



HORIZONS

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

Market Matters

U.S. China Trade War⁺ Benefits Oceania and EU⁺

In mid-June, U.S. dairy markets awoke to news that the United States and China had made their final revisions to \$50 billion in trade tariffs. China focused 38% of its targeted tariff effort on U.S. agriculture, with a 25% retaliatory tariff placed on all dairy products. The news kicked off a bout of lower spot prices in the United States, which lingered through July 6, the day the tariffs became effective. But that was just the start.

On July 10, the Office of the U.S. Trade Representative (USTR) announced an additional \$200 billion in Section 301 tariffs against China. In return, China delivered its next list of retaliatory tariffs, which included lactose, whey protein concentrates (WPC) and isolates (WPI), infant formula, and casein/caseinate. These tariff increases were more moderate than the first round, ranging from 5% to 25%, and suggested that U.S. supply could be challenging for China to replace. The second round of tariffs took effect on Sept. 24.

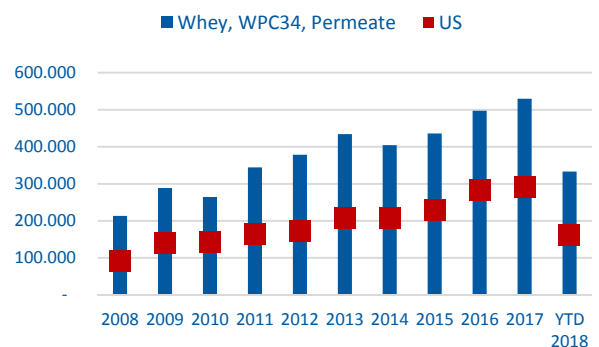
Escalating tariffs

The Trump Administration has since threatened additional tariffs on more Chinese goods, and some U.S. dairy groups believe that China could further raise tariffs on U.S. dairy products. Some believe the U.S. negotiating tactic is an attempt to weaken China's economy to bring it to the negotiating table. The tactic could be succeeding. Recent reports indicate that China's economy has slowed, and at the end of October, the yuan had reached its lowest level in a decade. However, the trade war has spread beyond U.S. and Chinese borders and appears to be negatively impacting other Asian currencies and economies. Several countries have just released dairy trade data for September that show the trade war could be causing a widespread slowdown in trade as dairy products become more expensive in dollar terms and consumer confidence begins to show signs of weakness.

After years of working to develop relationships in China's highly coveted dairy market, which is clearly dominated by processors in Oceania and Europe, the United States started to make significant advances. While the United States is unlikely to dislodge New Zealand as China's largest supplier of milk powder,

U.S. manufacturers have been successful in China's expanding whey protein market. China's whey imports have grown at an 11% compound annual growth rate over the last decade, with a lot of that growth propelled by feed uses. But estimates based on reports from trade partners suggest that China's whey imports through September could be 16% lower than a year ago on decreased volumes from the United States, with higher volumes from Europe offsetting some of the U.S. declines. For the January through September period, U.S. exports to China of whey protein concentrate (WPC) with 80% or higher protein increased 26% despite modest tariff increases. Given China's rising WPC demand, current tariff levels are unlikely to negatively impact U.S. suppliers.

China's whey imports (MT)



Source: GTIS and Ceres

As the end-of-year holiday demand season winds down, the U.S. dairy industry could be sitting on significant dairy product supplies, and prices are already well below those in competing regions. European and Oceania dairy companies, despite being free-trade oriented, could struggle to keep from being pulled into the swirling vortex of declining prices created by the U.S.-spurred trade wars. But the cost will be even greater for the United States. Without a clear definition of success, the United States could end up with ineffective policy for decades that favors European and Oceania dairy processors.

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Hoogwegt Forecast

	U.S. average prices			EU average prices			Oceania average prices		
	\$/t	\$/lb	Trend	\$/t	\$/lb	Trend	\$/ton	\$/lb	Trend
SMP	1.985	0,90	Stable	1.710	0,92	Stable	2.035	0,92	Stable
FCMP/WMP	3.420	1,55	Firm	2.900	1,31	Stable	2.700	1,22	Weak
Butter	5.500	2,49	Stable	5.015	2,27	Firm	4.050	1,83	Weak
Cheddar	3.440	1,56	Stable	3.590	1,63	Stable	3.700	1,67	Weak
SWP	1080	0,49	Stable	820	0,37	Weak			
Lactose	770	0,35	Stable	730	0,33	Stable			

U.S. prices stated ex-works / incl. expected CWT subsidy where

applicable; world prices stated FOB main port; EUR/USD: this week 1,189

World Comment

It's business as usual at the global supply side of the dairy market. New Zealand is in the middle of a strong milk season with favorable farmgate prices. Growth in the US seems to be consistent with mixed comments on farm economics. Until now there doesn't seem to be a strong trigger for contraction. In Europe, the Q4 figures will be interesting to see as these will show how serious the silage shortage is. Until now, there is not much cause for concern. Worldwide demand is steady, although growth figures fall short of 2017 percentages. Pipelines have been filled in 2017 and with current favorable protein prices and more reasonable fat prices, import markets like to keep these pipelines filled. China's milk production is expected to decline in 2019, resulting in additional import demand. There are no signs of shortage yet, as WMP market prices declined significantly this week. European butter prices have stabilized but are well above world market levels. Protein prices are rangebound with EU origin still most competitive, due to continuous intervention sales by the European commission. With farmgate prices favorable and prices workable for end users, the market seems to have found some balance.

Bring it Home

U.S.-China Trade War Affects Other Dairy Buyers

U.S. financial markets are expressing concern over a domestic trade policy that seems to lack direction, is driving up costs, and cutting into corporate profits. At the end of October, U.S. stock markets erased all of the gains they accrued in 2018 as the United States threatened to intensify its trade war with China. A prolonged dispute increases the risk that the global economy will weaken.

Financial disaster also looms for U.S. farmers. Domestic prices have collapsed, and forecasts indicate farm incomes, on an inflation adjusted basis, could drop to 15-year lows. The multi-front trade war, which has no end in sight, has created an oversupply of agricultural products and placed export markets out of reach for U.S. producers. To garner support in America's heartland for what appears to be an unwinnable trade war, the Trump Administration announced it would provide \$12 billion (U.S.) in subsidies to U.S. farmers hurt by retaliatory tariffs. But the administration's attempted goodwill has fallen far short of actual losses.

On-farm losses for U.S. dairy this year will hit an estimated \$1 billion, far exceeding the \$112 million in subsidies provided to dairy. In late October, U.S. dairy trade groups asked for additional monies to help struggling producers, many who could be out of business by the end of this year. While the United States sees good reason for its position, Chinese consumers also feel justified in their support of their government's actions, a sentiment that could result in fewer sales of U.S.-made goods in China.

The next wave of the trade war appears to be building and is poised to crash over participants and bystanders alike. As the United States pushes hard on China's economy, other Asian nations' currencies are declining, slowing dairy trade. At the same time global milk output expands, demand could slow, depressing prices further. If November talks between presidents Donald Trump and Xi Jinping fail, Bloomberg reports that those close to the issue say the United States will announce more tariffs in December.

Did You Know?

In 2017, the United States was the largest supplier of whey and permeate to China. That year, China imported 55% of its whey needs from the United States.

Most, 93%, of China's alfalfa imports originate in the United States, and higher alfalfa costs in China have led to increased costs on large dairy farms, particularly in South China.

In 1997, China ranked 26th in global cheese imports with just over 235 MT. Last year, China ranked 7th, importing 108,000 MT.

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