



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

**MARKET MATTERS**

**A World of Difference**

Dairy farming around the world varies tremendously in terms of efficiency and style, but recent high milk prices have encouraged the world's dairy farmers, particularly those in major exporting countries—both in the developed and developing world—to increase milk production. And, for the most part, the developing world appears to be increasing output faster than the developed countries.

Year-over-year production gains for the first six months of 2011 have reached double-digits in Argentina, Chile, and Uruguay, albeit these countries are increasing output from a lower base than regions like the European Union, Oceania, and the United States. Except for in New Zealand, output gains have been more moderate in regions of the world with highly developed industries where a growing number of producers rely on purchased or grain-intensive rations.

Milk Production, January–June 2010		
	Production (million metric tons)	% Change from Previous Year
Argentina *	5.742	+ 14.37%
Australia	4.593	+ 0.60%
Brazil *	5.466	+ 4.23%
Chile *	1.141	+ 12.58%
New Zealand	7.400	+ 12.17%
Ukraine	7.698	- 2.21%
EU-27	82.628	+ 2.29%
United States	59.782	+ 1.59%
Uruguay *	1.085	+ 18.02%

*Source: Eucolait. \* million liters.*

Looking first at the European Union, milk production for the first six months of the year was 2.3% stronger than a year earlier at 82.3 million metric tons. The European Union with its 27 member states is by far the world's largest milk-producing region, and Germany, France, and the United Kingdom are the largest milk-producing countries in the region. In 2010, Germany accounted for 21% of total EU-27 milk production, while France accounted for 17% and the United Kingdom about 10%. The Netherlands and Italy followed with 8% each. Interestingly, Germany, the United Kingdom, and the Netherlands have some of the lowest five-year average milk prices of the top-10 milk-producing countries in the European Union. EU dairy farming is still subsidized through its Common Agricultural Policy (CAP), but reform is under way, and by 2015, milk quotas are set to expire. Milk prices in the top-10 milk producing countries ranged between about 27 and 34 euros in 2010.

With near record-high payouts, profitability has improved dramatically over the past several years in New Zealand, the world's largest exporter of dairy products. According to Dairy New Zealand, net profit for New Zealand producers in fiscal year

2011 was expected to reach \$1.49 (NZ) per kilogram of milk sales, which compares with only 35 cents in fiscal year 2010 and a negative 91 cents in 2009. Net profit in 2008, the last time milk prices soared, was \$1.65.

Dairy farms in the United States rely heavily on purchased feed. Until the 2008 and 2011 run-ups in feed prices, larger confined dairy operations had been able to weather milk price volatility better than the more traditional and typically smaller farms that grow at least some of their feed. But that might be changing as larger farms struggle to cash flow due to declining margins brought on by skyrocketing feed costs. The average U.S. all-milk price for 2011 is estimated to break \$20/cwt.

Argentina's dairy industry is also undergoing consolidation. In 2009, the country had approximately 1.85 million dairy cows on 11,800 dairy farms. Most—about 95%—of Argentina's dairy cows are located in the central region where average herd sizes are increasing and the number of dairy farms is declining by about 4.5% each year, which is similar to what has occurred in other countries with developed dairy industries. More than half of a typical milk cow ration on an Argentine dairy farm is sown pasture (56%). Other feed sources include corn silage (17%) and grain concentrates (27%), which are used by 96% of dairy farms. The average dairy farm in Argentina uses a small to medium-sized milking parlor although many smaller farms still use the pass-through system.

Dairy farming is also developing in traditional import markets. For instance, in China there are generally three types of dairy farms. Pasture-based systems are found mostly in remote rural areas of Inner Mongolia, Tibet, Xinjiang, Qinghai, and Gansu. These systems have traditionally produced a large share of the country's milk, but much of it is consumed on farm. Cows on production systems located in the rural areas of Heilongjiang, Liaoning, Hebei, Jiangsu, Shandong, Henan, Sichuan, Yunnan, Shaanxi, and Ningxia provinces receive more grains than cows on farms in more remote areas. The third type of system, referred to as suburban dairy farms, is found in rural areas surrounding Beijing, Tianjin, Shanghai, and other large cities. These farms are typically larger and rely more heavily on purchased feed than their more rural counterparts. It is estimated that suburban farms supply more than half of the demand for milk and dairy products in many large cities. China's 2012 milk production is anticipated to rise 5% over this year's output to 32.2 million metric tons, but growing demand for dairy should keep imports strong.

India, where more than half of total output comes from buffaloes, has also posted strong production this year and next year's is expected to be even stronger. This year's cow milk production in India is expected to hit 52 million metric tons, with next year's production forecast to reach 55 million metric tons, a rise of 5.8%.

## HOOGWEGT FORECAST

	U.S. Average Prices			EU Average Prices			Oceania Average Prices		
	\$/ton	\$/lb	Trend	\$/ton	\$/lb	Trend	\$/ton	\$/lb	Trend
SMP	3.200	1,45	Weak	3.275	1,49	Stable	3.300	1,50	Stable
FCMP/ WMP	4.300	1,95	Stable	4.050	1,84	Stable	3.650	1,66	Stable
Butter	4.080	1,85	Weak	5.150	2,34	Weak	4.250	1,93	Stable
Cheddar	4.190	1,90	Firm	4.550	2,06	Stable	4.200	1,91	Stable
SWP	1.545	0,70	Firm	1.375	0,62	Firm			
Lactose	1.765	0,80	Firm	1.750	0,79	Firm			

U.S. prices stated ex-works / incl. expected CWT subsidy where applicable; world prices stated FOB main port; EUR/USD: this week 1,375

## WORLD COMMENT

Last week dairy markets were mostly steady and balanced. While the Northern Hemisphere is at the low of the milk season, the Southern part of the globe is having a record flow of milk. This milk seems to find its way to the final consumer fairly easily. Prices were mostly steady in the past week; perhaps with the exception of AMF and whey products. AMF sank even further in the gDT auction due to limitations in butter processing capacity and lack of specific demand. Whey is performing very well around the globe; demand continues to grow in the food industry, whilst the EU and US calf milk replacer industry are also seeking supply. Butter in the USA and in Europe are readying for a correction in price; Jan – Feb (future) deliveries are trading at discounts. The European price level is not conducive to export; while the US is closing in. Cheese demand and prices in both these production regions are showing strength in the front months thanks to the Holiday Season; the first quarter expectations are less optimistic. SMP from the various regions is currently trading at more or less the same level. FCMP from Oceania is still leading, but the price gap with South America and Europe has gotten smaller.

## BRINGING IT HOME

## Exports Fall as Output Accelerates

Global demand for dairy products is rising at a rapid rate, but so, too, is world milk production. In New Zealand, dairy producers have been increasing milk deliveries since the start of the year, and the upcoming season is expected to put even more milk on world markets. Australia's milk deliveries have not been as impressive, but producers there are also expected to increase season-over-season output.

New Zealand's year-over-year exports for the January through August period are down 1.84%, compared with the first eight months of 2010, while Australia's exports are down more than 18%, driven mostly by reductions in cheese and skim milk powder exports. However, Oceania's 2011-12 production season is still ramping up.

Of all the major exporting regions, South America has been growing milk production at the most rapid pace. For instance, on a year-over-year basis, monthly milk production increased between 7% and nearly 20% in Argentina for the January through September period. Dairy exports out of Argentina, however, are down nearly 33% from 2010 exports for the January through August period, driven mostly by lower whey and butter exports.

While U.S. gains in output have been nowhere near as strong as gains in South America, for a developed dairy

industry the size of the United States, year-over-year monthly output gains starting in January have been substantial, between 0.4% and 2.2%. The United States has benefitted tremendously from both production problems that have occurred elsewhere in the world and global demand growth. For the first eight months of the year, U.S. exports of dairy products have increased nearly 45%, compared with the comparable period a year ago, and export gains have occurred in every major export category, including butter, cheese, skim milk powder, and whey.

Still, the European Union remains the largest exporter of cheese and whey. And New Zealand remains the largest exporter of butter and milk powders.

The major challenges facing all milk production regions of the world going forward will continue to be weather, feed costs, and milk price volatility. At this time, world milk prices are dropping as consumers pull back from higher prices—but some market analysts expect the pullback to be short lived. Feed prices are also falling but the benefit producers are expected to see from falling feed costs will most likely be offset by lower world milk prices—at least for awhile. In the developed world, labor costs and availability of labor will remain an issue as well.

## Did you know?

- New Zealand producers have the lowest cost of milk production followed by Poland and India.
- Milk production is expected to grow significantly after the European Union ceases the milk quota system in 2015.
- Japan has the highest cost of milk production, followed by Switzerland, Norway, and Canada.
- Milk production in Japan, a major importing country, is expected to drop below 2010 levels.

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