

Dairy Market Insights

Second Quarter 2022

1. Summary

Markets at tipping point

- Although global milk supplies remain tight, commodity prices have eased across the dairy complex. This partially reflects softer consumer demand, some hesitancy on the buy side, and a lot of European traders at the beach or in trattoria. These effects have layered on the weaker demand for dairy ingredients in the short-term in China as its consumers build the confidence to resume “normal” life after strict COVID lockdowns.
- The greatest change in fundamentals has occurred in the US. Market tension is slowly loosening as milk output gradually recovers, with better margins along with signs of softer demand as households adjust to rising living costs. If this worsens, US prices will increase their influence in cheese and SMP export markets as manufacturers seek different opportunities.
- Consumer sentiment has weakened as inflation reaches more consumers around the world. Confidence has plummeted in the US (where it is already impacting dairy spending) while the mood in the EU is quickly darkening.
- Global trade has been mostly positive – especially from developing regions outside China. There remains much uncertainty as China’s cities are not out of the woods. The rest of the world has given up controlling spread of the virus – the difference is China’s poor vaccine coverage makes it the government’s problem. Mobility is quickly returning, but it will likely be Q4-2022 before stocks are cleared and milk supply tightens again.
- Supply-side constraints remain the dominant influence in the outlook for the global dairy market well into 2023 as the effects of war and weather maintain pressure on feed and energy costs. Milk prices are near their peak in Europe and Oceania which will alleviate some of the margin pressure but won’t alter the willingness or ability of producers to add cows, especially with the attitude of some governments to the future of dairy farming.
- Feed prices have eased as crop conditions look a little better, but a good portion is due to speculative investment fund sell-offs with growing recession fears. Energy prices remain high, while fertilizer prices have weakened but most of the hike in input costs are yet to reach many farmers’ cashflows.
- EU summer looks less extreme than before, while drought in the west of the US is worsening.

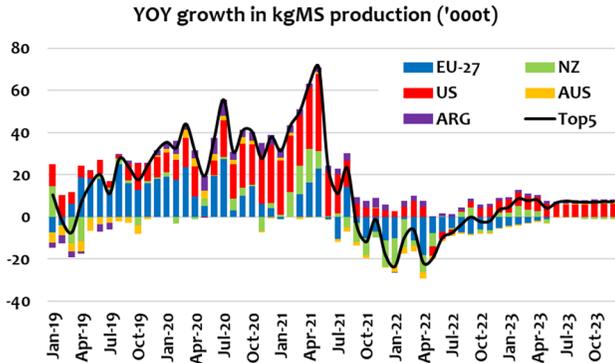
Contents	Pages
1. Summary	1
2. Some key indicators	2
3. Global market drivers	3
4. Commodity overview	4
5. Australian outlook	5-6
Glossary of key terms	8

What it means for Australian dairy farmers

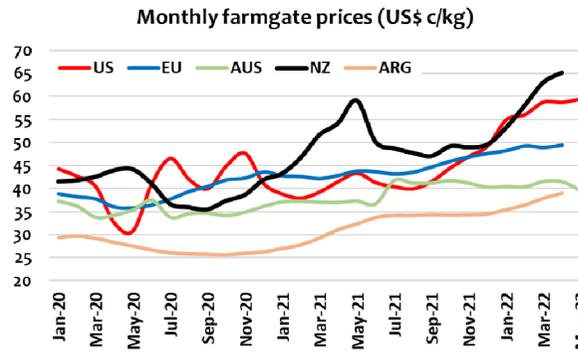
- The spot commodity milk value (CMV) was \$9.54kgMS at the end of June. The CMV was recalculated for 2021/22 to account for escalating fuel and energy prices. On this basis, the CMV eased slightly, down 3% since the previous update at the end of March.
- Spot cheddar prices have fallen US\$570/t since the end of March. Butter prices had an even larger correction, falling US\$770/t over the same period. Milk powder prices have also fallen, SMP down US\$300/t since March while WMP spot quotes fell US\$350/t. On the positive side of the ledger, the Australian dollar fell 6c between March and June, insulating local returns from falling commodity price impacts.
- The announcement of opening prices in June has highlighted the scramble for a dwindling milk pool in southern Australia. Price offerings have been adjusted four times during June as processors compete to secure uncontracted milk.
- The intense competition has pushed southern farmgate prices to a weighted average of \$9.60kgMS at the time of writing, more than \$2kgMS above 2021/22. While these prices will ease the impact of increased input costs for farmers, processor margins will be under immense pressure managing costs for raw milk, along with labour, energy, fuel, freight and packaging.
- Passing on all inflated costs will be challenging in an environment of high and broad-based inflation, with retailers seeking to address cost of living pressure through key food product price freezes, and would leave processors to absorb a larger percentage of the increase.
- **To learn more about current 2021/22 season regional farmgate pricing, and track CMV movements visit the Milk Value Portal at milkvalue.com.au**

2. Some key market indicators

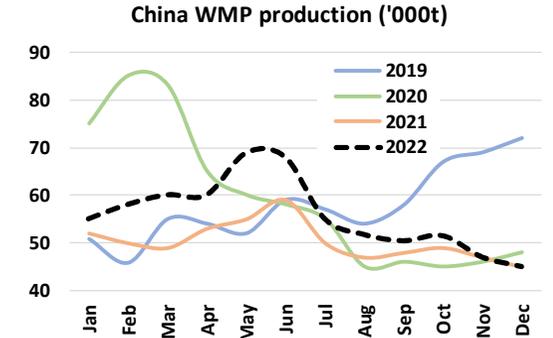
Top 5 exporter milk production will recover in late 2022, led by the US



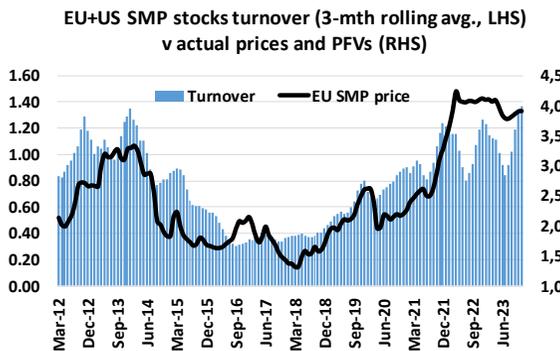
Farmgate milk prices continue to rise, but not fast or substantially enough to stimulate milk growth



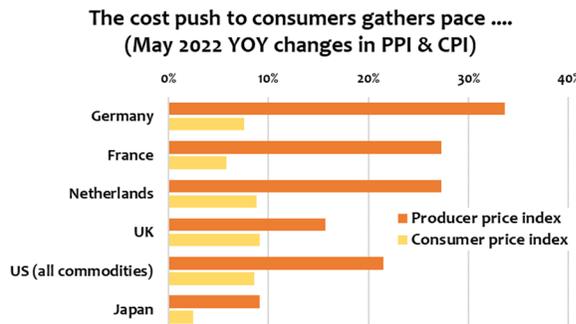
China's altered milk use has increased WMP stocks and weakened import demand in the short-term



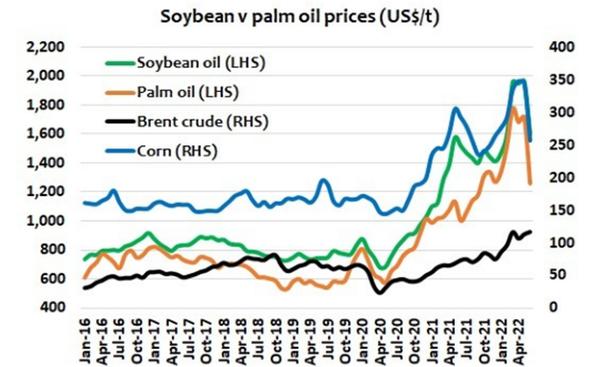
EU SMP and butter fundamentals (a faster stock-turn) have kept prices firming. Our projections show an easing in this tension for SMP and some pushback in butter demand



Strong increases in input and supply chain costs are reaching consumers in the EU and US, eroding household spending



Veg oil prices have slumped with the lifting of export bans and expected increase in SE Asian production. Mounting recession fears have also driven sell-offs by fund investors



3. Global market drivers

The table summarises the critical variables affecting market fundamentals in the short to medium term.

Issue	Summary and importance	Analysis and impact
EU-27 milk supply & product mix	<ul style="list-style-type: none"> • Tight EU milk supplies will continue to strongly influence global fat and protein markets • Product mix changes will continue to favour cheese while demand remains firm and milk growth is limited 	<ul style="list-style-type: none"> • High input costs will continue to pressure milk output (volume and composition), despite margin relief from higher milk prices and some easing in feed costs. Sustained high fertilizer costs will affect pasture growth and forage availability into 2023. • EU weather holds the key to any improvement in output. • Weaker milk supply and sustained cheese and cream demand, means lower availability of SMP and butter. This is worsened with high energy costs discouraging milk drying in some regions.
Diverse US production influences	<ul style="list-style-type: none"> • Improving US milk output may be threatened by farm exits in South-West 	<ul style="list-style-type: none"> • Improving farm margins may support per-cow yields, while cow numbers gradually rebuild. The pressure from water shortages sustains the risk of large farm exits. If cheese demand continues to slow, this may swing more milk to SMP/butter in the west.
Weaker consumer spending	<ul style="list-style-type: none"> • May impact product mix and export competitiveness 	<ul style="list-style-type: none"> • Higher costs of living is pressuring consumers but the impacts on dairy demand will be more likely seen in US cheese and EU butter. This may affect milk use at the margins.
China's demand recovery	<ul style="list-style-type: none"> • This will drive a recovery in imported ingredients and products later in H2-2022 	<ul style="list-style-type: none"> • Improving consumer mobility will gradually restore food service and convenience demand. • Local WMP stocks will be consumed as milk availability tightens, but supply chains need to be destocked before a strong trade revival for SMP, cheese and butterfat will occur.
NZ spring output	<ul style="list-style-type: none"> • Availability of WMP may reduce with little or no milk growth and a mix shift to SMP/butter in shoulder periods 	<ul style="list-style-type: none"> • New season conditions remain less than ideal in key regions. • Milk prices are likely to be higher than the previous season, but input costs and regulation remain barriers to growth.
Affordability in developing markets	<ul style="list-style-type: none"> • Higher dairy prices may meet resistance as consumers face rising living costs 	<ul style="list-style-type: none"> • Demand for protein remains robust in most major markets despite higher prices, while regional buying is near trend. • WMP and fats are more price sensitive and may slow.
Uncertainty in the macro environment	<ul style="list-style-type: none"> • The complex impacts of war and the contagion of geo-political and economic fear may increase turbulence. 	<ul style="list-style-type: none"> • The Russian war on Ukraine war is driving elevated crude oil, grain and veg oil prices. • The risk that fear will increasingly affect commodity markets without change in fundamentals will remain a key watch-point.

4. Commodity overview

	Considerations	Influences on fundamentals	Expected direction in 3-6 mths
SMP	<ul style="list-style-type: none"> EU SMP supplies remain tight with weaker milk supply and processors prioritizing cheese Higher energy cost curtailing volumes Reduced milk output in south-west US Significantly lower US domestic use Weaker Chinese demand, while demand from other developing regions remains robust 	<ul style="list-style-type: none"> Continued weak milk output in the EU and US continues to limit SMP availability Reduced use of skim milk concentrate in fat-filled milk powder easing in veg oil costs Weaker demand in some price sensitive markets Shipping conditions in the US improving Favourable NZ stream returns will add to off-peak production 	<p>Following EU and US lifts with premium over competitors</p> 
Butter	<ul style="list-style-type: none"> EU butterfat supplies are tight, on lower SMP output, higher foodservice demand as tourism surges Shortages of veg oil have kept prices firm Weak US SMP/NFDM output with rising cream demand Good developing world demand despite rising prices 	<ul style="list-style-type: none"> Limits on EU butterfat supplies with lower SMP output and cream demand for summer Improved veg oil supplies will keep prices under pressure Higher US/EU butter prices meeting some resistance Risks to demand in price-sensitive developing markets NZ mix shift will add to off-peak production 	<p>Following EU lead, risk of pushback against higher prices in some markets</p> 
Cheese	<ul style="list-style-type: none"> Firmer EU/NZ fat & protein values supporting price EU persistent demand despite rising prices, rebuilding foodservice volumes in holiday regions US demand fears as household spending tightens Steadily improving demand in most developing regions as foodservice trade reviews 	<ul style="list-style-type: none"> Firm protein and fat values Improving US milk output in cheese-rich regions Risk of US domestic consumer demand with weaker household incomes and elevated cheese and butter prices EU/US COVID infections limiting production Improving foodservice demand in developing countries 	<p>At least steady on EU lead, vulnerable to US exports, easing with pushback on high prices</p> 
WMP	<ul style="list-style-type: none"> Reduced availability from major producers Weaker Chinese demand due to COVID impacts Declines in some price-sensitive markets High veg oil prices kept fat-filled powder prices firm Large discount to fat & protein values in WMP 	<ul style="list-style-type: none"> Weaker short-term demand as Chinese activity recovers Improving oil exporter incomes support demand Likely weaker NZ WMP output in 2022/23 Improving Brazil demand may slow LatAm exports outside the region, especially given the low inventories in Argentina 	<p>Vulnerable in short-term to weaker demand from China & SE Asia, potential for recovery with China's fluid milk demand</p> 

5. Australian outlook

Critical issues

Milk production

- Milk output in southern regions remained weak and will finish the 2021/22 season about 4% down on the prior year. The national weather outlook for Q3-2022 remains highly favourable for pasture conditions and brings a large risk of conditions being too wet.
- The La Niña event has officially reached an end, with a majority of indicators currently at neutral levels. However, some outlooks suggest La Niña may re-form later in 2022, and spring is expected to be wetter than normal.
- Grain prices remain elevated in line with global market trends but have eased from a peak in May.
- New season (2022/23) southern region milk prices have been driven higher by strong competition and opened at an average of around \$9.60kgMS, close to \$2kgMS above full season average prices for 2021/22.
- It is not expected this will drive a higher production result given continued farm exits, competition for land use and ongoing labour shortages.

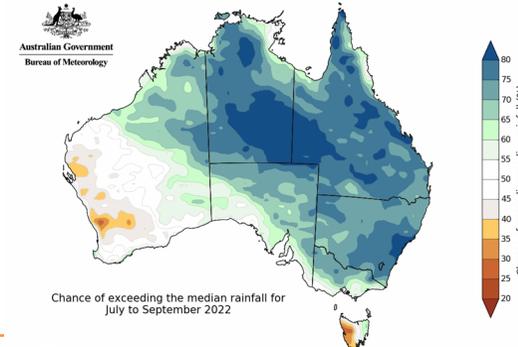
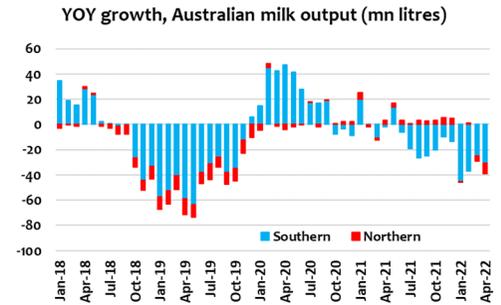
Milk prices

- There have been some late-season lift in milk prices which will push full 2021/22 season prices for southern manufacturers closer to an average of \$7.50kgMS.
- The spot CMV remains near \$9.50kgMS. The A\$ has weakened 5.5c in the past quarter to add \$1/kg to this spot CMV benchmark.
- **Assumed conversion costs** in the actual/historical CMV calculations and in this projection have been adjusted due to the higher costs of energy and diesel, which we estimate have lifted drying costs 50% in recent months.
- Current indicative regional farmgate milk prices can be monitored at the [Milk Value Portal](#).

Outlook assumptions

- The higher on-farm margins that come from the huge lifts in milk prices should exceed the lifts in input prices and stabilise milk production in the 2022/23 season. We assume a 1.1% fall in production.

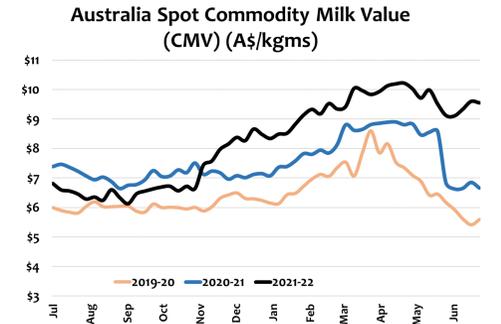
AUS milk and product output ('000t)					
	Milk	Fats	Cheese	SMP	WMP
2020	8,688	55	367	189	33
2021	8,634	63	424	217	39
2022	8,391	69	452	215	40
YOY % changes					
2021	-0.6%	15.3%	15.6%	14.7%	17.2%
1H-21	1.2%	25.1%	-3.1%	33.2%	37.4%
2H-21	-2.1%	9.0%	31.9%	5.0%	2.8%
2022	-2.8%	10.1%	6.7%	-0.9%	0.9%
1H-22	-4.9%	-0.7%	19.7%	-0.6%	-16.1%
2H-22	-1.1%	18.1%	-1.5%	-1.1%	17.1%



Model: ACCESS-S2
Base period: 1981-2018

Model run: 27/06/2022
Issued: 30/06/2022

- New season milk prices soared higher through June as the bidding season drew 4 rounds of announcements by most companies. At the time of writing, this will leave the weighted average southern price at \$9.60kgMS, as major processors scrambled to fill their milk needs from a declining milk pool against a plethora of small buyers and contractual options.
- Farmgate milk value are usually higher than the full year CMV estimate, and the environment suggests domestic premiums from cheese, fresh products and butterfat are assured. Stream returns for SMP/butter are slightly weaker than the CMV projection.
- If the cheese price is US\$300/t weaker (to average US\$5,425/t) and the A\$ lifts to US71.5c (as above), the full season projected CMV sinks by close to A\$1.00kgMS



5. Australian outlook

Critical issues

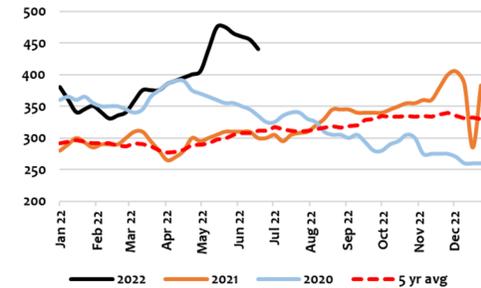
- Food retail sales grew 6% in the 3 months to May-2022, but food service (cafes and restaurants in the ABS data) grew 15% benefitting from increased patronage as well as healthy price increases, despite the pressures on staffing with COVID infections remaining a large challenge.
- Latest manufactured product data continued to report the large shift in cheese output (up 30% in the 9 months to March-2022), while imports remain a little weaker (down 10% in 6 months) than the prior year.
- The data shows a slowing of NZ imports with the rising export shipped prices, and a slight lift in tonnages from the US. With the gap between local and US cheese values expected to remain healthy with shaky US demand, that source of product could increase in coming months.
- This shift in milk use has brought a small (4%) cut in SMP output, while SMP exports have continued to expand and were up 25% in the 6 months to April.

Markets

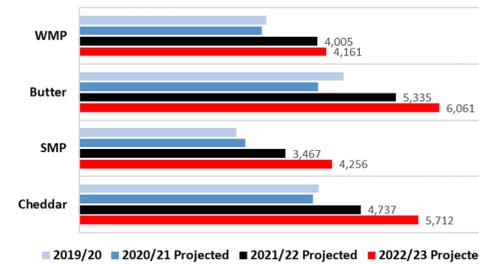
Outlook factors

- The ability to pass on full input cost increases in retail, foodservice and industrial markets will be critical but challenging in the face of broad-based inflation.
- COVID is far from over, and the prospect of another infection wave, featuring faster circulating sub-variants with significant immune-escape threatens the foodservice recovery.
- Major retailers have responded to cost of living pressures by announcing price drops on key products for winter, targeted at healthier products.

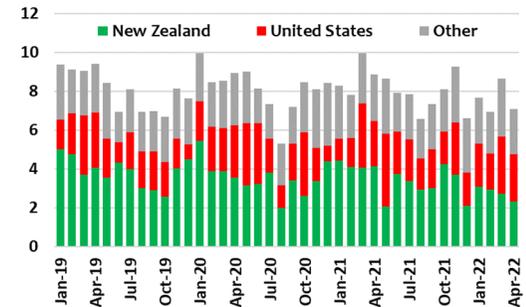
Nth Victoria feed grain prices A\$/t



Product values used in outlook modelling (US\$/t)



Australian cheese imports by supplier ('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-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
LatAm	Latin America	Mainly focused on major dairy producing and importing countries Argentina, Uruguay and Brazil.
MENA	Middle East and North Africa	
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	
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.
PFV	Projected Fundamental Value	Freshagenda's forecast for the future value of commodities based on the expected market fundamentals of supply and demand
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.