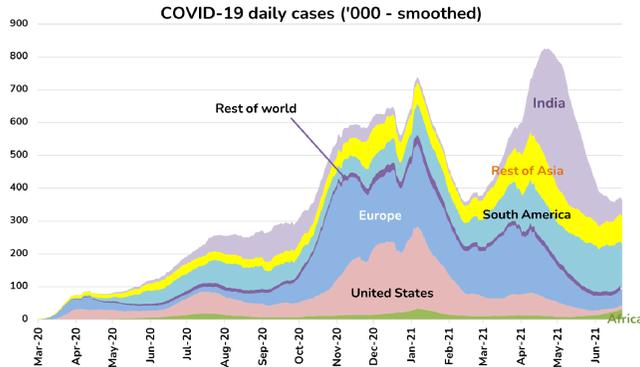
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What it means for Australian dairy farmers

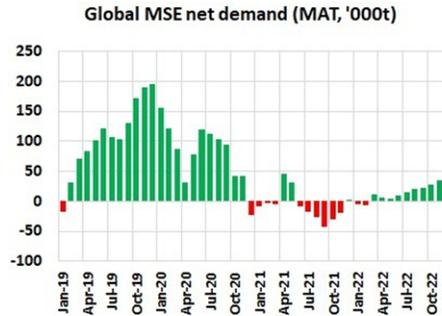
- The spot commodity milk value (CMV) has weakened from its peak in April above \$7kgMS, with a sharp fall in Oceania commodity prices.
- There was a fall of more than US\$1,100/t in spot butter prices between mid-April and the end of June as GDT prices eased from the pressure of heavy Chinese buying on the platform, while there was also a small fall of US\$200/t in cheddar prices. These were offset by an almost US2c fall in the A\$. The CMV indicator was back near A\$6.80kgMS by the end of June.
- With a further easing in commodity prices anticipated in coming months, our **projected CMV for the 2021/22 season is in the range A\$6.40-\$6.60kgMS**, based on a forward hedge of A\$ = US76c.
- Opening prices were announced on 1 June, but the bidding war has continued throughout the month, reflecting intense competition for milk supplies – particularly in strategic supply regions in southern Australia.
- Milk prices for the **2021/22 season for manufacturing use in southern regions started the season in a A\$6.85-7.10kgMS range**.
- With value capture above the CMV expected to be in the \$0.60 to \$0.70kgMS range this would suggest, **based on our current CMV forecast a full season price in the range A\$7.00 and \$7.30kgMS**.
- The key sources of risk to this forecast come from increasing competition in key cheese markets, and continued Australian dollar volatility.
- To learn more, visit the Milk Value Portal at milkvalue.com.au

2. Some key market indicators

Global case numbers were quelled in May and June with the increasing coverage of vaccine inoculations, but the virulent Delta variant threatens another wave. There is uncertainty as to the full extent of the spread into Africa and parts of Asia with poor reporting systems

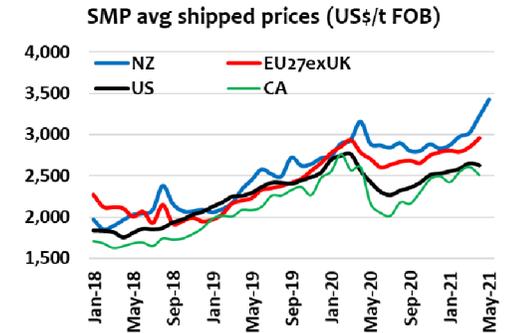


The global dairy market is finely balanced with small developing surplus. The effects of this are felt differently across producers depending on domestic balances

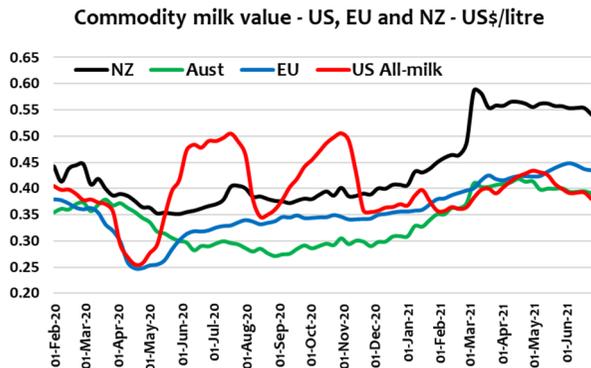


*MSE is a milk equivalents calculation based on the butterfat and protein used in commodity products.

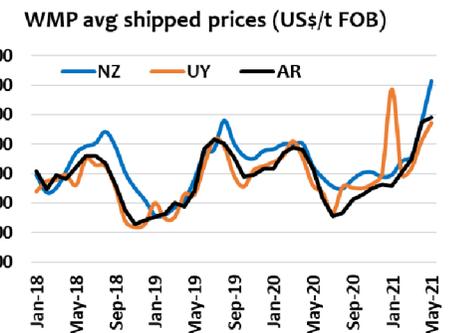
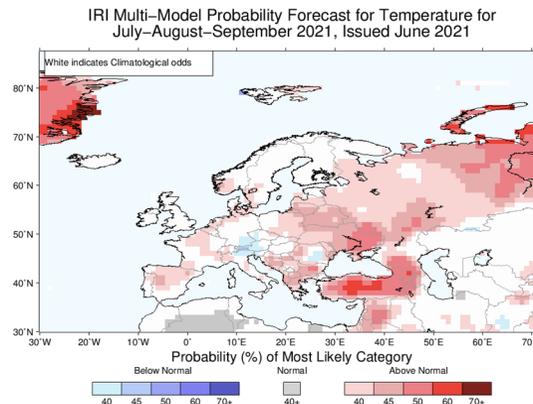
Affordability is a key risk in coming months. Recent trade data shown in this report is at prices well below recent GDT and domestic wholesale prices



Global milk values have steadied as milk supplies improved and commodity prices moved sideways. The US has the biggest drop in milk values with the surge in cheese output



The EU weather outlook is for a little more rain than normal and temperatures slightly warmer which will support crop yields and may improve milk production margins. The US west is gradually being consumed in a worsening drought that may yet affect corn yields and quality and push feed costs higher



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"> • Vaccine rollouts vary greatly in the race against the more dangerous Delta variant, and others that will emerge from worst affected outbreaks. • A further wave of infections has occurred in most regions, affecting more of the exposed populations in developing Asian, African and Latin American countries. 	<ul style="list-style-type: none"> • We will start to see more policies and practices emerge for the ways we will live with the virus in future to enable (for inoculated people) the resumption of travel and tourism and increased safety in commuting and workspaces. • This affects the durability of shifts in demand between retail and foodservice and ensures an uneven demand recovery
Government policies	<ul style="list-style-type: none"> • China’s crackdown on commodity prices appears to have run its course • US government is considering easing biofuel mandates which will loosen feedstock balance sheets a little. • US government supports move closer, with a promise to make payments to farmers who “missed out” in the supports that came to compensate for market upheavals in H2-2020. There is still no clarity on the mechanism for the proposed donation program of US\$400m designed to affect butter. 	<ul style="list-style-type: none"> • Feed grain prices have reverted to fundamentals • Measures will be lightly supportive for US milk production but probably the last to be seen for some time.
Macro outlook	<ul style="list-style-type: none"> • There is growing consensus that medium-term inflation risks are receding and that refilling supply chains will ease pressures in H2-2021. • The restructure of labour markets will be ongoing, and shortages will continue to put pressure on operating costs in food supply chains. • US government however flagged earlier-than-expected interest rate rises lifting the US\$ and weakening feed commodity prices. Potential easing of US asset purchases may increase the support for the US\$. 	<ul style="list-style-type: none"> • Supply chain cost pressures will remain through into 2022. • This may affect affordability in some markets exposed to costs in US\$
Logistics	<ul style="list-style-type: none"> • Shipping and port congestion challenges remain a factor slowing trade in the US and European terminals. 	<ul style="list-style-type: none"> • Port stock-builds may continue to affect prices from time to time • Fragility of supply chains remains an ongoing risk – the recent COVID flare up in Southern China is case in point
Trade disputes	<ul style="list-style-type: none"> • The relationship between the China and major western nations has worsened after the G7+ summit. 	<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 and food prices stay in focus.

4. Commodity overview

	What will support prices	What will weaken prices	Expected direction in 2021
SMP	<ul style="list-style-type: none"> Ongoing demand from China and SE Asia Limited EU-27 availability, with slow growth in milk, prioritising cheese output to meet demand Higher whey protein prices improving demand for SMP/NFDM (where substitutable) Improving Mexican demand for US exports, demand potentially aided by local drought 	<ul style="list-style-type: none"> Stronger US milk production, weak cheese demand increasing SMP/NFDM stocks where flexibility exists Shipping delays adding to a short-term stock-build Competitive pressure on EU/NZ prices from US exporters 	Slightly weaker with a reducing premium over competitors 
Butter	<ul style="list-style-type: none"> Sustained retail demand in EU-27 markets Slow growth in EU-27 milk output + sustained cheese demand/milk usage to minimise cream surpluses 	<ul style="list-style-type: none"> High prices will meet resistance in developing markets Weak US market reducing scope for NZ imports Slow food service recovery in developing markets Weaker veg oil prices 	Prices weakening with reduced demand from developing regions 
Cheese	<ul style="list-style-type: none"> Improving food service sales in US and EU-27 markets Food service re-openings in Asian regions Improving UK import demand for EU-27 product with reopening food service channels 	<ul style="list-style-type: none"> Strong growth in milk output into the December quarter of 2021 in US cheese-rich regions (Central and California) Intense competition in Asian markets Competition from US exports at low prices for EU-27 and NZ exporters 	Weaker with declining fat values, subject to competition in key markets 
WMP	<ul style="list-style-type: none"> Persistent Chinese demand supported by the cost advantage for imports Weaker EU WMP output with limits on milk availability, strong SMP/butter valorisation Improving Brazilian demand 	<ul style="list-style-type: none"> Weaker underlying “synthetic value” with lower fat prices Pushback against elevated prices in developing markets Weaker veg oil prices lowering prices of fat-filled alternatives 	Weaker fundamentals with slowing demand at elevated prices 

5. Australian outlook

Critical issues

- The outlook for seasonal conditions remains favorable in major production regions. Autumn rainfall has been lower than average, and major irrigation storage levels in the Murray Darling Basin remain steady.
- **Feed grain prices have reverted to long-term averages**, while there are abundant forage supplies. Crop estimates are favorable and will keep downward pressure on prices, helped by easing global benchmarks.
- **Farmer confidence has improved** with the prospect of higher milk prices and good seasonal conditions. Confidence scores regarding individual farm profitability in Dairy Australia surveys have not been higher at the start of a season.
- Milk growth will however remain sluggish in the south and fragile in fresh milk regions, that will pull more milk away from Nth Victorian plants. A higher portion of farms intend no change in farm output in 2021/22.

Milk production

- Milk prices for the 2021/22 season for manufacturing use in southern regions started the season in a A\$6.85-7.10kgMS range.
- The opening price bidding season has been more intense this year given the steady demand from export markets, improving domestic demand and lack of growth in milk.
- Increased direct sourcing of milk by Coles for use in its cheese business has been one of the strongest influences in southern regions.
- The draw of milk to service northern fresh market requirements will sustain competitive tension in Nth Victoria despite a recent steadying of milk collections in those regions.

Milk prices

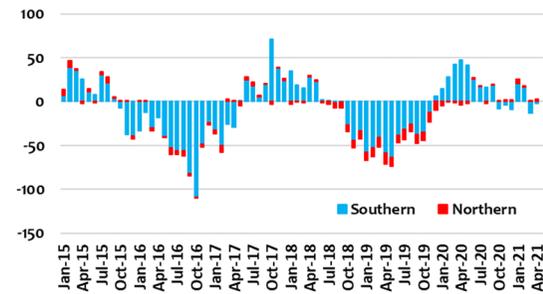
Outlook factors

- Milk production will likely remain under pressure from farm exits as many seek the option of capitalizing on a climate of good returns, despite conditions and margins being supportive for production. We assume output will lift 1% in the 2021/22 season.

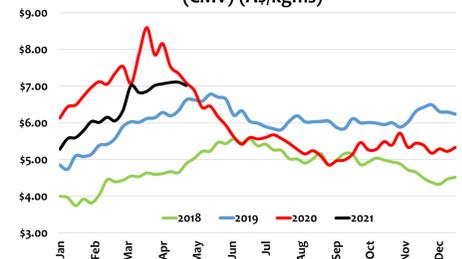
AUS milk and product output ('000t)					
	Milk	Fats	Cheese	SMP	WMP
2020	8,666	52	385	167	47
2021	8,723	57	388	179	44
2022	8,811	60	394	175	45
YOY % changes					
2021	0.7%	9.8%	0.8%	7.3%	-5.6%
1H-21	0.7%	-11.9%	0.7%	8.9%	-13.5%
2H-21	0.6%	25.3%	0.8%	6.4%	0.9%
2022	1.0%	6.5%	1.6%	-2.6%	1.7%
1H-22	1.0%	22.1%	2.0%	-3.8%	2.3%
2H-22	1.0%	-1.3%	1.3%	-1.9%	1.3%

- The differential between CMV and average farmgate milk price was \$0.60-0.70c/kgMS for the 2020/21 season, with the CMV for the year averaging near A\$5.90kgMS (our full season estimate from May 2020 was A\$5.91kgMS).
- The differential in 2021/22 will be similar, affected by:
 - Competition for milk reflecting pressure from higher domestic market share of milk use
 - Stronger brand shares in retail cheese sales
 - Expected increased price competition in grocery as retailers protect sales and margins and react to household income pressures
- Our projected spot CMV – based on NZX futures and an implied cheddar value derived from regression analysis using fat and protein values and CME cheese futures – is below \$6.40kgMS as shown.

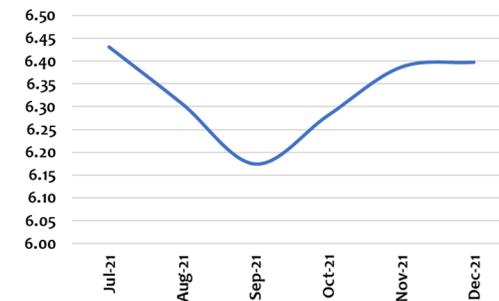
YOY growth, Australian milk output (mn litres)



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



Australian CMV, A\$/kgMS



5. Australian outlook

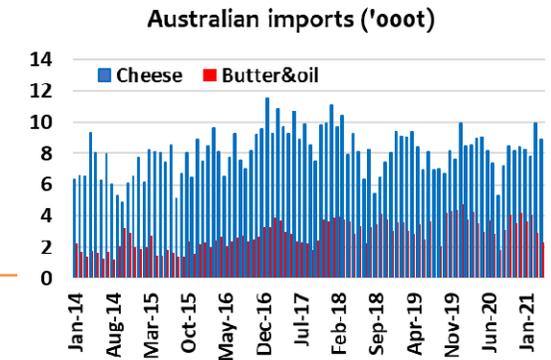
Critical issues

Markets

- Grocery sales growth has eased with the reopening of dining out venues. The disruptions to food service trading with COVID outbreaks hampers a broad-based recovery of demand from the sector.
- Imports of cheese were 2% lower on a rolling 6-month basis to April-2021. The US lost a small % of share compared to the average for 2020, mostly due to the lift in imports of speciality cheese from the EU once food service channels reopened.
- Butter imports slowed 12% in the 6 months to April-2021, falling in monthly volume as unit prices lifted but also as local milk supply provided increased cream supplies.

Outlook factors

- Consumer confidence has rebounded into early 2021, but retailers will be looking at tactics to maintain momentum after a bumper 2020.
- There will be continuing pressure on cheese margins from a competitive cheese market.



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-27	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.
FOB	Free on Board	A shipment term used to indicate whether the buyer or seller is liable for goods that are damaged or destroyed during shipping
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.