



HORIZONS



Insights on Today's Global Dairy Business from the Hoogwegt Companies

Market Matters

South America's Changing Role in Global Markets

The South American dairy sector reflects a diverse combination of dairy exporters and large consumer markets. The continent has a population of 429 million. Almost half of the population lives in Brazil and more than 82% resides in urban areas. How the global dairy industry views South America and its impact on world supplies, continues to evolve.

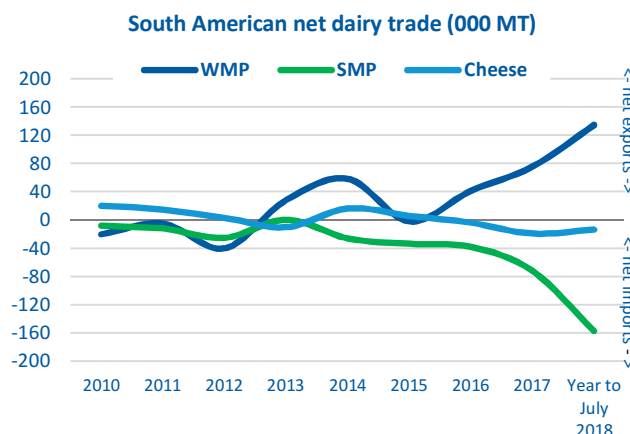
South America is home to countries with considerable milk production potential, but it is also burdened with volatile weather and political fluctuations that have, at times, led to setbacks. For example, last year's La Niña pattern resulted in extremely wet weather and that drove Argentina's milk production 14.6% lower compared to the prior year. Argentina produced 10.1 billion liters (22.9 billion pounds) of milk last year, the lowest annual total in many years and well below the 2012 peak. Neighboring Uruguay, home to just 3.5 million people, produced 1.9 billion liters (4.3 billion pounds) of milk in 2017, 6% more than the prior year but lower than 2013's high. Argentina's and Uruguay's relatively low-cost, pasture-based milk producers can typically satisfy most of Brazil's import requirements. However, annual volumes vary based on the price competitiveness of products from other exporters and the adequacy of Brazil's milk supply. Once touted as a country with promise, Chile's annual deliveries have remained near 2 billion liters (4.5 billion pounds) for the past decade. Brazil, both a major producer and consumer of dairy, reported milk deliveries of 24.1 billion liters (54.7 billion pounds) in 2017, a 4% improvement over 2016.

The Mercosur advantage

Significant internal dairy trade occurs within South America. Brazil, Argentina, Uruguay, and Paraguay are members of the free-trade bloc Mercosur. Several other countries, including Peru and Chile, are associate members and as such are granted tariff reductions when trading with the bloc.

Brazil, with a population of 210 million—five times that of Colombia, the next most populous country—tends to be milk deficit, importing whole milk powder (WMP) to offset changes in local milk availability. Brazil's WMP imports reached a high of

126,000 metric tons (MT) in 2016, a year when weather negatively affected local milk production. Brazil's dairy sector serves internal demand for fluid milk and cheese, but it is also a significant producer of commodity milk powder.



Source: Global Trade Tracker/Global Trade Atlas

Some Mercosur members have created considerable turmoil for other partners, resulting in changing relationships. In 2015, Venezuela was a large importer of WMP, supplied mostly by its Mercosur partners. Since then, Venezuela's financial crisis, which was sparked by slumping oil prices, significantly altered trade and financially damaged Argentine and Uruguayan dairy processors, leading to the expulsion of Venezuela from Mercosur in 2016.

Net external trade from Mercosur, in milk equivalent terms, isn't significant in the context of global trade, but interesting differences exist between major commodities. For instance, WMP exports are expanding, while skimmed milk powder (SMP) imports are rising. Cheese imports are also rising, but to a lesser extent.

Government policies implemented intermittently have attempted to protect farmers and consumers from global market prices. Occasionally, Argentina has resorted to export taxes to discourage trade and protect consumer prices, while Brazil has used import controls to reduce risk for farmers.



Hoogwegt Forecast

	U.S. Average Prices			EU Average Prices			Oceania Average Prices		
	\$/ton	\$/lb	Trend	\$/ton	\$/lb	Trend	\$/ton	\$/lb	Trend
SMP	1.960	0,89	Stable	1.850	0,84	Weak	2.000	0,91	Stable
FCMP/WMP	3.200	1,45	Firm	3.125	1,42	Weak	2.750	1,25	Weak
Butter	5.310	2,41	Stable	5.200	2,36	Weak	4.250	1,93	Weak
Cheddar	3.660	1,66	Stable	3.750	1,70	Weak	3.600	1,63	Weak
SWP	1145	0,52	Firm	975	0,44	Stable			
Lactose	770	0,35	Stable	900	0,41	Stable			

U.S. prices stated ex-works / incl. expected CWT subsidy where applicable; world prices stated FOB main port; EUR/USD: this week 1,157

World Comment

Milk prices in all major milk production area's are profitable so many market participants expect milk production to be quite good in the months ahead. Especially New Zealand is having a very good start of the season and has increased available volumes significantly, mainly for WMP, which has caused NZ prices to move down over the last weeks. Global demand for FCMP outside China has been modest.

In Europe there are still quite some concerns about available silage due to the spell of dry, hot weather over the summer months; effect of this will only be seen early 2019 though. Global fat market is under pressure; both for butter as well as for Cheese. The SMP / NFDM market has 2 sides; USA and NZ are stable at quite healthy levels, whereas EU market remains by far the most competitive origin and it seems unlikely that prices will move up sharply in the short term. However, in the mid term this spread will have to correct itself; big question of course is if EU will move up or NZ/USA prices will come down. SWP in USA is exceptionally tight, mainly as more and more liquid whey is flowing to WPC80 production.

Bring it Home

Net Imports Increasing in South America

Brazil and Argentina have been experiencing deepening economic crises as they struggle to manage rising public debt and inflation. Argentina's peso has lost close to 50% of its value against the U.S. dollar this year, and regional interdependencies have dragged down Uruguay's peso. Stronger export earnings and rising domestic inflation have driven up milk prices paid to Argentine farmers by 30%, but feed, fuel and other input costs have also increased, maintaining pressure on margins.

South American dairy producers will likely continue to juggle challenging economics for some time, but for now, better weather appears to be driving a recovery in milk supply and external trade across the region. More favorable weather has helped both Argentina and Uruguay increase milk production by close to 7% in the first seven months of 2018. Brazil's output rebounded through April 2018, but then poor weather and a transport strike caused output to decrease.

The ebb and flow of South America's milk supply continues to

find its way into world markets. Brazil's faltering milk output in mid-2018 sparked a revival of WMP imports, and the Argentine peso's slump against the Brazilian real could encourage even stronger dairy imports in Brazil. At the same time, recovering oil prices boosted Venezuelan SMP imports from Mexico, while weaker South American currencies likely helped boost Argentina's and Uruguay's year-to-date 2018 WMP exports to more than 80% and 26%, respectively, compared to 2017. Both countries saw significant sales increases to North Africa.

A strategic study commissioned by the U.S. dairy industry a decade ago hypothesized that South America could be a competitive threat to global dairy exporters due to its low-cost, pasture-based systems. However, the study might have overlooked what have been insurmountable setbacks caused by economic instability, negative weather due to climate change, and a lack of investment in infrastructure. At the same time, though, South America has been a notable importer of dairy products—something the study did not even consider.

Did You Know?

Brazil produced close to 34 billion liters (77.3 billion pounds) of milk in 2017, making it the world's fifth largest milk-producing country.

Mexico exported 103,000 MT of SMP to Venezuela in the first seven months of 2018, compared to 29,000 MT in 2017, according to Mexican customs data.

In September 2018, Argentina's government announced that an export tax of 4 pesos per U.S. dollar would apply to all agricultural goods including dairy products.

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