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Market Matters

Dairy Exporters to Face Multiple Challenges in 2019

As 2018 winds down, milk production in major dairy-exporting regions has slowed to a 1% gain over the prior year and dairy trade has picked up. Most of these regions face significant challenges heading into 2019. Fallout from U.S. trade disputes with China and Mexico has created significant financial stress for U.S. dairy farms. Weakened economies in Asia, financial turmoil in Latin America and persistent drought in Australia continue to threaten dairies there. At the same time, stable conditions in New Zealand, and to some extent in Europe, ensure world milk production will likely continue to grow in 2019—at least in the near term.

This past summer, severe drought throughout much of Europe decimated pasture growth and forage production, pushing EU-28 milk production below 2017 levels in September. Limited forage supplies in some areas of the EU-28 is expected to pressure second-half 2018 output 0.3% below year-earlier levels. In 2019, the European Commission expects fewer cows coupled with higher output per cow to drive milk production to 167.9 MMT, up 0.8% from this year's level, with the additional milk manufactured into cheese, up 1.5%; butter, up 1%; and skim milk powder (SMP), up 0.3%.

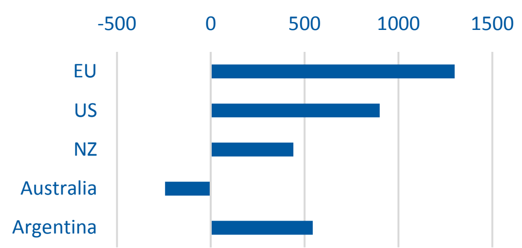
U.S. trade issues worsen on-farm stress

In the United States, milk production continues to grow despite significant on-farm financial stress, caused in part by ongoing trade tensions with China as well as a surplus milk supply. U.S. dairy producers have been sending milk cows to slaughter at an astonishing pace, yet due to 20-year lows in replacement heifer costs, U.S. producers milked 9.365 million head in October, slightly more than in October 2017.

Next year, USDA expects total milk production to reach 220.9 billion pounds (100.2 MMT), up 1.4% from this year's 217.9 billion (99.3 MMT), but that could be an aggressive forecast given current on-farm economics. U.S. cheese stocks are more than 9% larger than last year, but new cheese production capacity will draw milk solids into vats again next year. U.S. cheesemakers are hopeful that the government will soon lift tariffs on Mexico, spurring Mexico to eliminate retaliatory tariffs on U.S. cheese.

New Zealand producers are having a normal spring for a change, with good pasture conditions supporting an early surge in milk production. For now, milk prices remain above $6/kg of milk solids (NZ), and low-cost feed reserves are abundant. However, operating costs are higher this season than last, and with milk production climbing, prices could fall short of current estimates. At the same time, limits on the use of palm kernel expeller will increase supplementary feed costs in the shoulder of the season. In addition, a recent report from the Reserve Bank of New Zealand suggests new loans to agriculture could be limited in 2019.

Expected YOY changes in milk output in 2019 (MT)



Source: EC, USDA, Dairy Australia, and Freshagenda

The milk supply in Australia's southern export regions has been severely affected by dry conditions and margins remain under pressure due to poor pasture growth, increased feed grain prices, and high irrigation water costs. An expected El Niño could make bad conditions even worse. Dairy Australia expects milk collections for the full 2018-19 season to drop 6% below the prior season—a level not seen since the mid-1990s. More stable weather and improved milk prices have lifted milk collections in major milk-producing countries in Latin America this year. However, in Argentina, economic turbulence, rampant inflation, and a plunging currency could deepen on-farm losses and limit growth. While WMP exports from the region surged in 2018, the region's role in the world markets next year is uncertain.

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Hoogwegt Forecast

	U.S. Average Prices			EU Average Prices			Oceania Average Prices		
	$/ton	$/lb	Trend	$/ton	$/lb	Trend	$/ton	$/lb	Trend
SMP	2.050	0,93	Stable	1.990	0,90	Firm	2.080	0,94	Stable
FCMP/WMP	3.420	1,55	Stable	3.175	1,44	Stable	2.750	1,25	Firm
Butter	5.340	2,42	Stable	4.900	2,22	Stable	3.850	1,75	Stable
Cheddar	3.240	1,47	Stable	3.550	1,61	Weak	3.500	1,59	Weak
SWP	1060	0,48	Stable	965	0,44	Firm			
Lactose	770	0,35	Stable	965	0,44	Firm			

US prices stated ex-works / incl. expected CWT subsidy where applicable; world prices stated FOB main port; EUR/USD: this week 1,138

World Comment

After a long period of relative quiet markets and slow business, global dairy market seems to have woken up. Last GDT showed price increases for almost all products. And, where NZ SMP price increases were modest, we saw SMP market in Europe making decent steps up. European smp now trading at or above Oceania levels. Both fresh product and intervention smp remains tight and it is expected to remain so for the foreseeable future. Both internal EU as well as global demand seems to outpace supply and all future markets for NFDM/SMP show a fairly strong premium for the deferred months. NZ WMP might have seen the bottom and moved up for the first time since last July. The Cheese market is showing different signals and might need to move lower before buyers step in again. Fact is that the milk production in USA and EU has not been overly strong in recent months and with New Zealand season being over the peak some further price increases could well be possible. On the other side; we are approaching the holiday season in big parts of the world with traditionally less business being concluded, so again an interesting period ahead of us!

Did You Know?

While 2018 global trade in SMP through September has expanded by just 2.2%, U.S. exports surged 16%, while New Zealand exports tumbled 8%.

Argentina will launch a cash-settled raw milk futures contract on December 15 in an effort to help both producers and farmers protect themselves from price volatility.

EU Intervention stocks of skim milk powder (SMP) continue to decline, and the European Commission has indicated that it will not be buying product in 2019. Thus, even if the open period for Intervention is extended, as proposed, it will not pose a risk to the market.

Bring it Home

Low Prices Could Spur More Dairy Demand

The global economy is showing signs of weakening. Europe, the United States and China all face a rising threat of an economic slowdown. While few economists are predicting a global recession in upcoming months, risks to the world economy remain, including the ongoing trade war between the United States and China, continued conflict over Britain's exit from the European Union, and deflating crude oil prices—all of which could impact dairy demand.

Southeast Asia remains a key growth engine for milk powders and cheese, but a stronger U.S. dollar and the ongoing U.S.-China trade dispute have battered the region's economies. Reduced overall trade between the United States and China has added to an economic slowdown in China, New Zealand's top trading partner. New Zealand is a large producer of whole milk powder (WMP) and with WMP prices attractive, China is expected to increase imports through the peak import period as domestic milk and powder production slow. China continues to expand fresh milk production at the expense of other dairy commodities.

Uncertainty surrounding the implementation of Brexit is dragging on, and ongoing political debate within the United Kingdom hangs over the EU market. A "no-deal" outcome would not only cause financial market uncertainty, but also disrupt significant cheese trade into the United Kingdom in 2019. The sudden crash in oil prices has created uncertainty for economies in the Middle East and North Africa (MENA) region. Given rising geopolitical tensions, a recovery in oil prices could prove difficult, yet ongoing gains in dairy import demand from the MENA region will be critical to an overall market recovery.

Currently, weak global dairy product prices prevail, but the future direction of commodity prices is mixed. While strong growth in New Zealand milk production and heavy SMP inventories in the European Union and the United States weigh on markets, attractive prices for nearly all dairy products should continue to stimulate growth in dairy demand.

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