

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

Market Matters

Dust Finally Begins to Settle on Brexit

More than seven months have passed since the Brexit transition period ended on Dec. 31, 2020, the day the United Kingdom formally exited the European Union customs union and single market in accordance with the UK-EU Trade and Cooperation Agreement. The changes marked the end of frictionless trade between the European Union and United Kingdom, as well as the freedom of movement of workers. Prior to that, on Jan. 31, 2020, the United Kingdom left the European Union's political institutions, including the European Parliament and European Commission.

Since then, robust debate has occurred on the potential lasting effects of Brexit on the UK economy. While the UK economy is expected to see employment losses in certain exposed services and trade-dependent sectors, access to free movement of labor across the European Union is expected to cause worker shortages in many sectors including foodservice and agriculture.

Effects on Trade Considerable

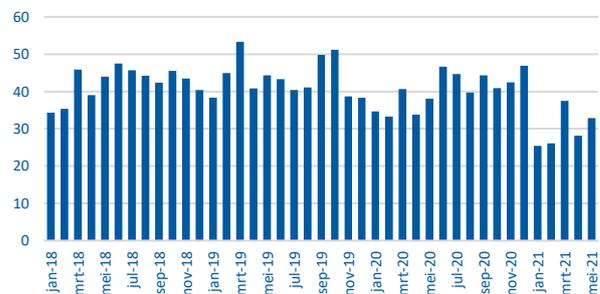
In addition to logistic costs and delays in documentation, the ongoing impacts on cross-border trade between the EU-27 and United Kingdom are considerable. The effects of Brexit alone on the UK dairy sector have been masked by COVID-19, which in the first half of this year has been more disruptive to the United Kingdom relative to other parts of Europe, given the severity and length of lockdowns required to quell the virus.

Sustained strength in grocery channel sales due to COVID restrictions has helped to keep the United Kingdom's dairy market relatively calm. Wholesale markets made a quick recovery and have been relatively stable since the initial shock of COVID's arrival in early 2020. Cheese and butter prices steadily improved in the first half of 2021 to exceed 2019 prices. And while favorable seasonal conditions in spring brought stronger milk production growth, the market absorbed it as demand improved.

Lower year-over-year commodity imports have also contributed to the stability. Year-over-year UK cheese imports, almost entirely from the European Union, were down 17%, or 30,000 metric tons (MT), in the first five months of 2021, due not only to

the closure of restaurants but also to the increased cost of trade. However, UK cheese exports (mostly EU-bound and largely specialty lines) plunged 47% over the same period and by a volume similar to the loss in exports. However, the mix of product types between these trade flows differs, and specialty cheese exporters have been adversely affected by the changes.

Monthly UK cheese imports ('000 MT)



Source: Global Trade Tracker

Meanwhile, 2021 UK butter imports have dropped nearly in half, while exports have slowed to a trickle. The post-Brexit lull in trade has been deep due to the building of stocks that occurred prior to the end of 2020. For perspective, between June 2020 and May 2021, UK cheese imports were down just 7%, while exports fell 18%. Over the same period, butter imports fell 16%, and exports, which likely will continue to weaken, plummeted 49%.

Some of the more complex consequences of Brexit are yet to be resolved. The cross-border movement of goods (including bulk milk and dairy products) between Northern Ireland and Ireland, while meant to be frictionless, include potentially unworkable measures and threaten to revive historical political tensions.

Part of the United Kingdom's rationale for leaving the European Union was to find its own opportunities in the trading world. The country has already signed a deal in principle with Australia (the first) and talks with New Zealand and the United States are underway with potentially large consequences for dairy trade.



Hoogwegt Forecast

	U.S. Average Prices			EU Average Prices			Oceania Average Prices		
	\$/ton	\$/lb	Trend	\$/ton	\$/lb	Trend	\$/ton	\$/lb	Trend
SMP	2,750	1.25	Stabel	2,975	1.35	Firm	3,100	1.41	Stabel
FCMP/WMP	3,975	1.80	Firm	3,675	1.67	Stabel	3,600	1.63	Stabel
Butter	4,200	1.91	Weak	4,700	2.13	Firm	4,900	2.22	Firm
Cheddar	3,850	1.75	Stabel	4,250	1.93	Firm	4,300	1.95	Firm
SWP	1200	0.54	Weak	1,200	0.54	Stabel			
Lactose	975	0.44	Weak	1,075	0.49	Stabel			

U. S. prices stated ex-works/including expected CWT subsidy where applicable; world prices stated FOB main port; EUR/USD: this week \$1,175.

World Comment

In last months' issue we spoke about a more equal playing field between the bulls and the bears. In the todays market we see that the market direction and sentiment strongly differs per region. Although the market is typically very calm during the summer holiday period we now see in Europe a fairly firm market, mainly caused by the disappointing milk production, both in volume as in protein and fat-values. This lower output is mainly caused by weather, but as well by high feed prices. The Southern Hemisphere is expected to have a strong start of the new season, both in Oceania and Latin – America circumstances are very favorable.

On the demand side we see that China and South-East Asia (SEA) are, again, suffering from strong government restrictions after number of COVID-19 cases have increased. Some the SEA countries expect that the import / consumption of dairy products could drop up to 30%. Chinese buyers reportedly already covered a decent share of their Q4 needs and local stocks could slow down import needs for the coming months. Middle – East and North African buyers are expected to come back in the coming months after a slow first half of 2021.

Logistical constraints are adding even more uncertainty to the global dairy market dynamics and price direction remains very uncertain.

Bring it Home

Easing Restrictions Mask Brexit's Impact

Recovery in the overall UK economy from the effects of COVID will be uneven. It could be several years before COVID is beaten in the United Kingdom—if at all. The UK government has taken a high-risk approach to juggling health and the economy, aggressively reopening society without restrictions and relying instead on a high percentage of its population to be vaccinated. Major forecasters expect the economy to reach pre-COVID activity in first-quarter 2022.

The possible emergence of new variants of the virus that are less responsive to existing vaccines is still a major source of uncertainty. The recovery in UK consumer spending has been strong in recent months, which continues to mask the effects of Brexit on trade. In July 2021, food-related spending returned to 2019 levels, according to Fable Data based on credit card outlays. The positive impact from the rush of many to dine out after months of restrictions, however, will quickly wear off.

A job support scheme that included furlough subsidies to save people from being fired has cushioned the effects of COVID on the UK economy. This support will end in September, and when its influence wears off, further employment losses are expected, possibly weakening household spending. Many economists expect weaker household spending to tip the economy into an economic slowdown due to these employment losses and rising costs for logistics, energy, and labor.

In addition, the UK dairy industry continues to face requirements similar to those the European Union has imposed on its farms to limit environmental footprints and uphold impeccable welfare standards. Meanwhile, UK producers are dealing with shortages of labor and the higher costs of inputs resulting from separation from the European Union, and that will make future growth harder to sustain.

Did You Know?

Weaker dairy trade, coupled with stronger milk collections in spring 2021, have improved the United Kingdom's self-sufficiency in cheese and butter.

The UK-Australia free trade deal provides Australia immediate access to a duty-free quota to the UK market for 24,000 MT of cheese, which rises in equal yearly installments to 48,000 MT in the fifth year of the agreement

Ireland's exporters have been most affected by a slump in 2021 cheese trade, accounting for just under 50% of the European Union's total drop in sales in the first five months of the year.

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