

Dairy Market Insights

Second Quarter 2023

1. Summary

Demand recovery remains elusive as global milk slows

- The outlook for market fundamentals continues to be mixed – while there are mounting supply side pressures from weather and poor margins that will slow milk output in the EU and US, weak demand remains a greater challenge for at least the remainder of 2023.
- In the short-term, commodity prices will likely weaken as buyers can afford to wait and see whether product availability is impacted by slowing milk output. The further complexity in the EU is that domestic ingredient demand has also been weakened by reduced consumption in major processed food categories.
- EU cheese and butterfat markets again briefly rallied with improving buying, but demand appears flimsy and seasonal. The large unknown remains whether demand for cheese in the EU can sustain any meaningful recovery when lower prices eventually reach consumers.
- The US dairy market continues to struggle under the weight of an oversupply of cheese, with stubbornly high cheddar output (to fill a set of new plants in central regions) that is well ahead of demand.
- This has been compounded by lower mozzarella production in the face of weaker domestic and export demand. Cheese market fundamentals should eventually improve as milk output stalls later in 2023 and the consumer economy improves.
- Meanwhile, the biggest export markets for dairy ingredients, China and Southeast Asia, are showing some positive signs. The recovery in demand for imported ingredients and products by China continues to show encouraging signs but consumer spending remains cautious.
- There is little evidence yet of a rebalancing in domestic milk supplies as UHT demand is recovering much slower than expected and domestic milk powder output continues to expand. Demand in cheese and butterfat is, however, improving.
- The lack of significant change in Chinese WMP demand has affected the NZ product mix which will sustain higher SMP and butterfat output. The seasonal production conditions for the upcoming NZ spring are, as always, uncertain – compounded by the transition to an El Nino climatic pattern, a lack of heifer exports, but with improving beef markets and pressures on farm cashflows that will sustain the producer caution and may limit milk growth.

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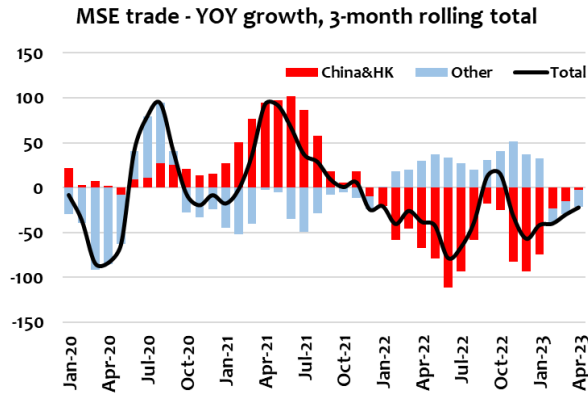
What it means for Australian dairy farmers

- The spot commodity milk value* (CMV) stood at \$6.29kgMS at the end of June, down 10% from the end-of-March. This compares with the Australian Commodity Milk Value (ACMV) of \$8.24kgMS based on domestic wholesale prices.
- Spot Oceania cheddar and butter prices have fallen US\$100/t since the end of March to US\$5,500/t and US\$5,700/t respectively. SMP prices fell US\$20/t over the same period to US\$2,930/t while WMP price was unchanged.
- 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. That said the average value of dairy products in the Australian market has fallen 20% over the past 12 months.
- The Australian dollar has remained stable, trading in a tight range around US\$0.67 since the end of March. Inflation remains a key concern for the Australian economy, impacting consumer confidence and feeding further interest rate rises from the Reserve Bank, although there are signs prices have peaked.
- The June price announcements for the 2023/24 continued throughout the month, finishing with a weighted average opening price of \$9.40kgMS this compares with \$9.60kgMS at the same time in 2022, just 2% lower.
- While dairy companies have passed record high milk and operating cost increases into the domestic market, the impact of shoppers trading down to private label and smaller pack sizes will impact margins, while export returns are under even greater downward pressure.
- **To learn more about current season regional farmgate pricing, and track CMV movements visit the Milk Value Portal at milkvalue.com.au**

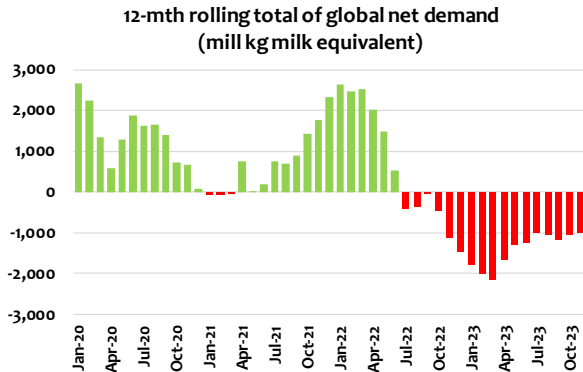
*The CMV was revised to account for updated product mix and cost information.

2. Some key global dairy market indicators

Global trade in milk solids equivalents is recovering with steady improvements in China, but there are weaknesses in other regions.

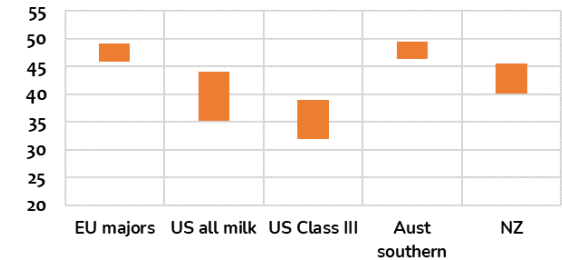


Improved production and weaker domestic demand built a surplus in milk volumes which is declining in H2-2023.

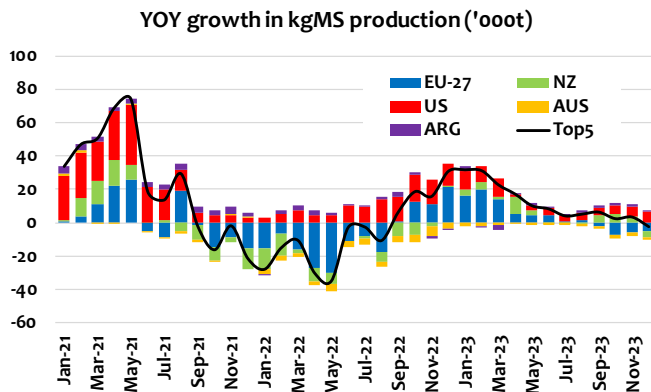


The US cheese price ensures US milk will be the cheapest through H2-2023. EU milk prices remain vulnerable to commodity prices, while Australia has locked in uncompetitive prices.

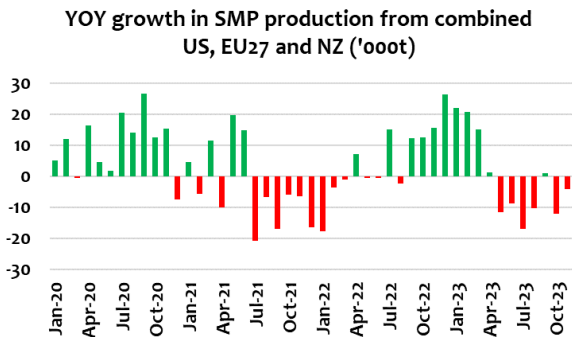
Major exporter expected farmgate milk prices in US\$/kg (H2-2023)



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

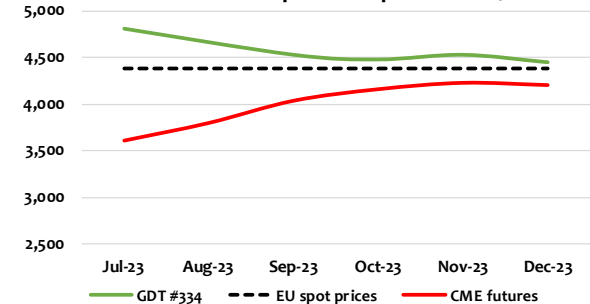


The big 3 producers are slowing their SMP production in H2-2023 as milk supplies decline. Much of the growth in H2-2022 came from NZ product mix shifts.



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

Cheddar forward price comparison US\$/t



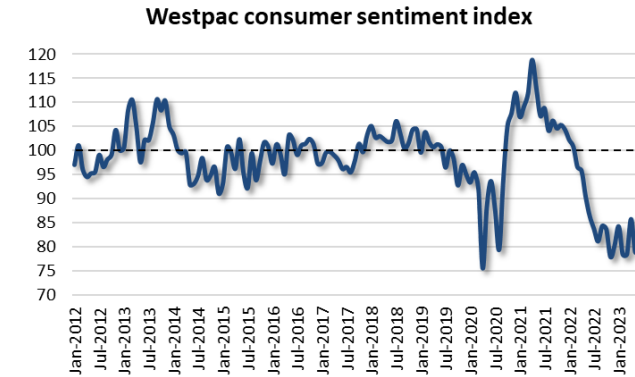
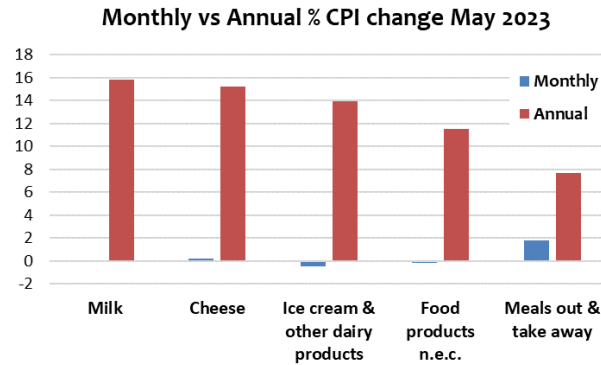
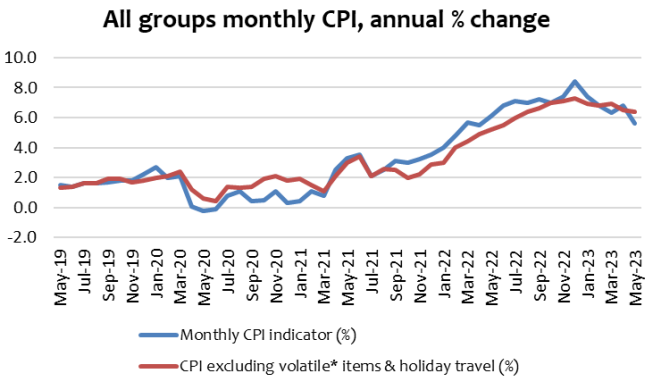
3. Major issues in the global market outlook

	Bullish (for prices)	Bearish	Uncertain
Demand	<ul style="list-style-type: none"> • Foodservice recovery in the US and some developing regions • There is sustained SMP demand from Mexico 	<ul style="list-style-type: none"> • Reduced domestic ingredient demand in EU and US • Shift in NZ milk use to SMP to avoid over-production of WMP • EU inflation pressures are impacting consumer demand for butter and cheese • Continued weak pork margins reducing whey demand • Weak EU feed demand for whey 	<ul style="list-style-type: none"> • Food service recovery in developing regions • MENA and SE Asian demand for WMP • Internal Chinese WMP balance as mobility improves, milk production slows and local stocks are worked through
Supply	<ul style="list-style-type: none"> • Likelihood of reduced US milk output with slowing in south-west regional production and narrowing on-farm margins • Slowing EU milk growth in the second half of 2023 • Slowing SMP output in major EU producers • Shift in NZ product mix to avoid WMP surpluses produces more butter and AMF • Abundant US cream supplies • NZ limiting WMP output to closely match demand • Weaker LatAm WMP with reduced milk output and shortages in Brazil • Increased US whey 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 • Sustained growth in milk and cheese output in central US regions as new processing capacity is filled • Weakness in WPC80 demand may lift dry whey output 	<ul style="list-style-type: none"> • EU-27 milk supply response given both falling milk prices and easing input costs • The extent of NZ spring peak milk production on product mix and availability

4. Some key domestic market indicators

The monthly CPI indicator rose 5.6% in the 12 months to May with food and non-alcoholic beverages amongst the most significant price rises at 7.9%. Within the food and non-alcoholic beverage category the main contributor was meals and takeaway food which rose 7.7% annually and 1.8% for the month. Annual increases in dairy product prices have outstripped other food but mostly fell between April and May.

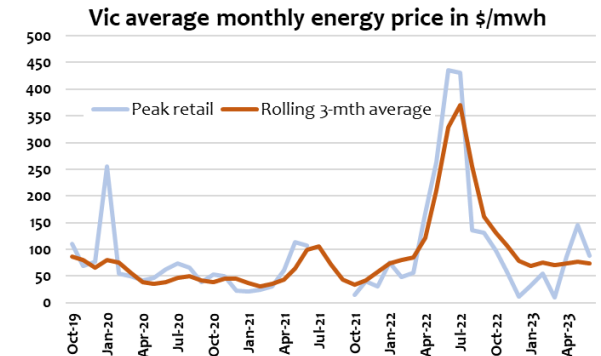
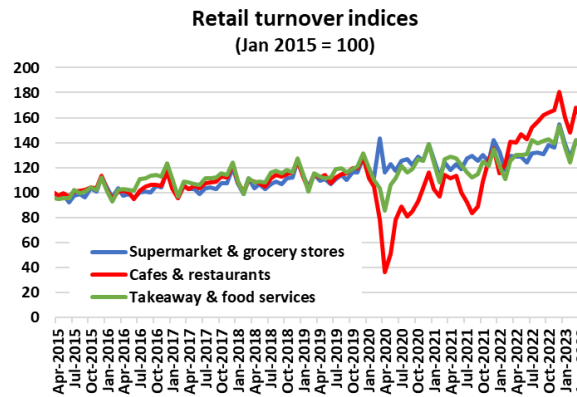
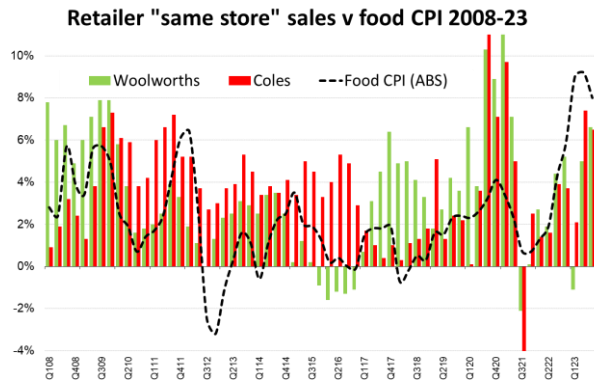
The Westpac-Melbourne Institute Index of Consumer Sentiment eased in May and June after spiking in April when the RBA paused interest rate increases.



Woolworths same store sales pulled ahead of Coles in the March quarter as food inflation eased slightly compared to late 2022.

Food retailing fell 1.7% in seasonally adjusted terms in April, while cafes restaurants and takeaways fell 0.2%.

Wholesale spot electricity prices have been reasonably steady in the past quarter, but electricity costs are set to rise in July.



Source: ABS 8501.0 Retail Trade, seasonally adjusted

5. Australian outlook

Critical issues

Milk production

- Milk production is stabilising in the lowest production months of the season, but this is most likely a short-term seasonal recovery. Some of the drivers of the decline in milk in recent years have (for now) reversed – the cull cow market has further weakened (more than halving in recent months) as beef processors are swamped with higher throughput, while heifer exports have dried up with the glut of milk in China.
- Grain prices are stable but still above long-term averages. Other impediments affecting labour and overhead costs remain, but the short-term conditions suggest improved output through the season.
- Feed grain prices continue to be elevated, but stable below \$400/t in the north of Victoria into June according to Dairy Australia. Hay prices steadied since March but remain 40% above the 5-year average.

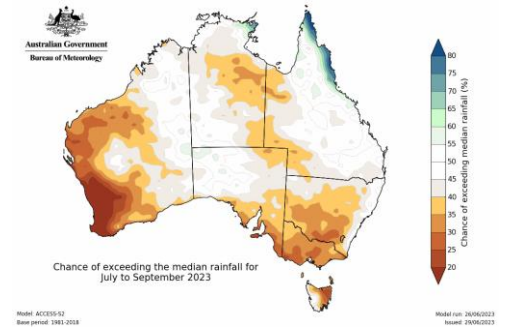
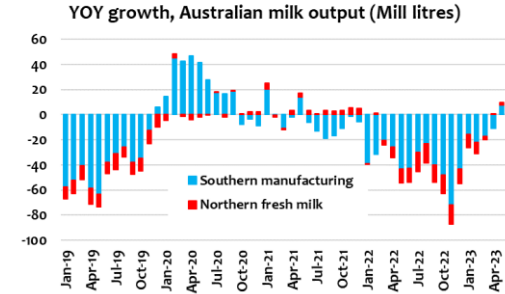
Milk prices

- Farmgate milk values in southern regions for fresh product requirements in the 2023/24 season were influenced by the early release of prices by retailer Coles and suggestions that other large buyers had secured requirements.
- This failed to reduce the intensity of competition through June after release of all milk contracts, which has again resulted in several rounds of increases and pushed Southern region farmgate milk prices within 3% of the previous end-of-season outcome.
- This process is exacerbated (and ongoing as we write) by the terms of the Code of Conduct that allows milk producers a generous cooling-off period.
- Current indicative regional farmgate milk prices can be monitored at the [Milk Value Portal](#).

Outlook assumptions

- Seasonal conditions are good for the coming spring and any effect of the late-arriving El Nino are likely to be felt in southern regions in 2024, given good soil moisture and irrigation water access.
- Feed costs are lower, pasture conditions at present look better and fertilizer costs much lower which will mean on-farm margin are similar or better than the prior season.

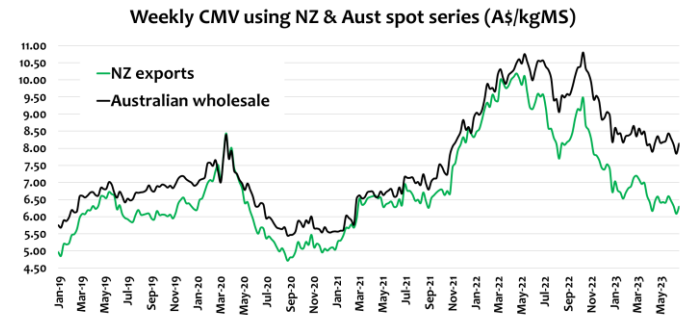
AUS milk and product output ('ooot)					
	Milk	Fats	Cheese	SMP	WMP
2022	8,094	47	394	206	22
2023	8,088	39	419	177	33
YOY % changes					
2022	-6.8%	-16.2%	1.9%	-5.0%	-43.3%
1H-22	-6.3%	-20.2%	9.8%	2.5%	-46.8%
2H-22	-7.1%	-12.5%	-4.0%	-10.1%	-39.9%
2023	-0.1%	-16.4%	6.5%	-14.0%	50.3%
1H-23	-1.8%	-38.6%	3.7%	-15.8%	27.3%
2H-23	1.3%	2.4%	8.8%	-12.7%	69.7%



FY2024 estimated prices (as at noon on 30 June 2023) by major southern milk buyers (\$/kgms)



Note: * mid-point of a range. Bega refers to an average of Victoria and Riverina only, and not fresh collection MSAs; Saputo is for exclusive MSAs, Coles is for Victorian regions.



5. Australian outlook

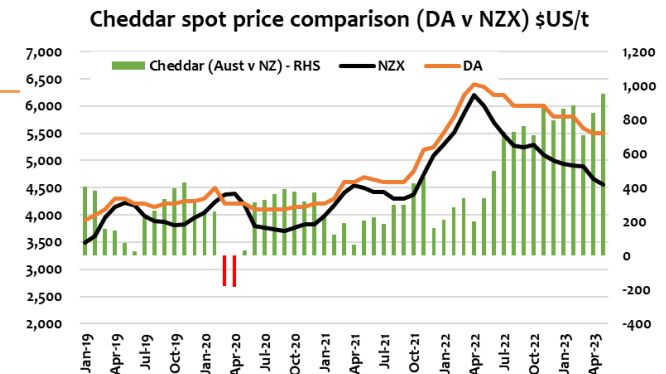
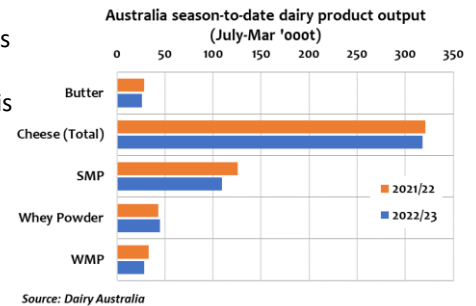
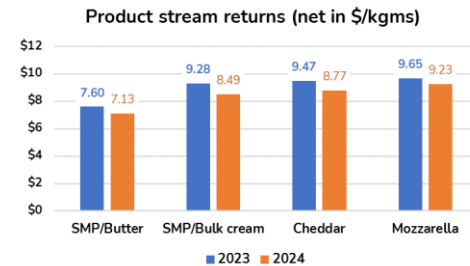
Critical issues

- The reported product mix has reverted towards cheese in recent months according to Dairy Australia. The fall in cheese output has reduced to just 0.8% in the 9 months to March (with a 5.6% decline in cheddar alone) while SMP and butter output each dropped 13%.
- Aust food retail sales lifted 6% in nominal terms in May, which was a little stronger than the prior month, but is still below the rate of price inflation.
- Retail sales volumes however remain weaker than the prior year in major dairy categories. The significant value drift to lower priced product (private label and smaller pack sizes) in both categories is continuing.
- Cheese imports increased 13% over the 10 months to April, growing at a much faster pace in 2023. Butterfat imports have grown 47% in this period.

Outlook factors

- The competitive tension for milk supplies has ensured the range of stream returns has not resulted in a larger spread of prices than in FY2023. The outcome is that some business models with a large exposure to global commodity markets that are forced to compete on milk prices are under strong financial pressure.
- The lower projected stream returns for commodities through the spring flush will reduce the scope for 3rd-party supply of milk to sustain plant throughput and put balancing-plant capacity at greater risk.
- Continued trading down by consumers as household budgets remain under pressure will impact processor margins, despite the pass-through of headline price increases. There is likely to be increased pressure for promotional spend to maintain brand shares.

Markets



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.