

Dairy Market Insights

First Quarter 2023

1. Summary

Short-term fundamentals weak, but improving later in 2023

- Short-term fundamentals remain weaker but should improve later in the year as global trade recovers and milk production slows.
- The largest dampener on the market remains the EU which gives the outlook a double edge. The EU sector is sending signals that prolong weak commodity prices, maintaining milk supply while local dairy demand weakens.
- While EU processors continue to encourage their farmers to produce more milk (even though prices are in decline), high retail dairy prices are causing households to consume less dairy – directly as cheese and butterfat, but also in food categories that consume dairy ingredients. High inflation will linger through 2023, while rising interest rates will further damage spending.
- These factors will, in the short term through the spring flush, ensure increased availability of SMP (and to a lesser extent butter) which will likely keep buyers away (especially in SE Asia) until there is a clear signal the market has bottomed.
- China’s much-anticipated demand revival is expected to remain slow and steady across dairy categories, and more complicated in the case of WMP as the local milk situation doesn’t appear to be quickly tightening. Food service sales have rebounded to some extent, but we anticipate a lot more caution from consumers with a weak property market and employment insecurity.
- China’s demand revival seems to be the major factor the world market is betting on – futures markets are pricing in a return of Chinese buyers to tighten WMP, SMP and butterfat markets. While the timing and strength of improved trade is highly uncertain, the EU consumer (and their yearning for cheese) is meanwhile also critical given their impact on underlying fundamentals.
- The pace of the WMP demand recovery has and will continue to have a huge impact on the balance of NZ output. To date that has been slower than expected, increasing available WMP stocks and keeping downward pressure on WMP values. NZ producers will aim to match the WMP demand with their product mix choices, but we expect they will keep SMP and cheese output higher than pre-2022 levels. This will likely come at a time when the EU and US output comes under pressure.

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What it means for Australian dairy farmers

- The spot commodity milk value* (CMV) stood at \$7.12kgMS at the end of March, down 5% from the revised end-of-December reading of \$7.50kgMS. This compares with the Australian Commodity Milk Value (ACMV) of \$8.30kgMS.
- Spot Oceania cheddar prices have fallen US\$280/t since the end of December to US\$4,700/t, while butter prices rose US\$220/t over the period to US\$4,830/t. SMP and WMP spot prices have also fallen, by US\$410/t and US\$30/t respectively.
- As noted previously, Australian wholesale prices remain significantly disconnected from Oceania spot prices due to critical local supply shortages and the sourcing strategies of major retailers.
- The Australian dollar weakened over the March quarter and stood at US\$0.69 compared to US\$0.67 at the end of March. Inflation continues to be a key concern for the Australian economy, impacting consumer confidence and prompting further interest rate rises from the Reserve Bank.
- However, with large buyers appearing to have secured sufficient supplies, the post-June competition for milk may be less intense this time around.
- Weaker stream returns for processors exposed to traded commodities will probably ensure a larger spread of prices given the pressure on processor margins.
- **To learn more about current season regional farmgate pricing, and track CMV movements visit the Milk Value Portal at milkvalue.com.au**

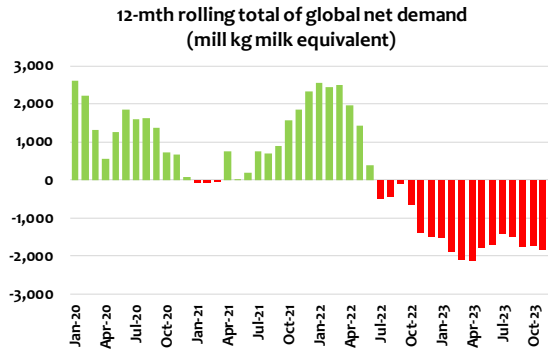
*The CMV was revised to account for updated product mix and cost information.

2. Some key global dairy market indicators

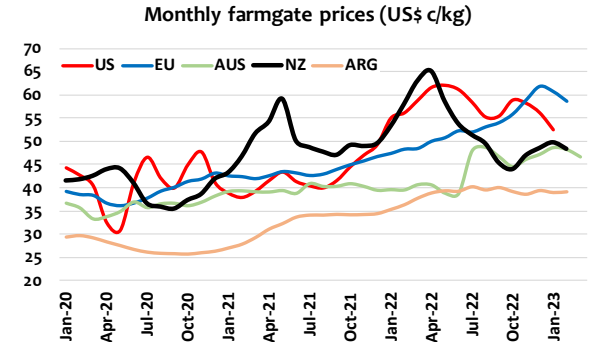
Global trade in milk solids equivalents was weaker than prior year volumes in late 2022, driven mostly by the collapse in demand from China.



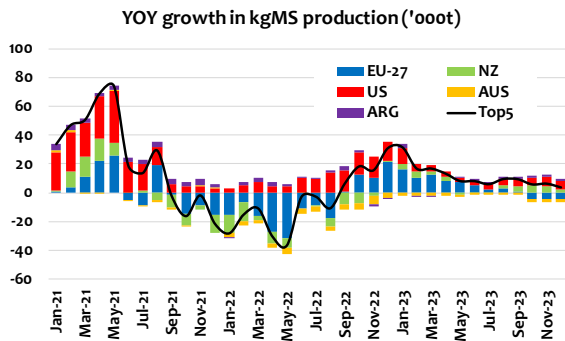
Improved production and weaker domestic demand built a surplus in milk volumes which is declining in Q2-2023.



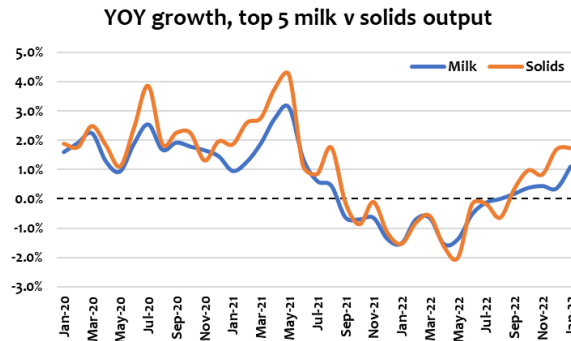
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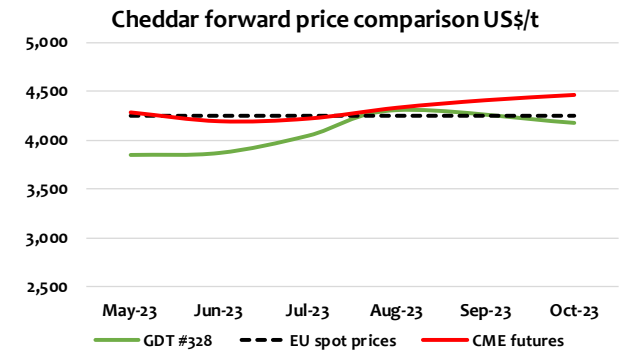
Milk output in the top 5 exporters will remain in decline until Q2-2023, but recently seen a sustained lift in milk solids mostly from the EU, adding to commodity product supplies.



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The risks for NZ and US export cheese prices are apparent with surplus EU gouda and edam supplies.



3. Major issues in the global market outlook

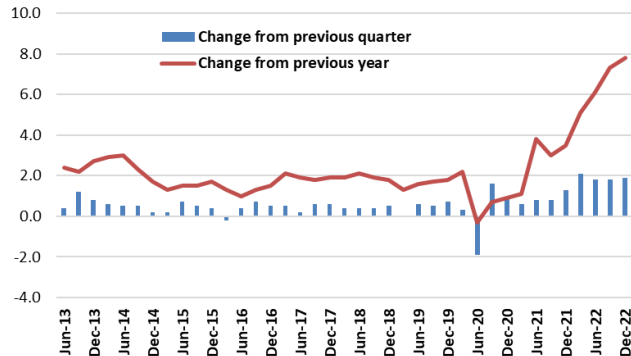
	Bullish (for prices)	Bearish	Uncertain
Demand	<ul style="list-style-type: none"> • Foodservice recovery in the US and some developing regions • Strong SMP demand from Mexico, and improved Chinese buying 	<ul style="list-style-type: none"> • Reduced domestic demand in EU and US • Inflation weakening European consumer demand and increasing SMP output • Slow recovery in Chinese demand , threats to wehey demand with weak pork margins 	<ul style="list-style-type: none"> • Timing of Chinese demand recovery and engagement with the GDT platform • Impact of US and European financial sector failures on interest rates and global economy • SE Asian buyers appetite for product given affordability pressures
Supply	<ul style="list-style-type: none"> • There are risks to US milk output with poor farm margins in western regions • Significant cuts to New Zealand WMP production to avoid surpluses • Weaker LatAm WMP exports with lower milk output and Brazil shortages • Increased US wehey supply in line with increasing cheese production 	<ul style="list-style-type: none"> • Improving EU-27 milk growth in the first half of 2023 driving a larger lift in SMP output • Faster growth in cheese-rich regions of the US • Shift in NZ milk use to SMP to reduce over-supply of WMP 	<ul style="list-style-type: none"> • Improved NZ butter export share with limited EU supply • Extent of EU-27 milk growth given both falling milk prices and easing input costs

4. Some key domestic market indicators

“Discretionary” inflation increased 2.6% in the December quarter reflecting higher holiday travel costs and meals and takeaway, annual movement reached a new high of 7.1%. Dairy products and related products recorded the highest annual change in food, increasing 14.9% while fruit and vegetables experienced the strongest quarterly fall since 2012 but were still 8.5% higher annually.

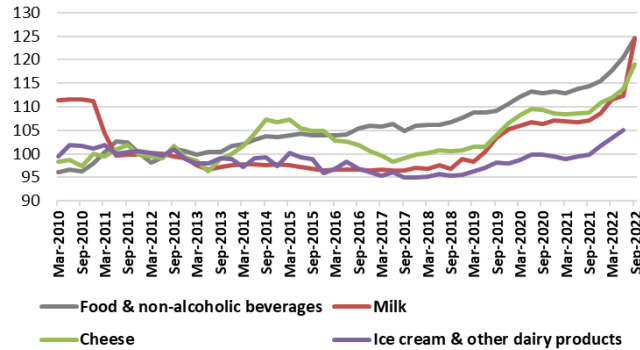
The Westpac-Melbourne Institute Index of Consumer Sentiment reversed gains in December and January and is languishing at near record lows. Inflation and rising interest rates the key concerns.

All groups CPI, quarterly & annual movement (%)

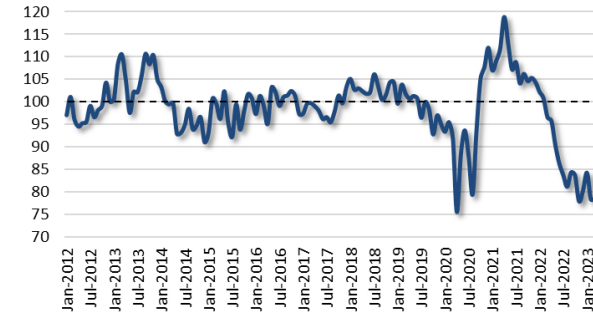


Source: ABS 6401.0 Consumer Price Index

Retail price indices (2011/12 = 100)



Westpac consumer sentiment index

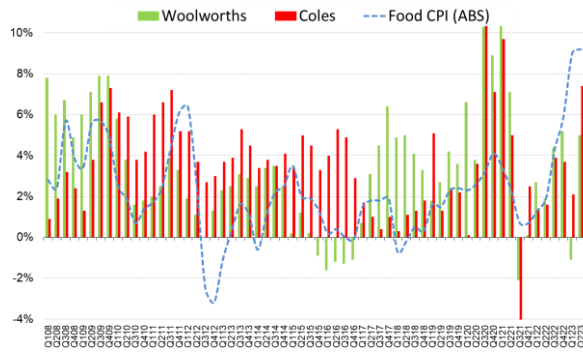


Major supermarket same store sales improved in the December quarter against more “normal” prior-year comparatives, and as price increases improve topline results.

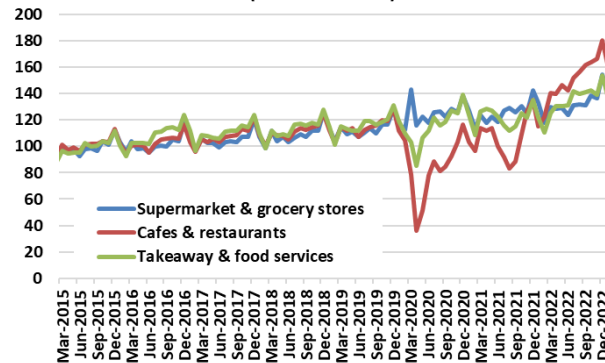
Food retailing rose 0.2% in seasonally adjusted terms in February, while cafes restaurants and takeaways rose 0.5%

Wholesale spot electricity prices continued to rise although at a slower rate in recent months.

Retailer "same store" sales v food inflation

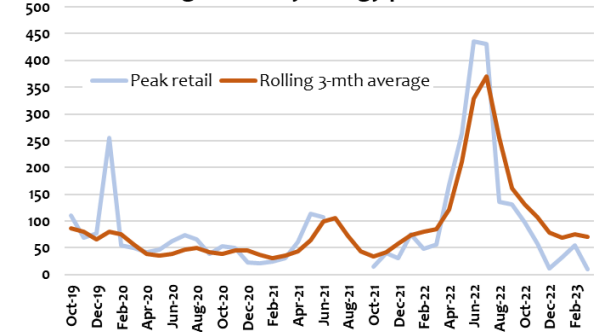


Retail turnover indices (Jan 2015 = 100)



Source: ABS 8501.0 Retail Trade

Vic average monthly energy price in \$/mwh



5. Australian outlook

Critical issues

Milk production

- Raw milk production will remain in decline over the remainder of the season, although the contraction in % terms in coming months may not be as pronounced as in the second half of 2022. We have slightly lowered our forecast national milk production from our previous update to fall 6% over the full FY2023 season, taking production slightly below 8bn litres.
- The ongoing exits of herds from production will further reduce cow numbers for the FY2024 season. The continuing demand from China for heifers, with the looming end of NZ live exports in April 2023, will remove more young stock from the industry. Feed grain prices continue to be elevated, but stable below \$400/t in the north of Victoria into March according to Dairy Australia. Hay prices steadied through March.
- While average bought-in feed prices have risen this season, fertiliser prices are falling, it is generally expected that production costs will continue to increase in the coming season, without a material improvement in access to farm labour.

Milk prices

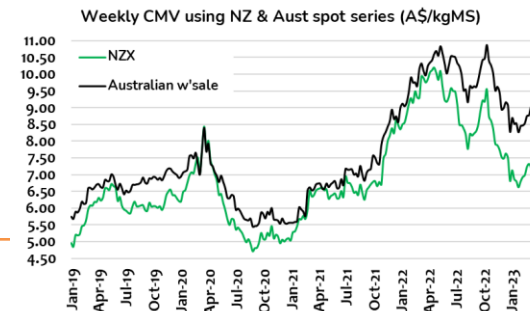
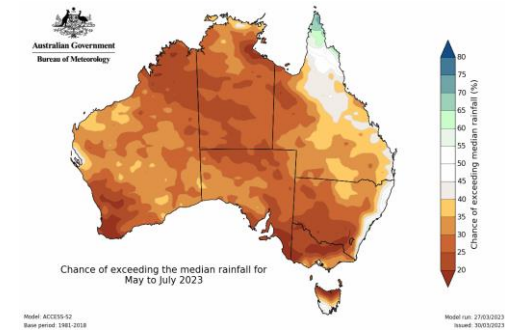
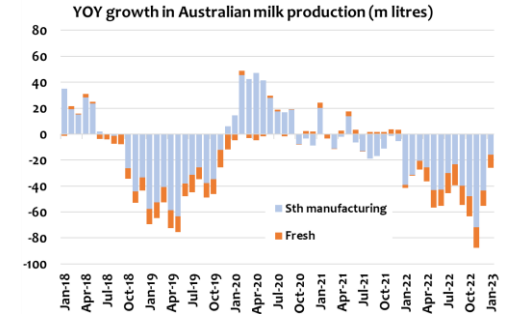
- Australian wholesale commodity prices suggested a spot Australian Commodity Milk Value (ACMV) close to A\$8.50kgMS in late March-2023. Cream markets remain firm, helping the average milk value for the pool.
- The projected mid-point of the ACMV for the coming season is close to \$8.30kgMS, but exposures to higher value in the butterfat market and weaker traded commodities will vary across companies.
- Current indicative regional farmgate milk prices can be monitored at the [Milk Value Portal](#).

Outlook assumptions

- We currently forecast a further fall of 3-4% in production in FY2024, to take production to near 7.8bn litres.
- Rainfall outlooks are generally poor and will worsen if the effects of the El Nino pattern take hold, so the prospects for spring are highly uncertain.

AUS milk and product output ('ooot)					
	Milk	Fats	Cheese	SMP	WMP
2022	8,094	47	394	206	22
2023	7,781	59	392	176	30
YOY % changes					
2022	-6.8%	-16.2%	1.9%	-5.0%	-43.3%
1H-22	-6.3%	-20.2%	9.8%	2.5%	-46.8%
2H-22	-7.1%	-12.5%	-4.0%	-10.1%	-39.9%
2023	-3.9%	26.6%	-0.4%	-14.6%	36.3%
1H-23	-4.8%	23.4%	-3.5%	-10.5%	9.1%
2H-23	-3.1%	29.3%	2.2%	-17.6%	59.3%

- Supply security remains paramount for dairy companies. However, large processors appear to have secured requirements.
- Coles' announcement that it will lock in prices for three more years at near current levels, is prompted by the need to secure its own milk supply.
- This may reduce the intensity of competition in June after release of all milk contracts.
- A greater spread of farmgate milk prices is likely, given the pressure on processor margins.



5. Australian outlook

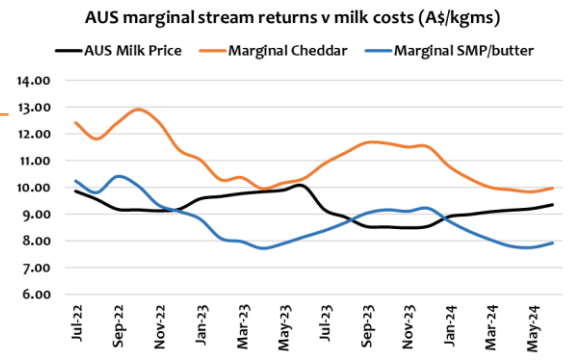
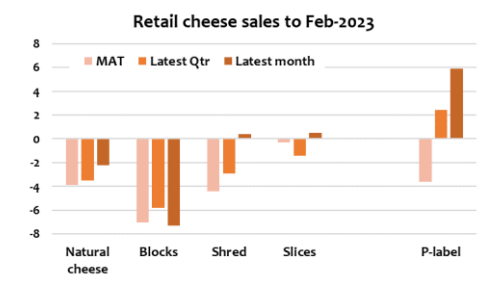
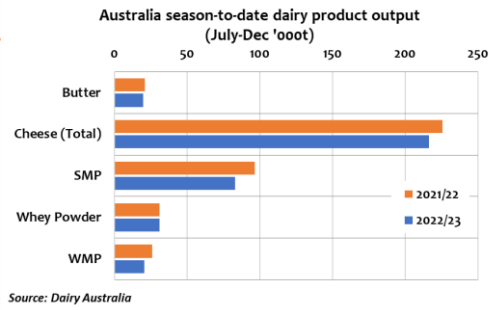
Markets

Critical issues

- The decline in milk collections drove a 3% fall in natural cheese output (with an 8.5% decline in cheddar) in the second half of 2022 according to the latest update from Dairy Australia, while SMP output dropped 14%. There is an important mix change within cheese with increased mozzarella output.
- Retail volumes are weaker than the prior year in major dairy categories. The significant value drift to lower priced product (private label and pack sizes) in both categories is continuing.
- While butterfat commodity values are falling, this is not (yet) translating to fresh cream values held up due to shortages of milk and butterfat, but may come under the influence of weaker AMF prices for in H2-2023.

Outlook factors

- Cream prices are also mostly locked in for H1-2023 despite the steep fall in butterfat values which shows a widening premium over the butterfat equivalent of AMF (based on GDT and futures prices through coming months).
- Projected stream returns for commodities through spring months at present show a small, uncertain advantage for the marginal returns from the SMP/butter stream over milk prices. This will reduce the attraction for manufacturers to seek third-party supply to sustain plant throughput in that period.
- Continued trading down by consumers in the face of the squeeze on household budgets will put pressure on processor margins, despite the pass-through of headline price increases. There is likely to be increased pressure for promotional spend to maintain brand shares.



Glossary and explanation of key terms

Acronym		Explanation
ACMV	Australian Wholesale Commodity Milk Value	The ACMV is calculated from Australian wholesale dairy product prices as distinct from spot export quotes used in the CMV
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
CME	Chicago Mercantile Exchange	US-based derivatives marketplace offering a range of futures and options products for risk management for agricultural commodities.
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%).
NDSPR		National Dairy Products Sales Report produced by the United States Department of Agriculture (USDA)
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	

Glossary and explanation of key terms

Acronym		Explanation
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
SGX	Singapore Exchange Ltd	Singaporean investment holding company that provides different services related to securities and derivatives trading and others. SGX and NZX formed a strategic partnership in 2022, agreeing to the listing of NZX's Global Dairy Derivatives contracts on SGX's trading and clearing platform
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.