



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

MARKET MATTERS

Bumpy Ride to Continue into 2012

Robust world dairy demand has helped sustain global prices at relatively strong levels, but whether global demand for dairy products led by China, the rest of Southeast Asia, and the Middle East can be sustained in 2012 will depend on whether world economic conditions deteriorate and political unrest escalates.

The current global economic uncertainty can be blamed in part on the failure of European leaders to develop credible solutions to the region's sovereign debt crisis and U.S. legislators' inability to develop a plan to gradually reduce the U.S. budget deficit while continuing to stimulate a fragile U.S. economy.

The Organization for Economic Cooperation and Development (OECD) warned last month that Eastern European countries are on the brink of recession. Assuming policymakers take sufficient action to avoid sovereign defaults, systemic bank failures, and excessive fiscal tightening, OECD expects the European Union's gross domestic product (GDP) to slow from 1.6% growth in 2011 to a 0.2% gain in 2012.

In the United States, economic recovery remains tenuous. Consumer spending slowed in October and business investment weakened. OECD projects U.S. GDP will rise 2% in 2012, after expanding 1.7% this year.

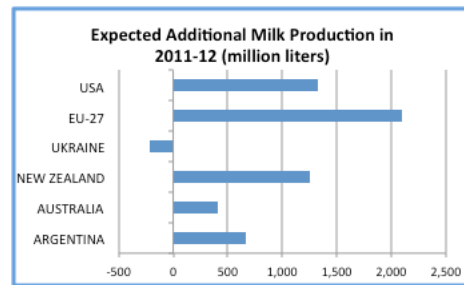
If Europe's debt crisis deteriorates, OECD says GDP growth in the European Union and the United States could be reduced by 2%. With successful resolution to the crisis, though, growth could be higher than expected.

OECD anticipates China's economy will expand by 8.5% next year, down from a 9.2% gain this year. The country's housing market is weakening, though, as homebuyers delay purchases and inventories back up, which could further hurt the overall economy.

Moderate economic growth or a worsening financial crisis would likely constrain global demand growth for dairy products or create further turbulence as traders' and buyers' access to credit dries up. At the same time, continued large gains in the world's milk supply will add to downward pressure on milk and dairy product prices.

Global inventories of dairy products remain at relatively

low levels, but expected 2011–12 expansion in milk supplies by the world's major exporters will add 5.5 billion liters (12.1 billion pounds) to the world market (see chart).



Positives for exporters

While the macroeconomic picture remains volatile, the following key factors are positive for dairy exporters.

China's whole milk powder import requirements are expected to remain strong as the Chinese industry rebuilds the integrity of its supply chains, repairing consumer faith in local brands. An important indication of import growth prospects will become apparent early next year as Chinese importers take advantage of a reduced-tariff window under a free-trade agreement with New Zealand.

The ascension of Russia to the World Trade Organization (WTO) will cut dairy tariffs from near 20% to 15% and limit the government's ability to protect local producers.

Improved political and economic stability in North Africa could support more powder and butter imports, while the prosperity of oil-rich economies in general will continue to be a key driver of increased dairy demand.

Strong consumer demand in Brazil resulted in dairy product imports close to 1 billion liters (2.2 billion pounds) milk equivalent this year, nearly 70% more than in 2010.

India's commitment to expand its dairy sector to match expected consumer demand likely will not be enough to stem a growing need for dairy imports.

Macroeconomic factors coupled with a trend toward growing global demand for dairy products in the developing world point to a bumpy ride into 2012.

HOOGWEGT FORECAST

	U.S. Average Prices			EU Average Prices			Oceania Average Prices		
	\$/ton	\$/lb	Trend	\$/ton	\$/lb	Trend	\$/ton	\$/lb	Trend
SMP	3.100	1,41	Weak	3.175	1,44	Stable	3.350	1,52	Stable
FCMP / WMP	4.080	1,85	Weak	3.950	1,79	Stable	3.725	1,69	Stable
Butter	3.860	1,75	Stable	4.750	2,15	Stable	3.950	1,79	Stable
Cheddar	3.640	1,65	Weak	4.500	2,04	Stable	4.300	1,95	Stable
SWP	1.580	0,72	Firm	1.475	0,67	Firm			
Lactose	1.800	0,82	Firm	1.700	0,77	Firm			

U.S. prices stated ex-works / incl. expected CWT subsidy where applicable; world prices stated FOB main port; EUR/USD: this week 1,34

WORLD COMMENT

In the past few weeks the global dairy markets moved at a slightly slower pace with Holiday demand mostly covered. Price differences between products from different origins became smaller. Oceania prices trended higher, while Europe and the USA mostly experienced stable to lower prices. With softer prices around the globe, butter is undergoing a correction. New Zealand AMF prices finally rose to restore the common AMF/butter ratio. FCMP from New Zealand, Argentina and Europe are practically on par after the last GDT. Chinese buying of New Zealand FCMP surged again in order to take advantage of lower import duties for the first imported 110.000 MT in 2012. SMP from Europe and the USA are more closely aligned, while still showing low inventory levels. With South-East Asia being fairly quiet, large parts of the Middle East appeared to be replenishing their stocks. Whey products and lactose are outperforming many industry expectations. Whey derivatives are increasingly utilized by the global food industry, practically exhausting the available whey stream. Lactose is needed most for standardization purposes by the Oceanic dairies. The significant milk production growth there explains of the extraordinary firm lactose market.

BRINGING IT HOME

Production Gains Mount for Now

The expectation for 2012 is that there will be no shortage of milk or major dairy commodity products on world markets.

Milk production in New Zealand strengthened in the second half of 2011 as good pasture conditions converged with strong milk prices. Milk output was ahead of year-earlier levels, showing 10% growth at the height of the seasonal peak, but full-season growth is expected to be in the range of 7–8%.

Milk production from southern Australia's export production region will grow 4-5% over the full 2011–12 season due to overall positive weather conditions and lower feed grain prices with Australian grain supplies approaching record levels. Exports from this region will not absorb the full production increase because domestic retail and foodservice markets (which take more than half the region's product output) are expected to expand 1–2%.

Milk output is rapidly increasing in Argentina and Uruguay due to stable milk prices and improved pasture conditions. The expansion will put more export

volumes onto the market, but increased import demand from Brazil and Venezuela will consume a large part of the region's growth.

In the United States, output continues strong but herd expansion is expected to be relatively flat into 2012 due to a lack of high-quality and sufficient quantities of certain feeds as well as strong cull cow prices. But milk prices that are at or near record-high levels in the United States will continue to spur output.

The European Union is expected to increase year-over-year milk production by 0.3% in 2012 on top of this year's 2% gain. Total EU milk production is forecast to reach almost 150.8 million metric tons in 2011 and 151 million tons in 2012 as milk yields increase and the region's milk herd contracts.

Without a steep drop in milk prices or major weather challenges in key milk-producing regions, global supplies of dairy products will be plentiful. Worldwide demand is likely to continue growing also. The dilemma facing buyers and sellers alike: Will both sides of the market keep each other in balance or ...

Did you know?

- The United States is now the major supplier of cheese to South Korea, claiming 45% of the country's market.
- Milk production in China is forecast to increase by 5% next year, compared with 2011 output.
- The United States exported 24% more nonfat dry milk and skim milk powder combined in the first nine months of 2011. Mexico, the top market for U.S. powders, imported at total of 127,000 metric tons, up 75% from the comparable period a year-earlier.
- Milk production in Egypt reaches 5.8 billion kg per annum. 40% is cow's milk, whereas 60% comes from buffalos

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