

# PERSPECTIVE

SEPTEMBER 2016

## The latest insights in global dairy markets

Your regular global overview of the dairy industry along with trends in milk production, commodity prices and dairy trade.

# Market at a glance

## Middle East & Africa

- 6%

May MAT  
Global Imports

## Russia

- 20%

May MAT  
Global Imports

## China

+ 27%

July MAT  
Global Imports

## Asia (excluding China)

+ 2%

May MAT  
Global Imports

## Latin America

+ 10%

May MAT  
Global Imports

## European Union

+ 4%

June MAT  
Global Production

+ 12%

May MAT  
Global Exports

## Australia

- 3%

July MAT  
Global Production

+ 6%

June MAT  
Global Exports

## New Zealand

- 2%

July MAT  
Global Production

+ 7%

July MAT  
Global Exports

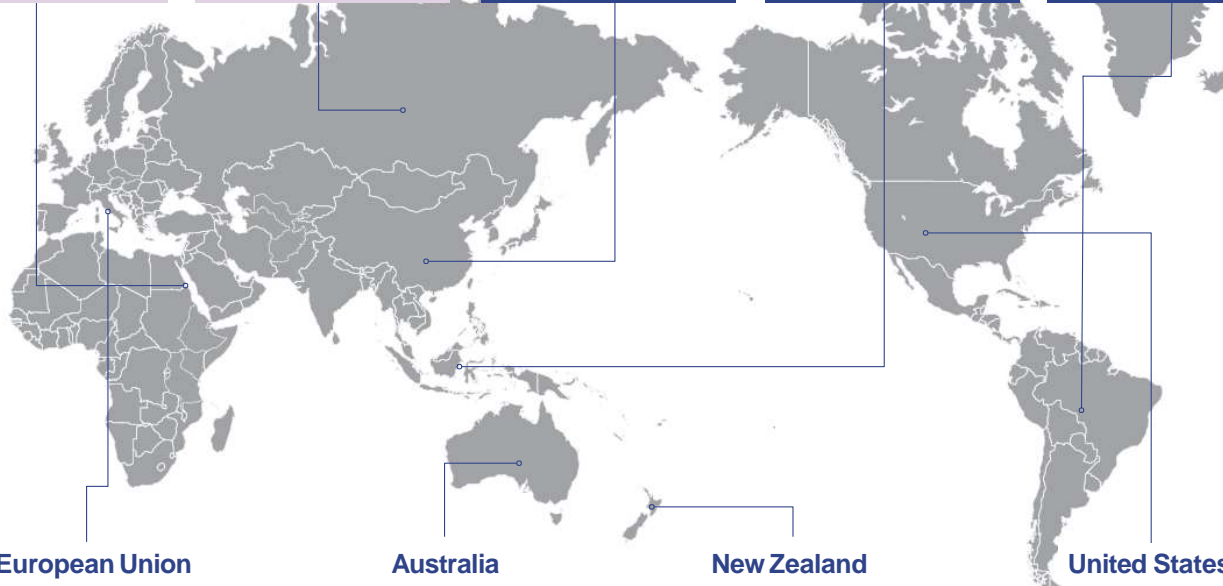
## United States

+ 1%

July MAT  
Global Production

- 7%

June MAT  
Global Exports





# Global overview



## Production

Global production continues to decelerate, as supply starts to rebalance after growing +1.7% during the first half of 2016. Significantly, EU production change has hit negative values (-2%) for the first time in 14 months, as top suppliers experienced contraction. There is potential for further declines as incentives to reduce production come into play from October. The EU Commission has now reduced their growth forecast to +0.9% for 2016, with negative YOY results expected for the rest of the year. Australia continued to see production declines in response to high costs and low milk price. Both NZ and the US saw minor positive growth YOY (+1%). This represents a positive start for NZ as it moves towards a new season, supported by generally favourable weather. In the US, the summer heat has not heavily impacted production. The USDA is forecasting outputs to grow +1.7% for the remainder of 2016.



## Imports

Dairy imports were largely positive this month, with the exception of MEA whose import volumes fell -15% (-53kMT). China July demand grew +9% (+16kMT) continuing a 13-month run of positive YOY growth. This continued to be driven by fluid and fresh dairy, and cheese; with growing interest in milk fats and infant formula. Although milk powder demand remains down, it has been improving. Asia YOY imports were also strong, growing by +7% (+25kMT) in May, where increased demand for fluid and fresh dairy could not counter declines in cheese, lactose and SMP. There are some indications that Japanese cheese demand is bouncing back. Cheese and WMP were key categories for Latin America import growth, which reached +5% in May (+70kMT). Russia imports continue to grow, jumping +25% (+19kMT) in May. Cheese, fluid and fresh dairy, and whey powder still lead demand here.



## Exports

This month's export results mostly mirrored production trends. EU dairy exports slowed in May, with growth back to single digits at +6% (+22kMT) YOY. Cheese and fluid and fresh dairy led exports, whilst SMP unsurprisingly saw the largest declines, with significant volume heading into intervention storage. Australia's June exports fell -8% (-6kMT) in light of continued drops in production. This is largely driven by milk powders, but was slightly offset by smaller volume exports of fluid and fresh dairy, cheese and infant formula. The US saw weak exports, growing just +2% (+4kMT) YOY. Declines here were mainly driven by SMP, lactose and cheese. NZ and EU players are benefitting from the US's retraction from their key butter and cheese markets. NZ's July exports grew +15% (+35kMT) YOY, led by SMP, butter and cheese. NZ WMP exports have been impacted by reduced demand from oil-dependent economies.



## Prices

The GDT Price Index rose +1.7% to reach 913 at TE 172 (20 September), following an increase of +7.7% to 898 at TE 171 (6 September). TE 172 saw 35,086MT sold to 175 winning bidders. Future markets are positive for both WMP and SMP, with prices expected to trend upwards through to March 2017. Despite the recent gains for butter, predictions for the next six months look less optimistic with prices expected to either stagnate or fall. Cheese forecasts were mixed with commentators predicting moderate declines through to minor growth.



## Food commodities

FAO Food Price Index hit a 15-month high in August to reach 165.5 points, up +1.9% from July and +7% from August 2015. Dairy Price Index averaged 154.6 in August, up +8.6% from July. Prices rose for all the dairy commodities that compose the index, in particular for cheese, WMP and butter. These results reflect a significant change in market sentiment, following falling production in the EU, a strong start to Oceania's dairying season and earlier than anticipated tightening of export supply. Skimmed milk powder quotations were subdued, as large EU intervention stocks are a potential source of future supply.

*Source: FAO*



## Weather

Several forecasters were favouring borderline neutral La Niña conditions, as the chances of La Niña developing have continued to drop: 75% in June, 55-60% in July, and most recently 40% in August. At this stage it looks likely that El Niño neutral conditions will develop as the Northern Hemisphere heads into winter. This is supported by lack of anomalies in typical indicators such as winds, convection and subsurface reparations. Sea surface temperatures were cooling, but the pace of cooling has slowed.

*Source: Qualitative assessment; Climate Prediction Centre*





# Global indicators



## Consumer

The EIU trimmed its forecast for global growth in 2016 to +2.1% (formerly +2.2%). Downgrades in the US growth forecast (due to inventory changes) have been a factor. The global growth forecast for 2017 remains unchanged (+2.4%), as are forecasts for 2018-20. Unexpectedly low bond yields in developed markets are pushing investors towards riskier assets, including those in emerging markets. If this continues, capital inflows will improve the economic outlook for these markets. However, many are still struggling due to depressed commodity prices. EIU industrial raw materials and agricultural commodities indices will post their fifth successive year of declines in 2016. This cycle is expected to turn from 2017.

*Source: Economist Intelligence Unit*



## Economic

Composite leading indicators (CLIs) in September point to stable growth momentum for the OECD as a whole, including the US, Japan, Germany and the Euro area. Growth in Canada is also picking up. Easing of growth is expected for France and Italy – who are suffering weakness in growth momentum. Volatility in data has lessened since the UK's referendum. Assuming this is sustained, the UK will likely see slowing of growth, with stabilisation at a lower level expected towards the end of 2016. Amongst emerging economies, the CLIs point to growth picking up in China, Russia and Brazil. India will experience firming growth.

*Source: OECD*

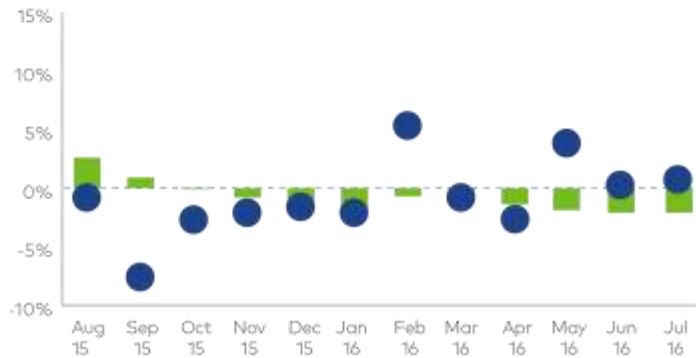


# Milk production in the major suppliers to world markets

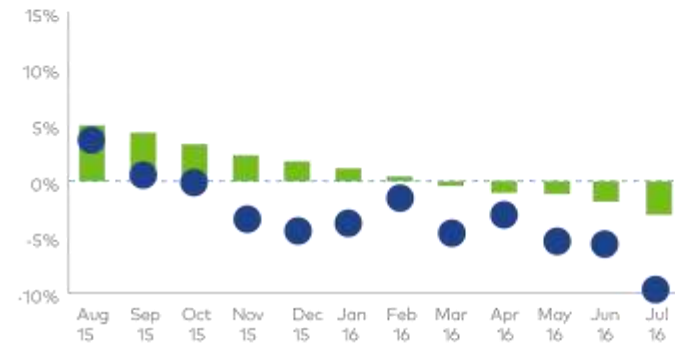
## Legend

- Moving Annual Total
- Year on Year

### New Zealand



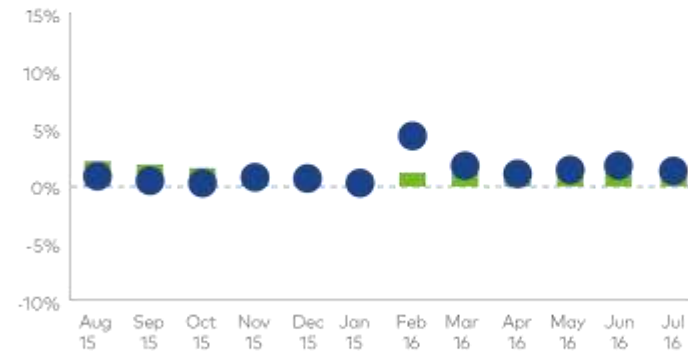
### Australia



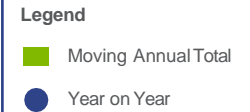
### European Union



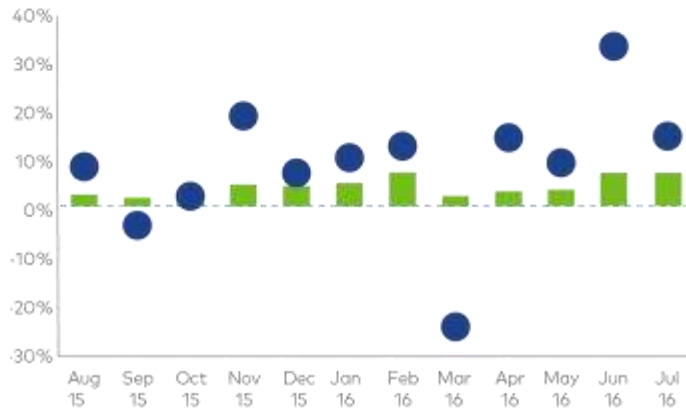
### United States



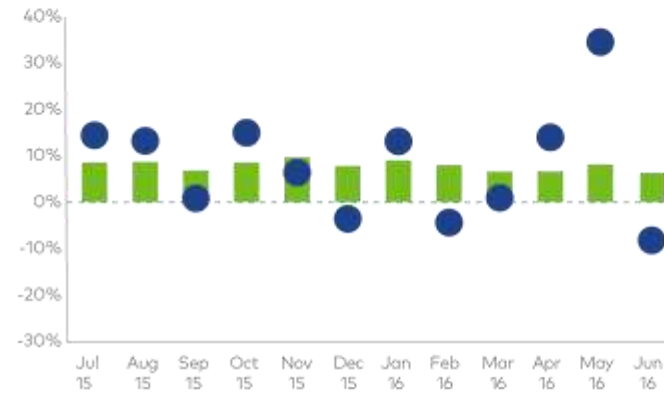
# Exports from the major suppliers to the world markets



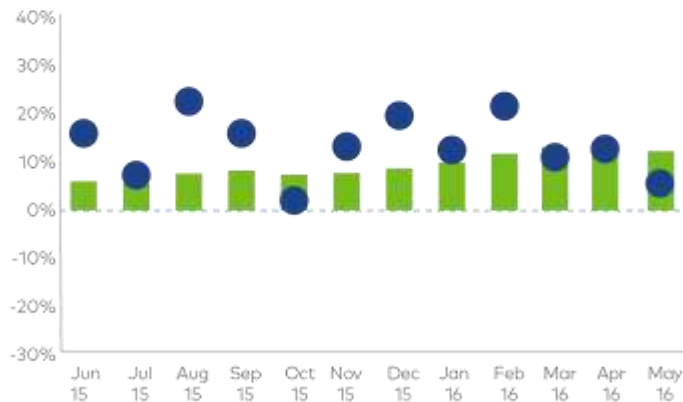
## New Zealand



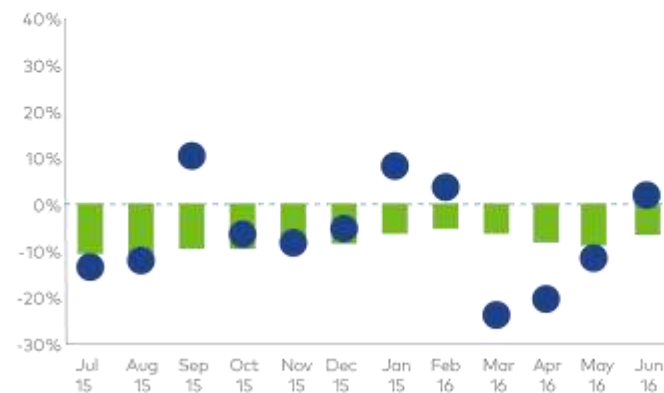
## Australia



## European Union



## United States



# Imports into the major importing regions

## Legend

- Moving Annual Total
- Year on Year

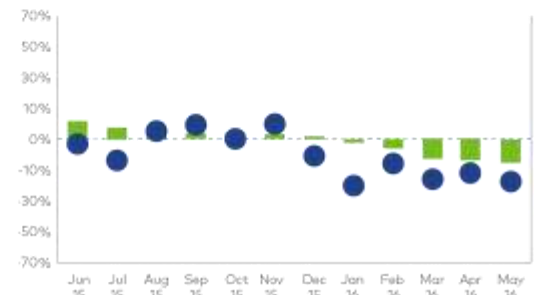
### Latin America



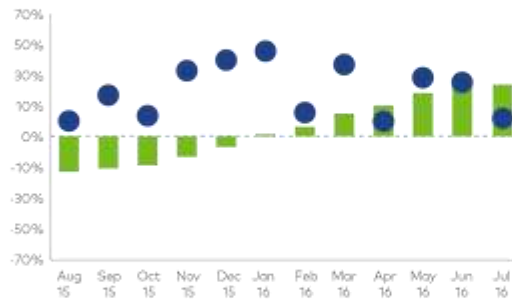
### Asia (excluding China)



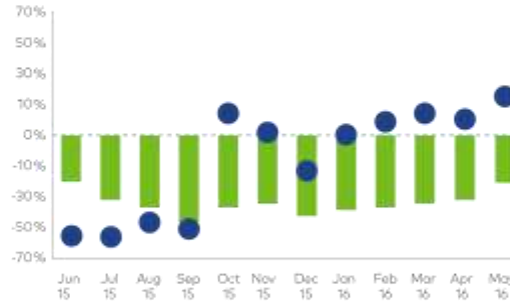
### Middle East & Africa



### China



### Russia

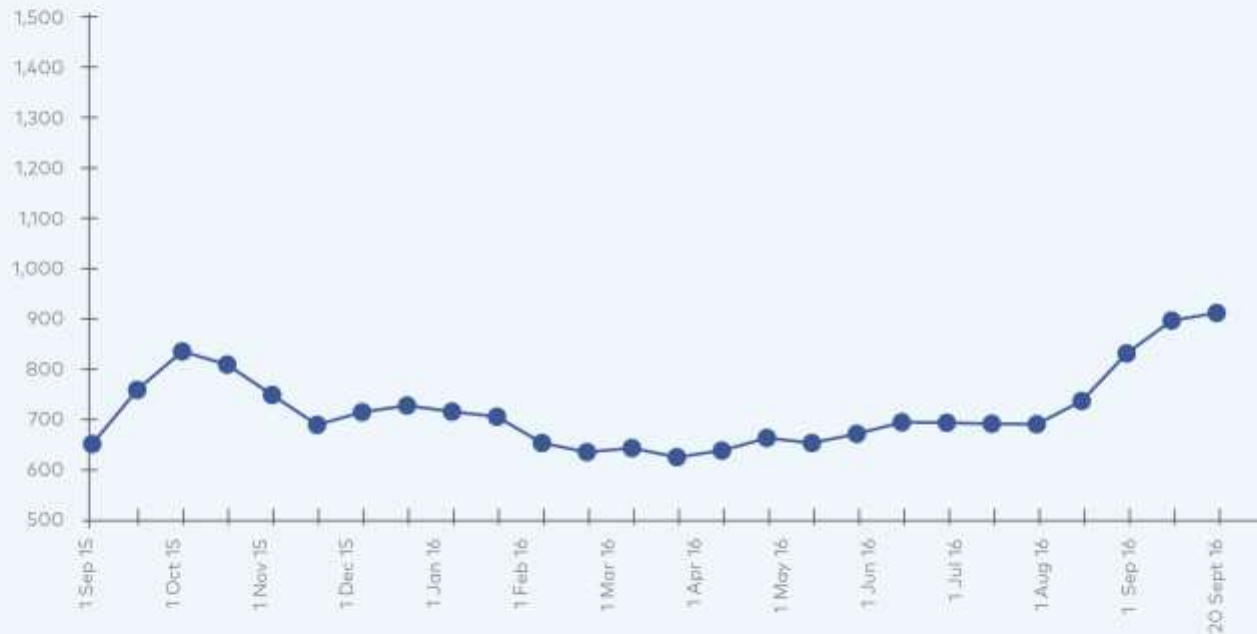






# Commodity prices

## GDT Price Index

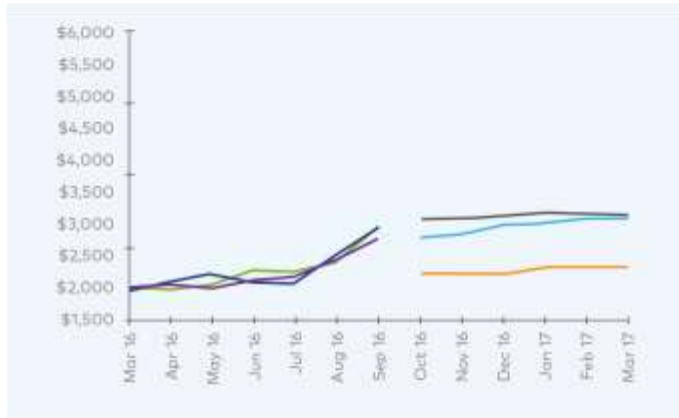


The GDT Price Index has been increasing over September, growing +1.7% to 913 at the conclusion of Trading Event 172 (20 September), following an earlier increase of +7.7% at TE 171 (6 September). TE 172 saw 35,086 MT sold to 175 winning bidders. Results were positive across the board, with the exception of WMP which saw a very minor change of -0.2%. Price growth was led by BMP (+7.0%), followed by AMF (+4.6%), Lactose (+3.7%), butter (+3.6%) and SMP (+3.0%). Cheddar and rennet casein saw more moderate growth at +2.2% and +2.0% respectively.

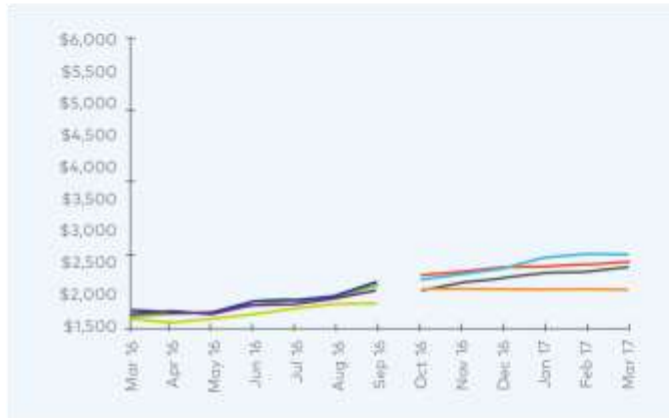


# Commodity prices

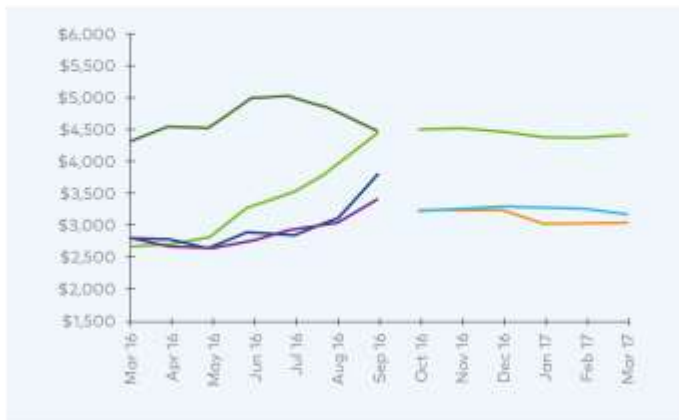
## WMP



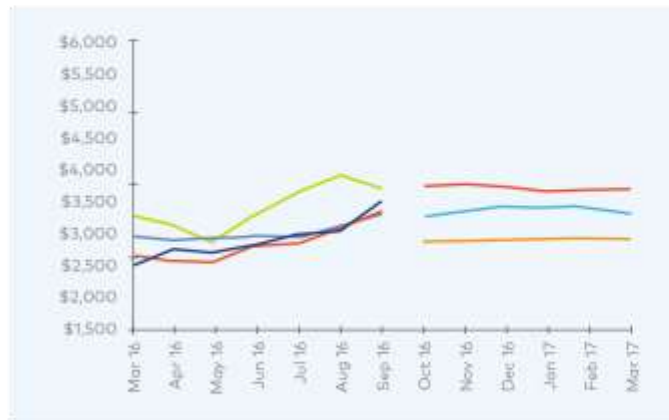
## SMP



## Butter



## Cheese



### Actuals

- GDT Fonterra
- USDA NASS
- USDA Oceania
- Dutch Dairy Board
- CME Spot
- EU Commission

### Forecasts

- NZX Futures
- CME Futures
- Rabobank Oceania
- Informa Oceania



# Updates from other commentators

## USDA, Dairy Outlook

### Recent developments for August 2016

- June milk production was reported at 17.8 billion pounds, up +1.5% YOY. Milk per cow averaged 1,905 pounds, +27 pounds above the same time last year. Milk cow numbers over June were at 9.33 million head, +5k more than June 2015. Future production may be supported by reduced feed prices, which have seen forecasts lowered across the board.
- Both imports and exports increased from May to June. On a milk-fat milk-equivalent basis, imports increased by +22 million pounds, while exports increased by +33 million pounds. On a skim-solids milk-equivalent basis, imports increased by +22 million pounds while exports increased by +85 million pounds. Notably, exports of whey products increased by +11 million pounds from May to June, while exports of NDM and skim milk powder decreased by -3 million pounds.
- Domestic demand for dairy was relatively high in the first half of 2016, +3.0% above the same period in 2015 on a milk-fat basis and +3.9% higher on a skim-solids basis. Both cheese and butter stocks remained high for June, despite a price reduction for the latter. NDM stocks are below the previous year.



# Updates from other commentators

## Dairy Forecasts for 2016

- Although forecasts of cow numbers have not changed, 2016 milk production is expected to lower by -0.3 billion pounds. This is due to the milk per cow forecast falling by -10 pounds and -20 pounds in the third and fourth quarters, respectively.
- Recent imports have favoured products with high fat content, so the 2016 milk-fat basis import forecast has been increased +0.1 billion pounds for the third quarter. The milk-fat basis export forecasts for the third and fourth quarters have been raised by +0.1 billion pounds, driven by WMP. With second quarter imports higher than expected, the annual forecast has been raised by +0.3 billion pounds.
- The forecast for imports on a skim-solids basis is raised by +0.1 billion pounds for 2016. With higher than expected exports of WMP and whey products, export forecasts on a skim-solids basis are raised by +0.2 billion pounds in the third quarter and +0.4 billion in the fourth quarter.
- Stronger domestic cheese demand is expected to lead to lower stocks on a skim-solids basis; skim-solids stocks are now forecast at 13.6 billion pounds the end of 2016.



# Updates from other commentators

## Dairy Forecasts for 2017

- As margins are expected to improve, this could lead to improved quality of feed. The 2017 forecast of yield per cow has subsequently been raised by +10 pounds per head. The milk production forecast now stands at 215.8 billion pounds, +0.2 billion pounds more than July's forecast.
- Imports of products with high milk-fat content are expected to increase, therefore milk-fat basis imports for 2017 are raised to 6.9 billion pounds, +0.2 billion more than forecast last month.
- The export forecast on a milk-fat basis is unchanged at 8.7 billion pounds. With higher butter stocks likely to continue into 2017, milk-fat basis ending stocks are now predicted to be 13.0 billion pounds, +0.2 billion pounds higher than last month.
- Imports on a skim-solids basis are unchanged, but exports are forecast +0.1 billion pounds higher due to larger expected exports of whey products. Ending stocks are forecast -0.5 billion pounds lower, at 13.3 billion pounds. The domestic use forecast for 2017 is raised by +0.4 billion pounds to 184.0 billion.
- As international markets improve and higher demand is expected, 2017 dairy price forecasts for cheese, butter and whey, have risen.



# Updates from other commentators

## Blimling, Forecast Update

September 2016

- Dairy prices in Europe are rallying, particularly for cheese and butter. Whilst SMP prices have also increased, these gains are muted due to heavy inventories. As the EU off-loads its intervention stock, upward price momentum could be impacted.
- In June European milk production fell -1.5% YOY, with early indications suggesting further declines are to come. These changes have been a response to lower milk price, which has been falling since 2015 as commodity prices plummeted. Co-operatives supported milk prices to soften the blow for producers, however it has been inevitable that EU farmers would eventually feel the brunt of globally low prices.
- As commodity prices in the EU start to rebound, milk prices will begin to rise with several co-operatives already announcing higher payouts for September. It is possible milk production will follow, but the EU Commission's voluntary supply management program could limit growth, potentially causing EU milk production to exceed downgraded expectations in 2016.
- Cheese is seeing some healthy holiday demand, which is helping with stocks. Convergence of prices with international competitors is also improving export opportunities, supported by sustained milk production growth, which is keeping supply up - particularly of fresh cheese variants.
- Butter experienced similar increases in demand and export opportunities. Although butter prices are facing downward pressure due to heavy inventories, sustained demand may balance this out.





# Updates from other commentators

## Informa Economics, Global Dairy Report

September 2016

- Although July demand was stronger than expected, it has still been weak compared to long run models. Dairy prices look to be largely supply-driven, with a 3-9 month lag between spot prices and changes in import/export quantities. This means that low dairy prices from Q2 2016 should keep global imports strong through to the end of the year even as spot prices continue to jump. Higher prices will not appear to impact demand until very late 2016, even then the impact will be small.
- Record low farmgate margins are expected to drive EU-28 production down -2% from October through to February. Government incentives to reduce production may drop this further to -3%, however these impacts are likely to be short term. YOY growth is expected to return by April or May 2017.
- Cheese performed better than expected, particularly out of Oceania. YTD cheese imports have been strong, up +4.6%, with most of the volume growth coming from China, US, and Australia. Likewise, butter has performed well at +9.9% YTD, while AMF/butter imports are up +13.1%.
- SMP imports remain weak, but improved slightly. Last month YTD imports were down -75 kMT, this month only down -69 kMT. When prices are advantageous some buyers will shift toward WMP instead of SMP.
- Imports of WMP were up +15.2% from last year. Despite improvement in demand, milk has shifted away from WMP and toward cheese and butter/SMP to take advantage of better returns.





Important note: The information and commentary contained in this 'Perspective from NZMP' is based on publicly available official government statistics; industry association reports; other published industry reports together with data and insights developed by Fonterra's Global Dairy Intelligence group ('GDI'). These sources are identified as appropriate in this 'Perspective from NZMP'. GDI insights and data are derived from a global dairy market model populated by publicly available data. The model inputs and outputs do not reflect Fonterra's non-public production, pricing or sales data. Fonterra Cooperative Group Limited and its group members involved in the manufacture or sale of NZMP branded products ('Fonterra') has provided this 'Perspective from NZMP' for informational purposes only. It does not constitute recommendations or advice for the purposes of making financial decisions regarding trading in dairy products or commodities, or dealing in financial instruments relating to dairy commodities. Although every effort is made to ensure the accuracy of reproducing and interpreting such information, no warranty or representation of such is made and Fonterra shall have no liability in respect of any reliance placed on such information in the formulation of any business decision.