

# Dairy Market Insights

Fourth Quarter 2021

# 1. Summary

## Supply remains tight for global markets

- The outlook for global dairy markets remains under the strong influence of tight milk supplies which will remain supportive of commodity values until pressure changes - which at the earliest will be Q2-2022 when the strength of the northern hemisphere spring flush is known.
- Commodity prices were pushed to extremes in late 2021 by acute shortages of protein and butterfat in Europe, made worse in recent months by the downward pressure on milk supplies as high input costs push milk producers into the red. Cost pressures won't be alleviated quickly although fast rising milk prices in some regions will help. That comes on top of a weak spring in NZ, and as poor margins drive falling cow numbers and per-cow yields in the US.
- Looking ahead, the outlook for market fundamentals has become even more complex (if possible) with the overlay of the emergence and rapid spread of the Omicron variant of COVID which is dominating infections in several countries. While – in these early days – it is expected to be less lethal than earlier variants, it will again disrupt food service trade, supply chains, travel and workplaces as less vaccinated populations in the US, Europe and developing countries are exposed.
- The demand side of for dairy remains resilient as domestic retail markets continue to grow, while trade activity is similar to pre-COVID levels, despite some pushback on strong prices where buyers have the luxury of waiting. Uncertainty for the food service trade has been extended with recent developments.
- While China's demand through the peak shipping period into Q1-2022 remains critical, the supply-side holds the key to the next six to nine months. Farm input cost pressures will remain intense and likely have an impact on spring grass growth in Europe, while strong beef prices are tempting for quick cash relief.
- Weather continues to play an important part in Oceania as La Nina persists, influencing post-peak milk output, while a NZ\$9/kgMS milk price will ensure a strong focus on yields using bought in feed. Lower milk availability leaves NZ manufacturers with interesting product-mix choices in H1-2022 given the strong SMP/butter and cheese streams and potential for uplift in WMP values (with the large discount on fat & protein values).

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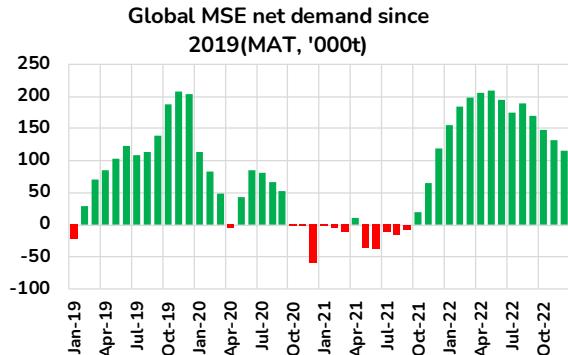
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## What it means for Australian dairy farmers

- The spot commodity milk value has recently jumped as commodity prices improved further and the A\$ lost value against the US\$, keeping the spot CMV above A\$8.00/kgMS in recent weeks.
- Spot cheddar prices have added US\$750/t since the end of September, while butter prices have risen US\$950/t. Milk powder prices have also risen, with SMP up US\$430/t over the final quarter of 2021 while WMP added US\$250/t.
- For local exporters, a slightly weaker A\$ has also helped improve this spot price benchmark but the direction of the currency remains highly uncertain given macro factors.
- The midpoint of our projected CMV for the 2021/22 season has lifted to A\$7.45/kgMS, based on the forward assumption for the US exchange rate of A\$ = US72.5c.
- The ability to pass on the benefits of a buoyant spot commodity markets to milk suppliers will be dependent on the exposures of individual manufacturers, the operational impacts of the Omicron wave in terms of exacerbating rising input costs and increasing uncertainty affecting marketing channels.
- This will be weighed against the highly competitive landscape for raw milk supply, as production remains constrained by farm exits and rising primary production costs.
- Looking further ahead to 2022/23 a midpoint of A\$7.50/kgMS for the CMV is currently forecast, based on an exchange rate expectation of A\$ = US74c.
- To learn more, visit the Milk Value Portal at [milkvalue.com.au](http://milkvalue.com.au)

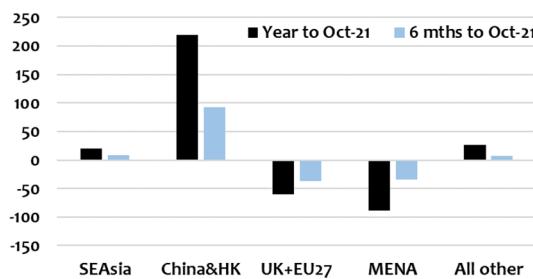
## 2. Some key market indicators

The global milk balance remains tight – but finely balanced as milk growth slows and high commodity prices also slowed some trade

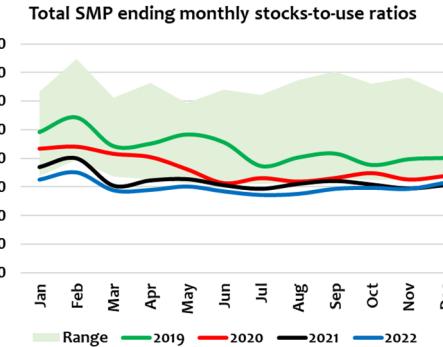


Trade has been dominated by China, holding together the global market balance, while the slump in EU-UK trade which is easing (and effectively self-cancels) has dragged on global activity

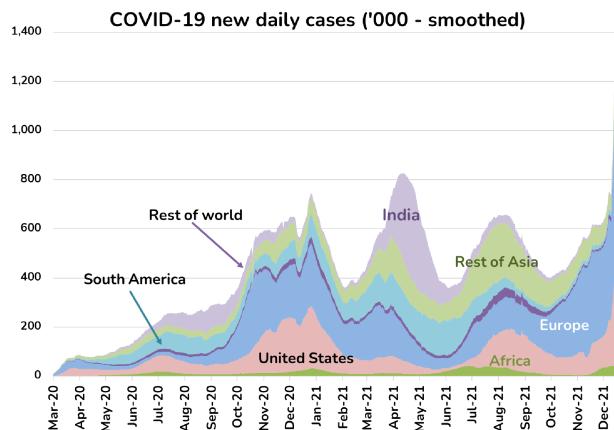
Changes in global trade ('000t MSE)



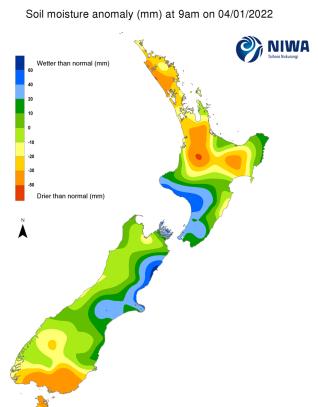
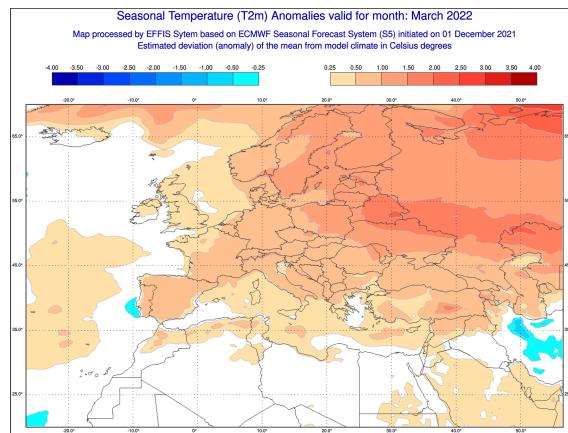
Tight SMP supplies will keep firm pressure on protein values



Global COVID case numbers have spiked with the spread of the Omicron variant with case numbers by 31-Dec 50% higher than the peak of Delta in India (and counting).



EU weather through late winter and spring is generally expected by long-range forecasters to be warmer than normal with average rainfall. NZ has been inconsistent in a La Nina event, with key North Island regions still dry.



### 3. Watch points

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

Issue	Summary	Analysis/impact
The Omicron wave	<ul style="list-style-type: none"><li>The ongoing rapid spread of the <i>Omicron</i> variant has caused disruption and a return to restrictions (see page 6)</li><li>The surge of Omicron infections had a double-edge – it has so far proven less harmful than earlier variants but spreading rapidly in unvaccinated and other exposed segments of populations.</li><li>What is unclear is whether this is yet another game-changer and a setback in the long battle against COVID in regions with low vaccinations. In the case of Delta, it developed due to uncontrolled transmission in India, and the risk of a repeat remains with low coverage in Africa and South Asia.</li></ul>	<ul style="list-style-type: none"><li>Restrictions are not likely to be lengthy but in the EU they have previously been supportive of dairy demand. Disruptions to manufacturing, supply chain, food service outlets and travel will be more significant as people stay home to recover</li></ul>
Macro outlook	<ul style="list-style-type: none"><li>As inflation continues to affect economies, there is an increased likelihood of earlier than expected interest rates rises in the US and others.</li></ul>	<ul style="list-style-type: none"><li>In Nov-2021, the US\$ lifted to its strongest against the Euro since June-2020, but has eased a little despite further support for the raising of the cost of money.</li></ul>
Energy	<ul style="list-style-type: none"><li><b>Crude oil</b> prices will remain volatile as the influences on air travel are mixed (and the effects of Omicron unfold), while the geopolitical issues associated with the aggression by Russia against Ukraine and the energy crisis in the EU will continue to provide uncertainty.</li><li>European energy prices are at extreme levels and likely to remain volatile as geopolitical games are in play regarding future security of natural gas supplies.</li></ul>	<ul style="list-style-type: none"><li>The oil market (for now) appears to have shrugged off the risk of the latest variant and OPEC is pushing ahead with plans to release more supply.</li></ul>
Input costs	<ul style="list-style-type: none"><li>There appears to be little scope for any quick alleviation in farm cost pressures.</li><li>Fertilizer prices likely staying elevated and supplies limited due to the spike in natural gas prices in Europe.</li><li>This could affect crops (choice and yield) as well as pasture application in Europe and NZ. Fertiliser prices hit all-time highs in the US in Nov-2021 and may push a % of farmers to switch more corn to soybeans.</li></ul>	<ul style="list-style-type: none"><li>Milk production growth is likely to be minimal until H2-2021.</li></ul>
Logistics	<ul style="list-style-type: none"><li>US west coast port congestion is easing although when it appears to be improving another problem flares.</li></ul>	<ul style="list-style-type: none"><li>Fragility of supply chains and high costs of freight will remain a fixture well into 2022 and ensure supply chain security will be a priority.</li></ul>

## 4. Commodity overview

	<b>What will support prices</b>	<b>What will weaken prices</b>	<b>Expected direction in Q 1 2022</b>
SMP	<ul style="list-style-type: none"> <li>Reducing EU availability, with declining milk, producers prioritising cheese output</li> <li>Weaker Sth West US milk output limiting availability</li> <li>Weaker NZ milk production will extend into H1-2022</li> <li>Persistent SE Asian demand</li> <li>Improvement in Mexico's demand</li> </ul>	<ul style="list-style-type: none"> <li>Slowing Chinese import demand with well-stocked market</li> <li>Pushback from some buyers (in short-term)</li> <li>Lower whey protein prices aiding demand (where substitutable)</li> <li>Shipping delays adding to risks of short-term stock-build</li> </ul>	Following EU and US lifts with a limited premium over competitors 
Butter	<ul style="list-style-type: none"> <li>Slow EU milk growth and cheese demand</li> <li>Weaker Sth West US milk output limiting availability</li> </ul>	<ul style="list-style-type: none"> <li>Higher butterfat prices will meet resistance in developing markets</li> <li>Weak overall demand for NZ exports, aided by lower US market access</li> <li>Slow food service recovery in developing markets</li> </ul>	Slightly firmer with tight EU availability 
Cheese	<ul style="list-style-type: none"> <li>Persistent EU domestic demand with meals at home</li> <li>Weaker EU milk output</li> <li>Improved demand in developing markets</li> <li>Stronger fat and protein values</li> </ul>	<ul style="list-style-type: none"> <li>Improved US output in cheese-rich regions, elevated cheddar stocks</li> <li>Competition from US exports at low prices</li> <li>Logistical barriers limiting US export shipments</li> </ul>	Steady with strong fat and protein values, subject to competition in key markets 
WMP	<ul style="list-style-type: none"> <li>Weaker NZ milk production will extend into H1-2022</li> <li>Weaker EU WMP output, slowing LatAm milk growth</li> <li>Persistent Chinese demand, reducing stocks to use</li> <li>Strong veg oil keeping fat-filled powder prices firm</li> <li>Attractive stream returns for cheese and SMP/butter</li> <li>Sustained large discount to fat and protein values</li> </ul>	<ul style="list-style-type: none"> <li>Pushback against elevated prices in developing markets</li> <li>Lower Chinese involvement in GDT events influencing pricing mechanism</li> </ul>	Firmer with tighter global supplies, supported by fat + protein values 

# 5. Australian outlook

## Critical issues

- The seasonal conditions in Southern Australia remain excellent, while the rainfall and temperature outlook is supportive of milk production. Major irrigation storage levels in the Murray Darling Basin have improved since our last update and water security is the best in many seasons.
- Feed grain prices have recently lifted well above long-term averages in line with global trends, which will bite into post-peak margins.
- Rainfall during harvest in Australia, especially in NSW, will see a significant proportion of the wheat crop downgraded to feed, which is expected to lower wheat prices in comparison with feed barley in livestock rations. Grain prices have recently eased as shown but far greater relief is expected.
- Milk growth will however remain weaker, under pressure from farm exits and record beef prices. It is expected that 2021/22 margins for southern regions will be generally weaker than the prior year despite the stronger milk price.
- We expect a small decline in milk production in H1-2022, but the fall could easily worsen if weather dries quicker than the weather outlook suggests, and grain prices remain sticky.

- The **spot commodity milk value** has recently jumped as commodity prices improved further and the A\$ lost value against the US\$, keeping the spot CMV above A\$8.00/kgMS in recent weeks.
- Milk prices for the 2021/22 season have moved higher with better commodity values and improved certainty for domestic markets.
- Rising supply chain and processing costs will limit further pass-through of the apparent lift in the CMV and may limit the available value-capture in domestic products and channels.
- There were some step-up announced in December for southern suppliers.

## Outlook assumptions

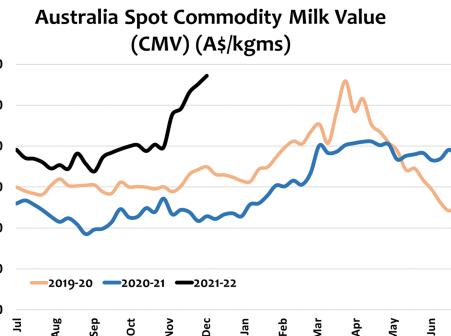
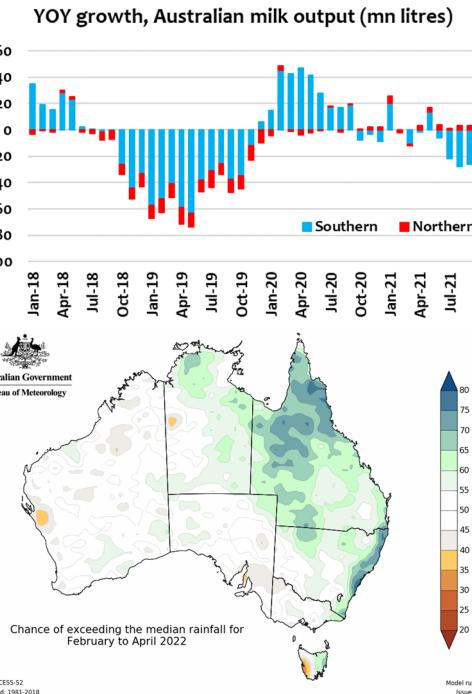
- The impact of the Omicron surge on food supply chains including the farm sector at the time of writing is significant and difficult to predict.

AUS milk and product output ('000t)					
	Milk	Fats	Cheese	SMP	WMP
2020	8,688	55	367	181	33
2021	8,628	61	376	196	43
2022	8,673	63	386	186	47

YOY % changes					
	2021	1H-21	2H-21	2022	
2021	-0.7%	11.9%	2.5%	7.8%	27.4%
1H-21	1.2%	25.1%	-3.1%	25.7%	37.4%
2H-21	-2.2%	3.4%	7.3%	-1.3%	20.3%
2022	0.5%	3.5%	2.7%	-5.1%	11.2%
1H-22	-0.1%	-5.1%	5.9%	-7.4%	24.9%
2H-22	1.0%	10.2%	0.2%	-3.6%	0.0%

- The midpoint of our projected CMV for the 2021/22 season has lifted to A\$7.45/kgMS, based on the forward A\$ = US72.5c, while it remains at A\$7.50/kgMS for 2022/23 using A\$ = US74c.
- While producers would like to see as much paid out as possible with rising costs of production in the outlook for H2-2022, the uncertainty in some sales channels, the significant rises in processor input costs, and the difficulty in logistics will ensure any uplifts are limited.
- Current indicative regional farmgate milk prices can be monitored at the [Milk Value Portal](#).



# 5. Australian outlook

## Critical issues

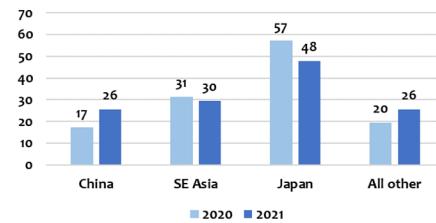
- Grocery sales growth has slowed with the return towards normalisation of sales between channels.
- The food service market will remain subdued and uncertain despite the reopening of those channels with vaccination rates but the rapid spreading of Omicron in major cities will significantly affect staffing in many outlets.
- SMP exports slowed in recent months, falling 14% YOY in the 3 months to Oct-2021 as milk supply tightened. All the decline came from slowing demand from China, down a quarter in that 3-month period. Cheese exports were 3% stronger in 2021 in the 10 months to Oct-2021, but flat in the most recent 3 months, weaker sales into SE Asia.
- Tighter domestic supplies and high cheese prices drove a jump in cheese imports from the US in Oct-2021, while butter imports are slightly lower while ingredients imports (especially WMP) remain weaker with the decline in Australia's infant formula trade.

## Markets

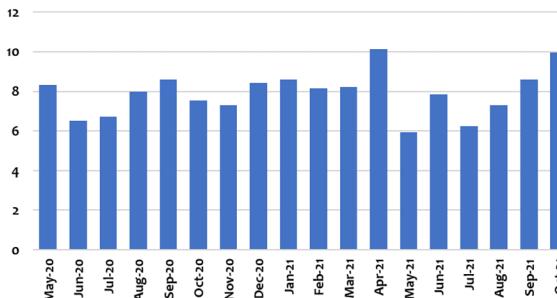
## Outlook factors

- The food sector is being affected by the Omicron wave of COVID-19 which quickly took hold over the Christmas and New Year period.
- There are already significant supply chain disruptions due to staff shortages throughout the wholesale, distribution and retail sector. Product rationalization is already underway, and delays in getting product to market.
- Food supply chains in general are being affected by large numbers of unwell and isolating workers, leading to delivery disruptions and emptying supermarket shelves.
- Anecdotally, many consumers have responded to a lack of testing infrastructure and alarming case number rises by limiting eating out and travel.
- There are increasing cost imposts - off an already challenging logistic path - with the situation worsening day-by-day.
- It is too early to say when the current Omicron wave will peak and what the impact will be on the local economy and consumer confidence and behaviour into 2022.
- Food manufacturers are facing escalating input costs in 2022 as well as increased market uncertainty as the global pandemic enters a new phase.

Australian cheese exports 10 months to Oct-2021 '000t



Monthly shipments of cheese to Australia ('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 <a href="#">here</a> .
EU-27	European Union European trading bloc including 27 member states
FMP	Farmgate Milk Price The average FMP 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
OPEC	Organisation of the Petroleum Exporting Countries OPEC is a permanent intergovernmental organization of 13 oil-exporting developing nations that coordinates and unifies the petroleum policies of its Member Countries.
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.