
Market Matters

Impact of China’s New Milk Regulations

As the world’s largest dairy importer, China represents opportunity, but the market is not without its challenges. In addition to being a culturally complex and economically diverse market, the country’s regulatory landscape is ever-changing. Many regulation changes have arisen to address challenges presented by a variety of informal supply chains that have sprung up to service the booming Chinese market. Most new regulations are aimed at addressing internal issues, such as food safety, but the protection of local farmers and manufacturers might also factor into tightening import rules.

Over the past eight years, as China’s appetite for imported dairy has grown, particularly in the wake of the damaging melamine scandal, new measures have been introduced to address food safety concerns and restore consumer trust. Today, dairy imports are overseen by the General Administration of Quality Supervision and Quarantine (AQSIQ) and the China Food and Drug Administration (CFDA), established in 2013 to streamline food regulation and enforcement.

Navigating new regulations

New measures are aimed at addressing widespread counterfeiting and adulteration by improving product traceability, particularly for infant formulas. The government has increasingly required importers to demonstrate control over their supply chains, and registration requirements have helped reduce the number of operators. Strides have also been made to regulate online sales and to crack down on those who purchase products in overseas supermarkets that are shipped to Chinese customers.

The harsher Chinese regulatory environment has also hastened the demise of smaller dairy farms and manufacturers, which are perceived as representing a greater safety risk. Local industry consolidation has been seen as key to improving oversight of local production by cutting down on numerous “backyard operators” looking to cash in on booming demand. A regulatory environment that favors larger, more professional operations has also been seen as a means of raising food safety and quality.

China’s infant formula imports (000 MT)

The infant formula market has been the most challenging for importers. A 2015 update to the Food Safety Law requires foreign manufacturing facilities to register with Chinese authorities. Currently, 78 plants in 19 countries are registered to export infant formula to China with AQSIQ’s Certification and Accreditation Administration. More recently, CFDA announced new measures to ration the number of brands formula importers and domestic producers can offer in the Chinese market to three, based on the three stages of infancy. Recipes for each brand must also be registered along with supporting research.

While many of these measures are necessary and valid, they have caused headaches for dairy importers. In the past, changes often were announced with little warning, and confusion about administrative details disrupted trade. However, the latest move to regulate brands came after significant consultation and a long grace period. The new rules are likely to mostly impact domestic producers, who account for an estimated 90% of the 2,000 brands currently on the market, many with similar “unscientific” formulations selling under multiple labels. This could trigger another round of consolidation in China’s dairy manufacturing sector.
Hoogwegt Forecast

<table>
<thead>
<tr>
<th>U.S. Average Prices</th>
<th>EU Average Prices</th>
<th>Oceania Average Prices</th>
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<tbody>
<tr>
<td>$/ton</td>
<td>$/lb</td>
<td>Trend</td>
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<tr>
<td>SMP</td>
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<td>FCMP/WMP</td>
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<td>Cheddar</td>
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<td>SWP</td>
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<tr>
<td>Lactose</td>
<td>770</td>
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U.S. prices stated ex-works / incl. expected CWT subsidy where applicable; world prices stated FOB main port; EUR/USD: this week 1.110

World Comment

Unfavorable wet weather conditions mainly on New-Zealand’s North Island, combined with reported strong buying from China have pushed WMP prices up strongly in most recent Global Dairy Trade event. Availability of European WMP is still limited and NZX futures are heavily traded at significant premiums, so on the short term no downward correction should be expected. The NFDOM/SMP spot market in the USA is unconvincing with decent availability. CME futures showing a premium for 2017, but current spot prices should allow some sales to the world-market. The European SMP market is still hesitant with a wide range in prices between various origins, brands and age-profile. Spread between SMP and WMP is about USD1000/mt today, which is well above the historical average. Fundamentally, the upside potential in SMP seems significant, but stocks in the whole supply chain and held by EU government could limit price increases.

Global butterfat market remains tight and the downward correction that was expected by some seems unlikely on the short term. Big question for the coming months will be how farmers in the world will react on recovering milk-prices; if milk production comes back quicker than anticipated, the current bullish sentiment can disappear quickly.

Bring it Home

Challenging Regs Could be Good in Long Term

The Chinese food regulatory environment continues to be highly political and dynamic. Food safety remains a fundamental concern for Chinese consumers faced with numerous contamination scares, thus it is imperative that the government demonstrate control and restore trust.

Dairy products—particularly infant formulas—are arguably the most sensitive and highly regulated foods in China, and they are likely to remain so. Past and future rule changes, as well as ongoing uncertainty about implementation, have the potential to add to business logistics costs. However, likely this will not influence demand significantly.

Increased confidence in dairy product safety through a comprehensive regulatory framework along with fewer, but more credible, brands could actually sustain and improve demand for the category as a whole. The latest rule changes are likely to impact local Chinese producers even more than foreign suppliers, whose offerings could be enhanced. To navigate such a challenging market, effective partnerships with distributors and retailers on the ground are vital for dairy suppliers. A comprehensive understanding of the Chinese political and regulatory environment, which allows changes to be anticipated and responses effectively executed, is critical to maintaining and growing market share in China.

Chinese regulators are increasingly looking to food safety authorities in exporting countries to help them develop suitable protocols that meet food safety and quality objectives and who can respond effectively to issues that might arise. An engaged and informed regulator at the point of origin is another key ingredient for a sustainable and successful dairy-exporting platform that can flexibly service China and cope with the inevitable and ongoing regulatory developments.

Did You Know?

China's infant formula imports have increased five-fold between 2007 and 2015, from just under 36,000 metric tons to over 180,000 metric tons.

China has an estimated 103 local infant formula manufacturers, with an average of 18 brands each, but some suppliers have more than 180 brands in their portfolios.

While the European Union has been China’s dominant infant formula supplier for the past decade and a half, its share fell to as low as 14% in 2009 before rebounding to 73% in 2015.

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