



Insights on today's global dairy business from the Hoogwegt companies

MARKET MATTERS

Tame Output to Keep Floor Under World Prices

Global milk supply—expected to show a year-over-year gain of 2% this year—has yet to fully recover from its steep 2009-10 drop following the global financial crisis and weather problems in Europe and Oceania. Continuing weather issues in several key milk production regions coupled with rising feed costs in the Northern Hemisphere and a deepening financial crisis in the euro-zone will likely keep world dairy markets firm into 2012. The outlook for continuing growth in world demand, particularly from the developing world, will further support markets, but risks remain.

Milk production in the **European Union**, which has been running well ahead of the prior year, has reached its seasonal peak, and drought across southern France and Germany has resulted in early peaks. Parts of Europe received less than 40% of long-term average rainfall between February and April, and even those areas that received rain saw less than 80% of their average. Drought is also being blamed for lower-than-normal fat and protein levels in Central Europe.

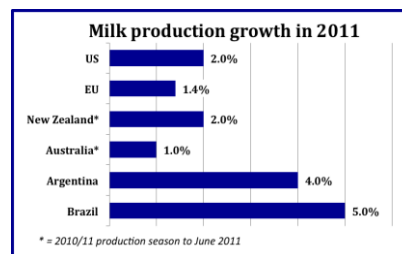
In Eastern Europe, milk production will peak in mid- to late-June. Production trends in Eastern Europe are mixed with the Baltics, Poland, Slovakia, and Slovenia showing year-over-year increases, and Romania and Bulgaria trailing year-earlier levels. Output in the European Union is expected to increase in response to strong global demand. EU production this year is expected to rise 1.4% above 2010 levels.

Hay stocks running low

Milk production in the **United States** is also peaking seasonally, but processors have been able to handle milk volumes without capacity problems. Heat and humidity should begin to take a toll on dairies in the Southeast, and on-farm feed supplies are running low in some areas of the country, with hay stocks in selected western states only 56% of last year's inventories, according to USDA.

Significantly higher feed costs along with a modest drop in the all-milk price are resulting in lower profit margins for producers. Both feed costs and weather should result in lower-than-average gains in milk per cow through the rest of this year, particularly in the West, where the majority of dairies rely on purchased

feedstuffs. Nevertheless, 2011 full year output will be strong, up an estimated 2% based on a 0.8% increase in cow numbers and a 1.2% gain in milk per cow. This is an increase from December's outlook of 1.5%.



New Zealand and Australia are wrapping up their 2010-11 milk production seasons. Output in **New Zealand** is now expected to exceed last year by 4%, which is below earlier expectations due to drought conditions on the North Island. Looking ahead, output growth in New Zealand is forecast to increase between 2% and 3% in the 2011-12 season as dairy producers respond to stronger forecast milk payouts. While seasonal conditions are good, farm finance may limit growth beyond this.

Conditions improving

Milk output in **Australia** will post a gain of less than 1% over the prior year for the 2010-11 season due to constraints in feed quality and cow numbers in the southern region, but 2011-12 production could grow 2% based on expected positive margins. Conditions heading into the 2011-12 season are favorable in export regions; feed quality and supply is in good condition and producers have guaranteed access to irrigation water. Some contraction of milk production is anticipated in other domestic supply regions.

South American milk production has rebounded strongly since late 2010, but available export volumes will be limited by stronger demand within the continent. Assuming a normal summer and stable feed costs, 2011 growth in **Argentina** production is expected to hit 4%, feeding through to double-digit gains in export volumes. Output in **Brazil** is forecast to rise 5% in 2011, up from December's forecast for 3% growth.

HOOGWEGT FORECAST

	U.S. Average Prices			EU Average Prices			Oceania Average Prices		
	\$/ton	\$/lb	Trend	\$/ton	\$/lb	Trend	\$/ton	\$/lb	Trend
SMP	3.640	1,65	Stable	3.550	1,61	Stable	3.800	1,72	Firm
FCMP / WMP	4.365	1,98	Stable	4.475	2,03	Stable	3.950	1,79	Stable
Butter	4.960	2,25	Firm	6.090	2,76	Firm	5.000	2,27	Stable
Cheddar	4.520	2,05	Firm	4.700	2,13	Firm	4.450	2,02	Firm
SWP	1.435	0,65	Firm	1.450	0,66	Firm			
Lactose	1.215	0,55	Firm	1.590	0,72	Stable			

U.S. prices stated ex-works / incl. expected CWT subsidy where applicable; world prices stated FOB main port; EUR/USD: this week 1,45

WORLD COMMENT

Last week dairy markets saw reasonable activity around the world. China slowed its import activity of milk powders after a record setting pace in the first 4 months of the year. Internal US demand was lackluster for NFD; while cheese, butter and whey continued to be robust. US Cheddar prices moved up strongly at the CME after a major product recall by one manufacturer. High feed costs are expected to curb milk growth. In the EU Gouda cheese prices weakened, in part due to slower import demand from Russia. EU cheddar prices, on the other hand, held steady thanks to decent demand from the UK. EU spray drying capacity remains fully utilized since February. Commercial stocks of SMP, FCMP and butter are practically non-existent, a rarity in the flush season. As of June 1 SMP stocks, as held by Brussels, started to move out of their warehouses to their buyers under the Most Deprived People's programs. The market is still readily absorbing these quantities, as expected. Internal EU and US butter and cream demand continues to outstrip supply, keeping prices at high levels. Whey products (incl. lactose) are being sold and used at a solid pace pretty much everywhere.

BRINGING IT HOME

Market Prices, Demand to Remain Robust

The international dairy market has enjoyed a strong price recovery that began in late 2009. This price surge was driven by strong demand from developing markets led by China and Russia. Product prices peaked in early 2011 at levels below those reached in 2008 as price resistance slowed demand increases and economic recovery in the United States, Europe, and parts of Asia began to weaken.

Already in 2011, Japan's economy has slipped back into recession and unrest in the Middle East has spread. High crude oil prices, however, are allowing many Middle Eastern countries to maintain import demand despite higher-priced dairy products. Likewise, Japanese imports are expected to hold up as Japan's industry attempts to meet demand in the face of herd losses and infrastructure damage.

Demand for dairy products from developing markets has remained robust despite rising commodity prices. Demand from the world's three largest dairy importers, China, Russia, and Mexico, will likely be steady for the next 12 months. China, which accounts for nearly 20% of the world's population, will continue to be the main driver of increased world demand for dairy and other commodities. Last year China's dairy imports increased by 20% to 904,000 metric tons. An emerging lower-

middle class as well as consumer concerns over safety of domestically produced infant formula products will sustain import demand moving forward.

Economic growth in Russia continues to drive expansion in the country's food service and hospitality sectors. Belarus remains the major supplier to Russia, but most products continue to be sourced from the European Union. Last year, Russia imported 410,000 metric tons of cheese (including from Belarussia), a 38% year-over-year increase.

Weakness in the U.S. dollar has been a major contributor to robust demand by making dairy product imports more affordable to many countries. With unemployment in the United States still high, the housing crisis persisting, and expectations for inflation declining, it appears the U.S. dollar will be unable to stage a sustainable rally. A weak dollar will continue to give a competitive edge to the United States, but the country has limited excess product. Thus Oceania and Europe will continue to supply most of the world's dairy needs.

However, rising food prices in the developing world, coupled with governmental attempts to quell inflation, especially in China, could dampen the steady growth in world demand for milk products.

Did you know?

- Whey product exports from the European Union were up 18% in first-quarter 2011, compared with first-quarter 2010.
- In first-quarter 2011, New Zealand skim milk powder exports fell 7% below year-earlier levels, while Australia exported 55% more than a year ago.
- China imported 182.000 MT full cream milk powder during Jan – April 2011: an 63% increase versus the same period in 2010.
- South America's participation in world dairy trade during the rest of 2011 will depend on how strong domestic demand is and whether governments re-impose export taxes.

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