Horizons.

Our insights on Today's Global Dairy Business

January 2023

#01

Editorial Note.

Ah, January –

A new start, a brand new year, and for many, the harsh reality of a reset of budgets and new performance indicators amidst the challenging Dairy market.

For many, 2022 was headlined by key phrases like "Re-Opening!" followed by "Zero-Covid for China" and then "Where's Chinese Demand?", to "Falling Prices"...

As we slowly awake from the festivities of Christmas and the New Year, one cannot help but wonder – what does 2023 entail?

Join us in our January issue of Hoogwegt Horizons, where we will dish out our usual "Market Direction" and "Deep Dive" sections.

In this issue, we have included two new segments talking more about the Whey Complex and a bit on the Futures Market, with contributions from our Global Whey (SWP, Lactose & Permeates) Lead John Kramer, and Director HTM Americas Adnan Mikati.

Also, on the "World Comment" section, we have Mona Dierkes from Hoogwegt Cheese talking about her experience as a female dairy trader!

Here's to a new year, new resolutions and breaking new boundaries!

Cheers!

Sincerely,
Hoogwegt Horizons Editorial Team

Market Direction

Eu Milk Production Is Key For Global Supply Strength In Q1.

Some EU processors are already starting to lower their milk prices in response to the rapid fall of dairy commodity prices.

Processors that have more of a retail focus than a commodity focus however will possibly be able to sustain the current milk price levels of on average around €0.55/kg a bit longer. It will therefore be questionable if dairy farmers will be discouraged from producing to the max in the upcoming season. The uncertainty on the input side of things – energy, fertilizer and feed grains in particular - may limit their risk appetite to some extent, but adverse weather may be the only real developments that can prevent a very strong peak season in Q2 of 2023.

In the other key export regions of Oceania and the US the incentives to push the pedal to the floor are apparently absent. US production is expected to cruise at a stable 1.5 – 2.0% in the new year since the elevated feed prices prevent stronger growth and the Oceania season appears unable to produce a positive number this year. So, a lot depends on milk production in the EU, but at this point in time the region seems capable of providing some more comfort for buyers.

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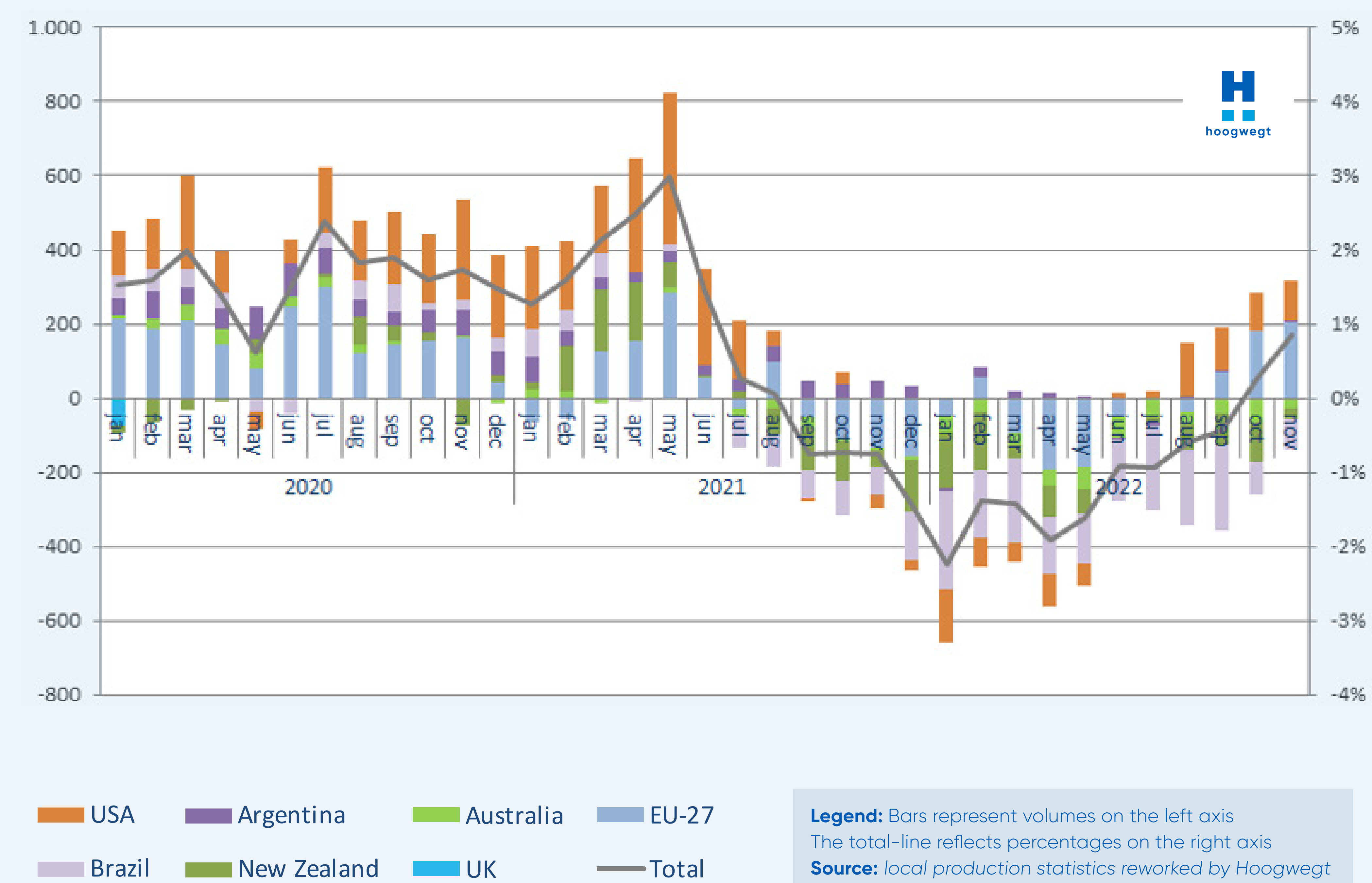
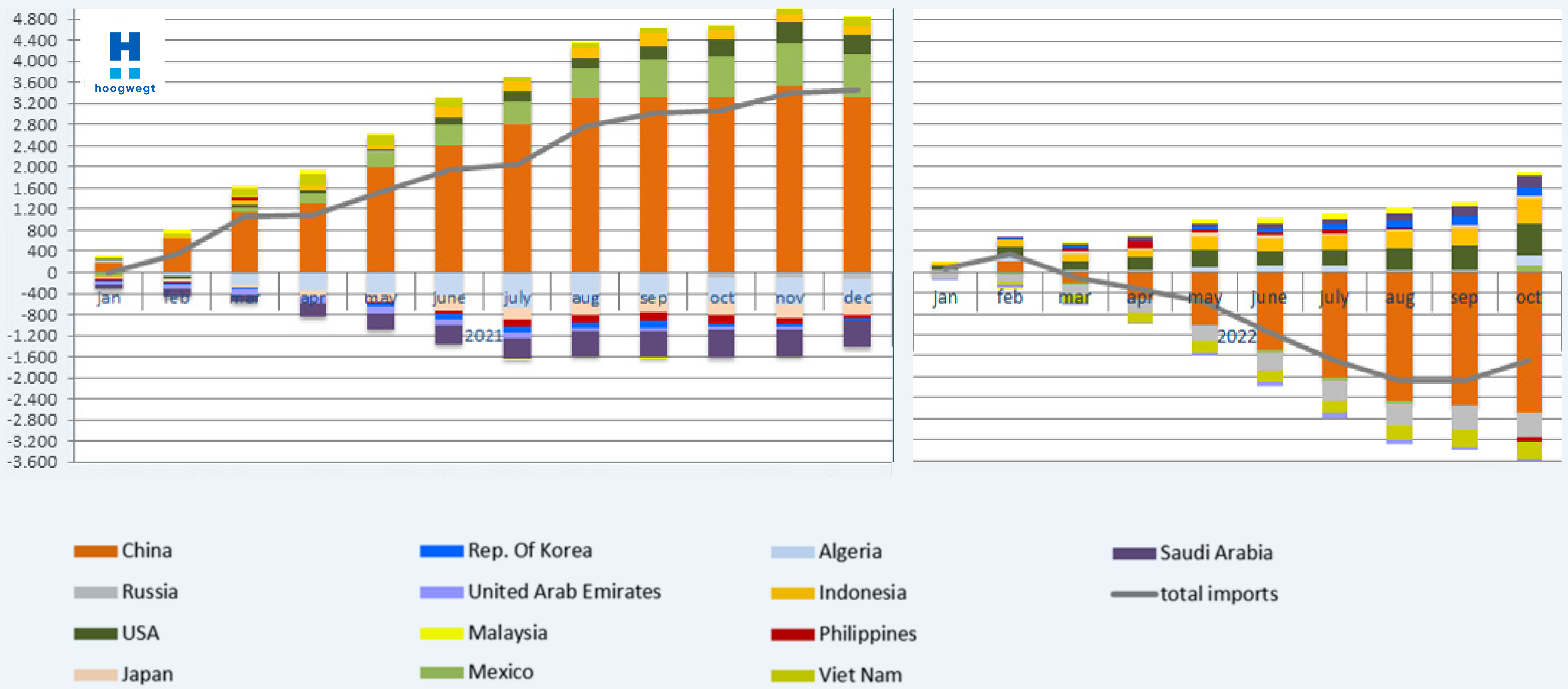
Milk supply growth in key exporting regions (Y-o-Y change, 1000t)



Legend: Bars represent volumes on the left axis
The total-line reflects percentages on the right axis
Source: *local production statistics reworked by Hoogwegt*

Imports by the big-13 importing countries (cumulative change compared to previous year, total imports in 1000t of MEQ)



NB: The graph displays monthly cumulative changes in import volumes compared to last year for each single country. The grey line is the total cumulative change compared to last year for all 13 countries combined

Source: Dairyntel trade data, reworked by Hoogwegt

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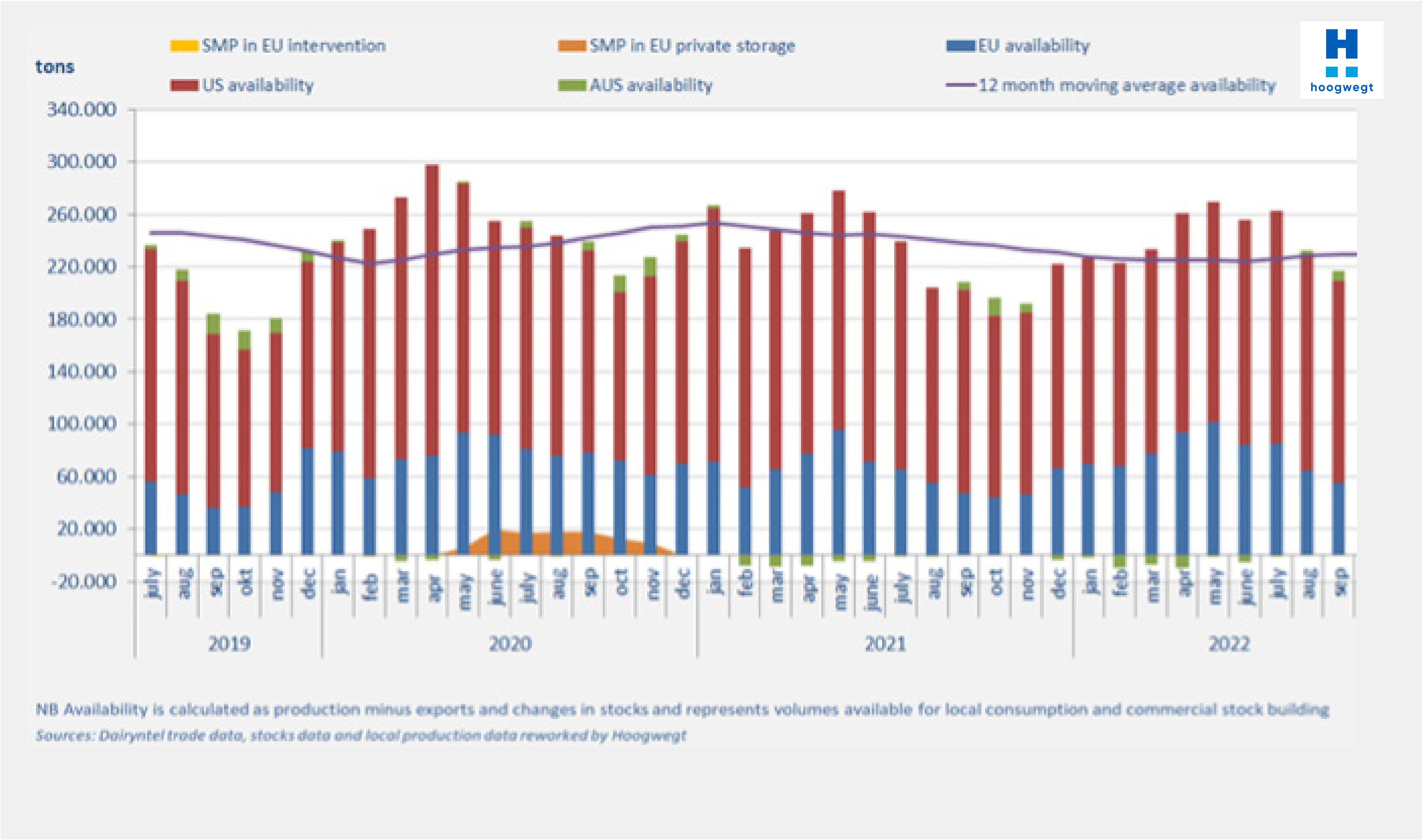
It is quite interesting to see that the total line of aggregated imports in the graph below strengthened considerably despite China going through another month of weak imports in October. Buyers in Mexico, Algeria, the US and Indonesia in particular appear to react to the improving availability of exportable surpluses since September. This suggests that the changing market balance allows the buyside to gradually abandon their "hand-to-mouth" strategy that became the norm during the many months of elevated dairy commodity prices and weak product availability. Buyers may remain cautious for as long as prices continue to fall and especially since no one wants more product than necessary on the balance sheet by the end of the year. Still, if the change in buyside behavior also boosts imports in the remaining months of Q4 then we may end up close to a flat line for total imports in 2022, despite China's massive fall in import volumes.

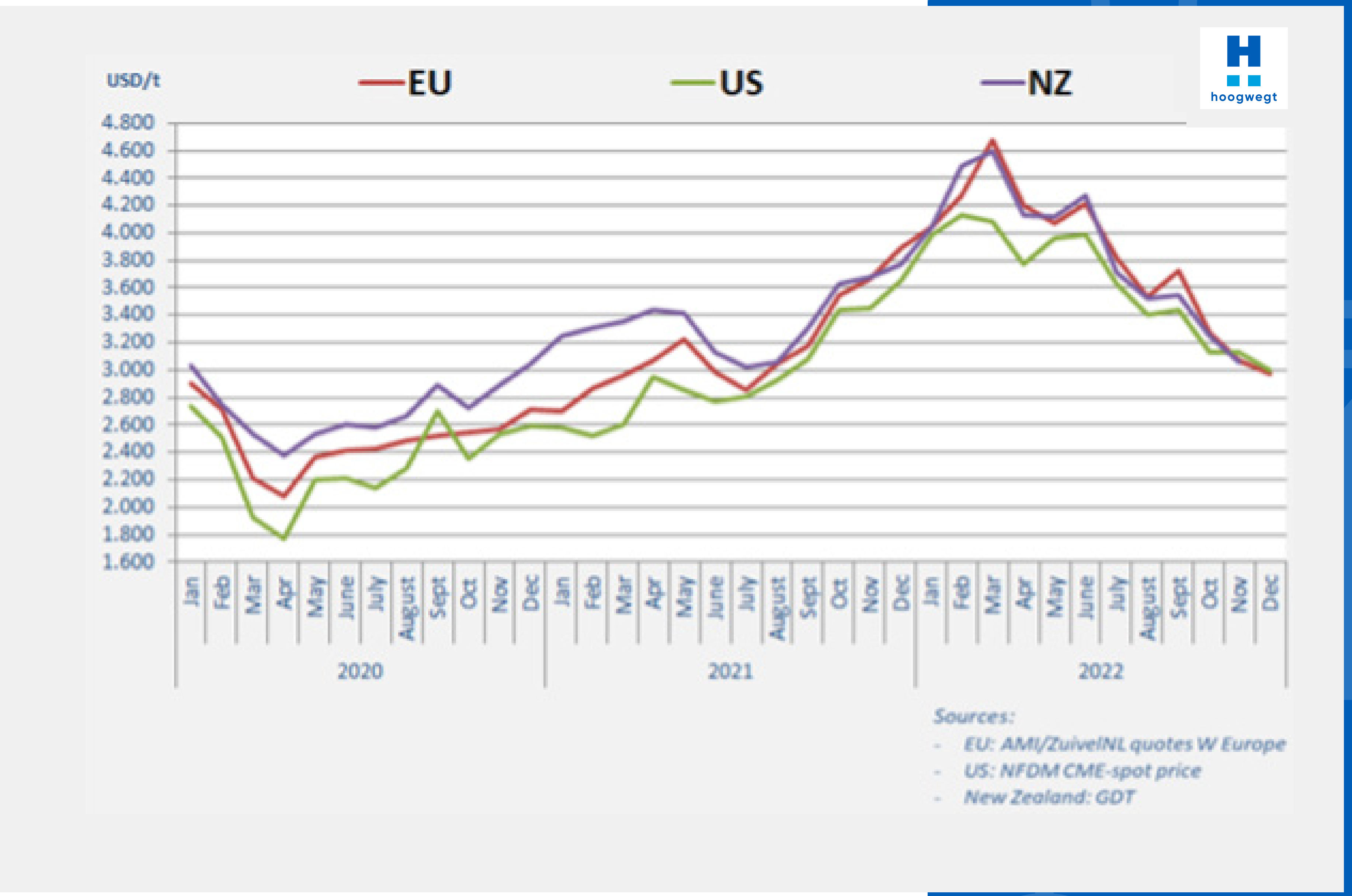
SMP: Prices converge perfectly at the end of 2022

SMP/NFDM prices seem to be converging in a narrow band around USD 3000/t. Exports out of the EU seem to be picking up due to good demand in Algeria, Middle East and SE Asia. The cost of drying has fallen somewhat so the declining cheese prices could push more milk towards the drying towers when milk production is picking up seasonally in the Northern hemisphere. The convergence of prices appear to indicate that competition for export demand is intensifying and going forward this will likely continue. The Southern hemisphere still has a lot of product to sell as we are right after the peak production months and despite milk volumes disappointing during the flush. US export activity is not too strong yet outside their nearby markets in Mexico and Latin America, but this may soon change as down season is behind us and output is expected to build to higher levels in Q1.

Production, exports and availability of SMP in EU, US and Australia[1])



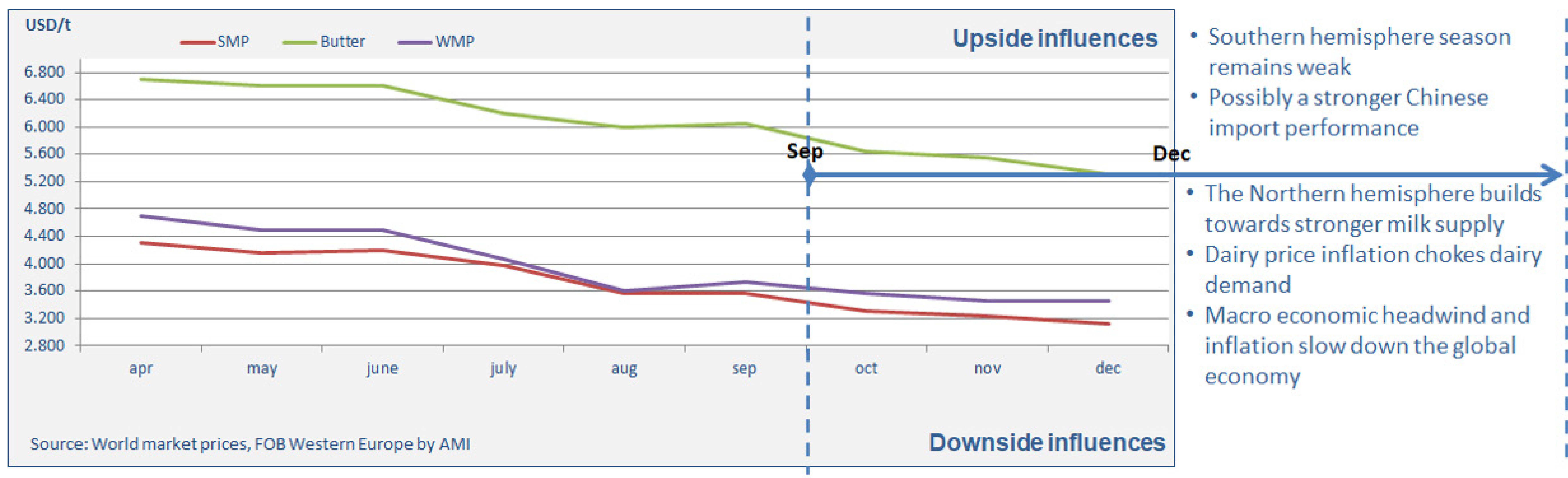
Monthly SMP prices in the main export markets



Looking forward

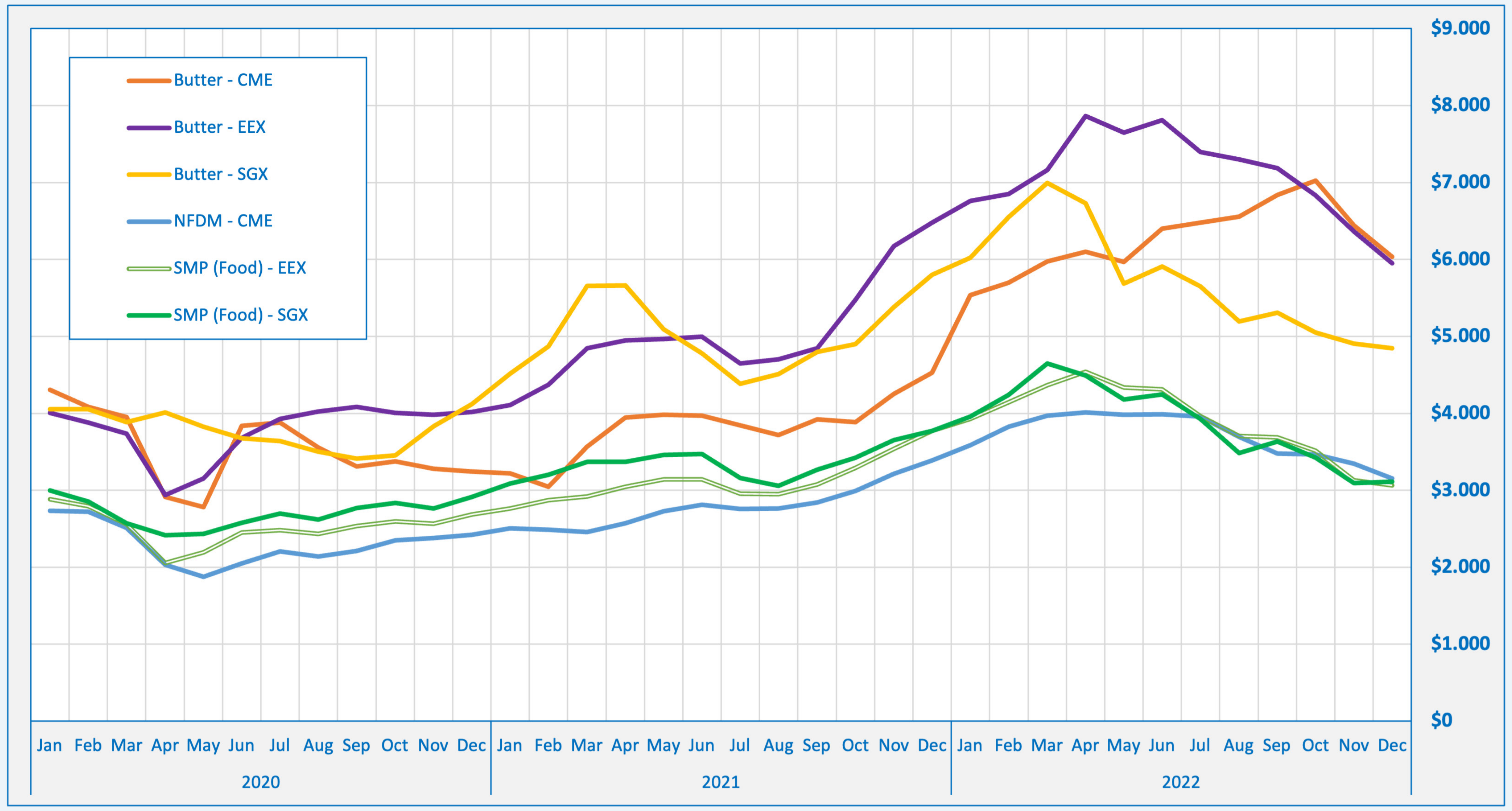
The upside and downside drivers of prices in the graph below have not really changed too much over the past couple of months. The market balance – and consequently the direction of price developments - will on the one hand largely be determined by the strength of Chinese import demand recovery, if and when it arrives. And on the other hand it will be the strength of milk production in the EU in particular that creates the biggest downward risk potential. We should probably also add the reaction of dairy consumption to the elevated retail prices into the equation. However, judging by the resilience of import demand – apart from China – and the initial data on market disappearance in the Western world, things have not been too bad actually. Household budgets will feel the impact of elevated food prices for sure, but data up until October do not seem to indicate a massive volume reduction in dairy purchases yet. Moreover, going forward we may – based on recent commodity price developments – already look forward to a gradual reduction in retail prices again. ■

Market Outlook for December 2022 - February 2023



Dairy Deep Dive

2023: Looking forward.



2023 has a lot to uncover, in dairy and beyond. Thanks to Europe's final sprint we still may finish 2022 off with a plus in milk production after months of red earlier this year. So we should start 2023 returning to normal in that sense.

In the past 11 years, milk production increased 1% on average annually. That's close to the number which we're projecting for 2023. We're supposing that H1 looks more promising than H2 in terms of milk production. We saw prices of skimmed milk powder, butter and the likes come off in the past months. Bear in mind that in the longer term, over the next years, North-West Europe's powerhouse The Netherlands, along with other countries, are looking into environmental restrictions on milk production. The question is - how much longer can countries still dictate production purely based on economics and not environmental concerns?

China

China's recent change in paradigm, shifting away from Dynamic Zero-Covid is on each watchlist. We think it will get worse before it gets better due to the current empty streets and low economic activity and spikes in Covid-cases. GDT 322 is exemplary for current lacklustre Asian demand. But similar to anywhere else there is eventually light at the end of the tunnel. China's has been struggling with a prisma of restrictions, some light and some heavier, for the past 3 years now. So we can imagine people are looking forward to some fun, some food services and some travelling when things are safe. Let's see how that unfolds.

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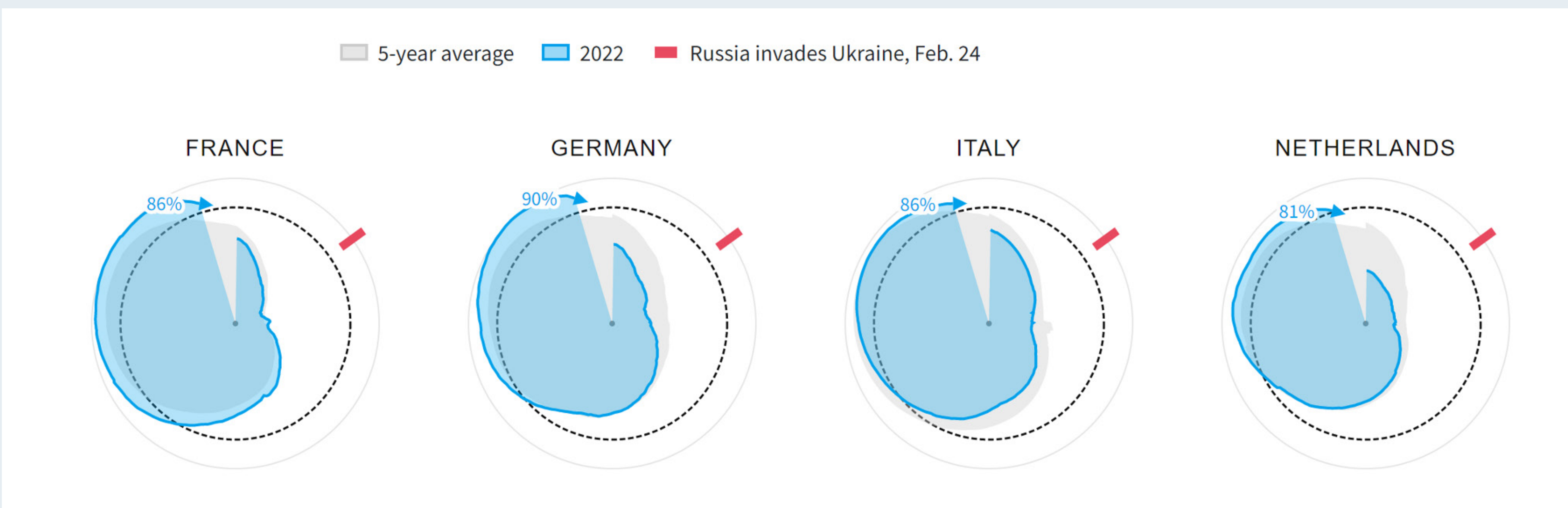
European gas shortages

So far so good for European gas storages. Europe survived the first cold spell. European average is currently at 85%. 10pp up from last year. Germany, France, Italy are above average. The Netherlands below average. Hungary and Latvia below average. EU met a target for refilling gas storage sites to 80% by November 1 ahead of time, and moved far above that when gas storages reached a high of 95.50% in mid-November.
Storage level began slowly falling on November 14, data from Gas Infrastructure Europe showed, but a snap of cold weather increased the pace of storage withdrawals in December.
Analysts believe hitting zero storage this winter is unlikely, so long as Europe can continue importing LNG and does not experience a super-cold winter.
In some of the upcoming days/weeks gas technically works deflative, and Europe has ratified some price caps. What is interesting though, is next winter. In 2023 we'll see how this unfolds, with China possible showing a bigger need for gas, Japan and Korea won't be caught off guard competing with Europe over LNG and Europe not being able to look at Russia for their gas. A lot of reasons why prices remain elevated?

European gas storages



Source: *Reuters*

A quick note on CME futures

By Adnan Mikati, Director HTM Americas

CME NFDM futures have experienced considerable pressures over the past month. At the time of writing December 20th, 2022, CME spot prices are sitting at one year lows, and many 2023 contract months have also made one year lows. Since reaching their highs in early June of 2022, there have only been 6 weeks of positive price action against 21 negative weeks. Further pressure on futures could be expected as prices move below 200 week moving averages. Prices bottomed out in the mid- 120s in the summer of 2021, prior to the massive bull run that saw the market move over 60 cents in 7 months. Will that be the next target? The forward curve has moved back into contango after months of inversion, indicating a build-up of inventory in the nearby. Daily volume has sputtered during this slide- 17% below the 6 month average and 67% below the 1 year average.

Contrary to typical history, nearby CME NFDM futures have held a premium to EEX SMP future for 2 months. This is a reflection of increased milk supply and surplus powder in Europe, as well as strong demand from Mexico that has supported the US NFDM market during its seasonal low production time. At the time of writing, January CME futures are trading at a 3.5 cent premium to EEX SMP futures, much higher than the 10 cent discount average persistent over the past 3 years. The CME / EEX premium seems precarious as we head into US flush with expectations of strong milk growth and a fragile macro-economic environment. Though the Euro has strengthened against the dollar back to 7 month highs, the US will likely need to compete more aggressively in international markets outside of Mexico for SMP/NFDM demand.

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Whey

By John Kramer, Global Head Whey

The whey complex is in a full speed downward correction after reaching historical highs over the last 12 months. Low global milk output meeting healthy consumption pushed prices to levels never witnessed before, both for Food and Feed applications. The pandemic driven lockdowns have been supportive for dairy consumption in general and more specific for whey proteins as such. Just before the Ukraine crisis developed first signs of weakening occurred. As with all commodities the first market reaction to the war outbreak was another upward tick, camouflaging the already started more bearish trends.

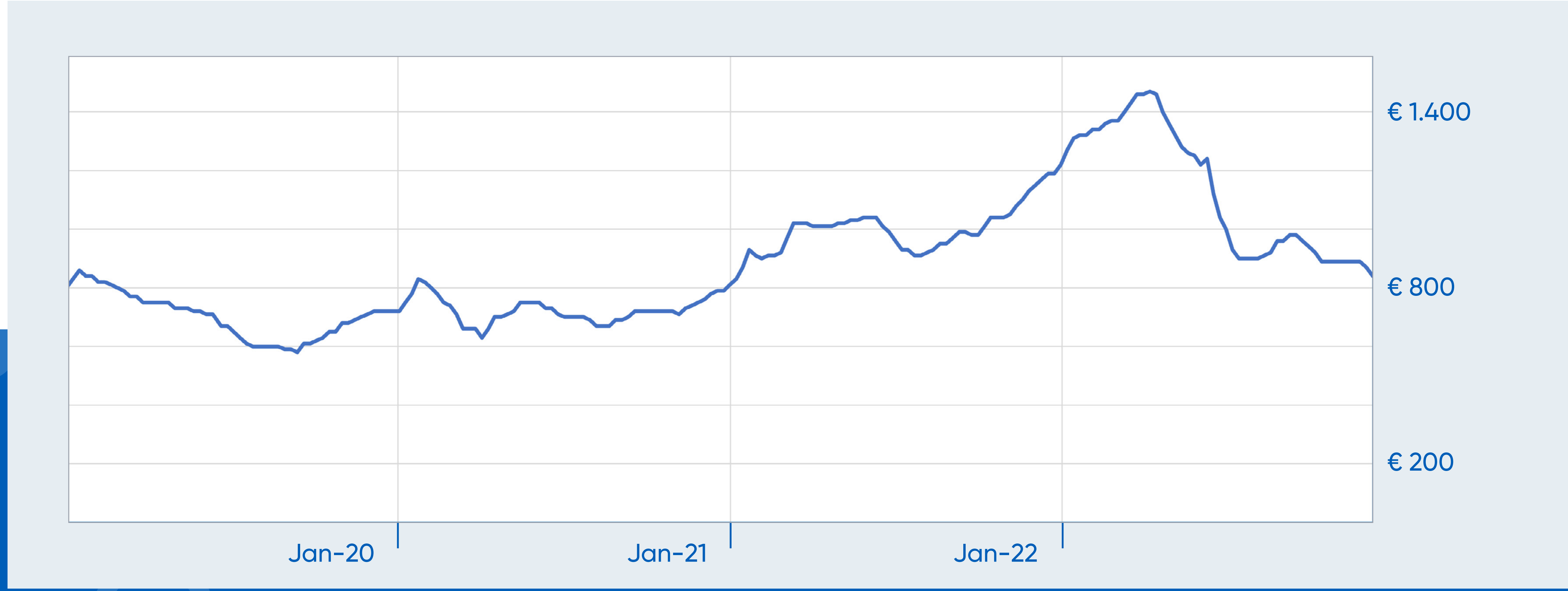
Since the summer we have entered a whole new playing field where milk output growth (USA and Europe) engaged lower consumption driven by double digit inflation numbers and demand destruction across the globe. Farmers are receiving pay out prices they never could have dreamed off and have released all breaks pushing their herds to maximum performance. We are in the midst of this part of the cycle and the question at stake now is where the downward rally will end and when.

Contrary to other dairy commodities the whey complex is still under heavy influence of Feed markets, more specifically Young Animal Feeds. Next to a large number of Food applications, the demand from this Feed markets continues to have a strong and direct effect on price forming.

In the Feed markets we have seen a clear fall back in demand over the last 12 months both in the Veal Fattening as in the Calf Rearing industries. To protect the margins on their Veal prices, integrations have set up very limited number of calves bringing down overall consumption. At the same time Farmers apparently chose to extend milking not so much by setting up new heifers but keeping older cows for another cycle supported by compound feed inputs. For now it takes a lot of imagination to see bullishness returning at least up to the seasonal peaks in USA and Europe.
To turn the current trend first farmers will need to receive the signal of lower milk prices and at the same time consumer confidence to return.

Especially the whey protein concentrates are taking heavy blows taking big downward steps week by week. Demand from Health Ingredients (sport nutrition) and Infant formulas (China) decreased not being able to absorb record prices. Since a lot of whey is directed to those applications the whole whey industry is suffering from this development. Right now it's hard to predict where prices will find a bottom under current circumstances.

Dutch SWP (feed) in Euro's/t



World Comment.

Mona Dierkes
Export Manager
Hoogwegt Cheese

Finally a female contributor has been asked to this internal stage. I am happy to introduce myself to you all. My name is Mona Dierkes, 34 years old and I love good food, plants and photography. Originally from Germany, I have moved to The Netherlands 16 years ago and fell in love with Arnhem, where I live and work.

My Hoogwegt journey started almost 6 years ago, when I joined Freek Jan and the team of Havero Hoogwegt as International Accountmanager. My role was to manage the product group "Hapro's" and increase our customer portfolio in South Europe. With my love for roman languages and the Mediterranean culture and climate, this was the perfect market for me and a good and challenging learning school.

I came from an international trading environment, importing nuts and dried fruits into the EU, so I was familiar with a major part of the macro and meso impacts that we see in dairy. The quick dynamics, short lines and the large freedom of decision taking were new to me though and inspire me a lot. It's an adventure and I'm never bored. In 2020 when we were all locked up in our homes, waiting for the first Covid wave to hit in, a new opportunity came my way. Our neighbours from the cheese team asked me to join their forces as Export manager and replace Marten Montijn who planned to retire. A new step within Hoogwegt to a new product group and a more trading related role attracted me. It turned out to become a turbulent journey where the cheese team had to re-establish and re-invent itself. I am proud to have played a leading role in this change and in our new team of young and international professionals.

Hoogwegt cheese was well ahead of the my Hoogwegt Strategy, starting early to collaborate with our Polish office on cheese market. One part of our strategy remains the bulk trading of Cheddar, Gouda and Mozza, and the other part is the re-packed cheese business lead by the Polish office. This combination is what makes us strong. So does our relationship with our partners: First Milk being in first in line. With their investments in sustainable farming, we will take a leading role in marketing cheese with low CO_2 footprint in the nearby future.

We play an important role in informing the other business units on what we see on the market. After all, more than half of the European milk is going into cheese production. Furthermore, cheese is a fresh product, therefore weakly productions and stock building have a quick impact on market sentiments.

The overall shortage of milk in Europe and a overall very good demand from all sectors created the situation which we haven't seen before: no availability of some cheeses on the short term. This created a panic among buyers and quick increase of prices up to 80% in the last 12 months. Interesting times for a trader!

This has changed in Q4 when the lack of demand has hit quicker and heavier than expected. Inflation kicked in and consumers had to make choices on how to spend their euro/dollar. The current market is determined by spot buying. Our customers are insecure about consumption in the upcoming months and want to keep their stock level as low as possible. Consequently we see overall stock building with producers and traders, resulting a large amount of offers and competitive prices for Q1.

Milk prices shall drop and follow on commodity prices but to a slower extend. This gap in milk price and high production costs on the one side and low spot prices on the other hand, creates a challenge where we will be taking an important role. With spot demand for cheeses remaining well, I expect cheese prices to stabilize by the end of Q1.

Time will tell and I am looking forward to face the challenges with our team, create solutions and new opportunities and add value.

Hoogwegt Happenings.

Did you know that Hoogwegt also deals with dairy products for Animal Feed?

In a move towards deepening our footprint in Whey, we are happy to announce that Hoogwegt has launched our very own Red Tulip brand for our new product line of Whey Protein powders for the global Animal Feed markets!
The Red Tulip brand is a bold new step towards our existing Feed Industry activities, creating a recognizable brand for our existing and our prospective customers.

Click here to view our video.

For further information, please contact one of our friendly export managers!