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Horizons.

Our insights on Today's Global Dairy Business

June 2023

#06

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Editorial Note.

This June issue of the Hoogwegt Horizons explores the global milk supply as we move past the EU peak season, and towards the upcoming new 23/24 season in Oceania.

We also look at the March and April 2023 SMP Export numbers from our top producing regions. The data might paint a slightly different picture from what most are seeing in the market.

As usual, we have our quick notes on Whey and the CME Futures Market.

Guest contributor Gert-Jan Willemse, Commercial Director of Dairy Essentials Europe writes about what it's like being 30 years at Hoogwegt and the importance of Corporate Social Responsibility in our ever-changing Dairy landscape.

We also put the spotlight on our MyHoogwegt Portal and the upcoming new features. Information on how to sign up for this service can be found on page 13.

Enjoy!

As always,
Hoogwegt Horizons Editorial Team

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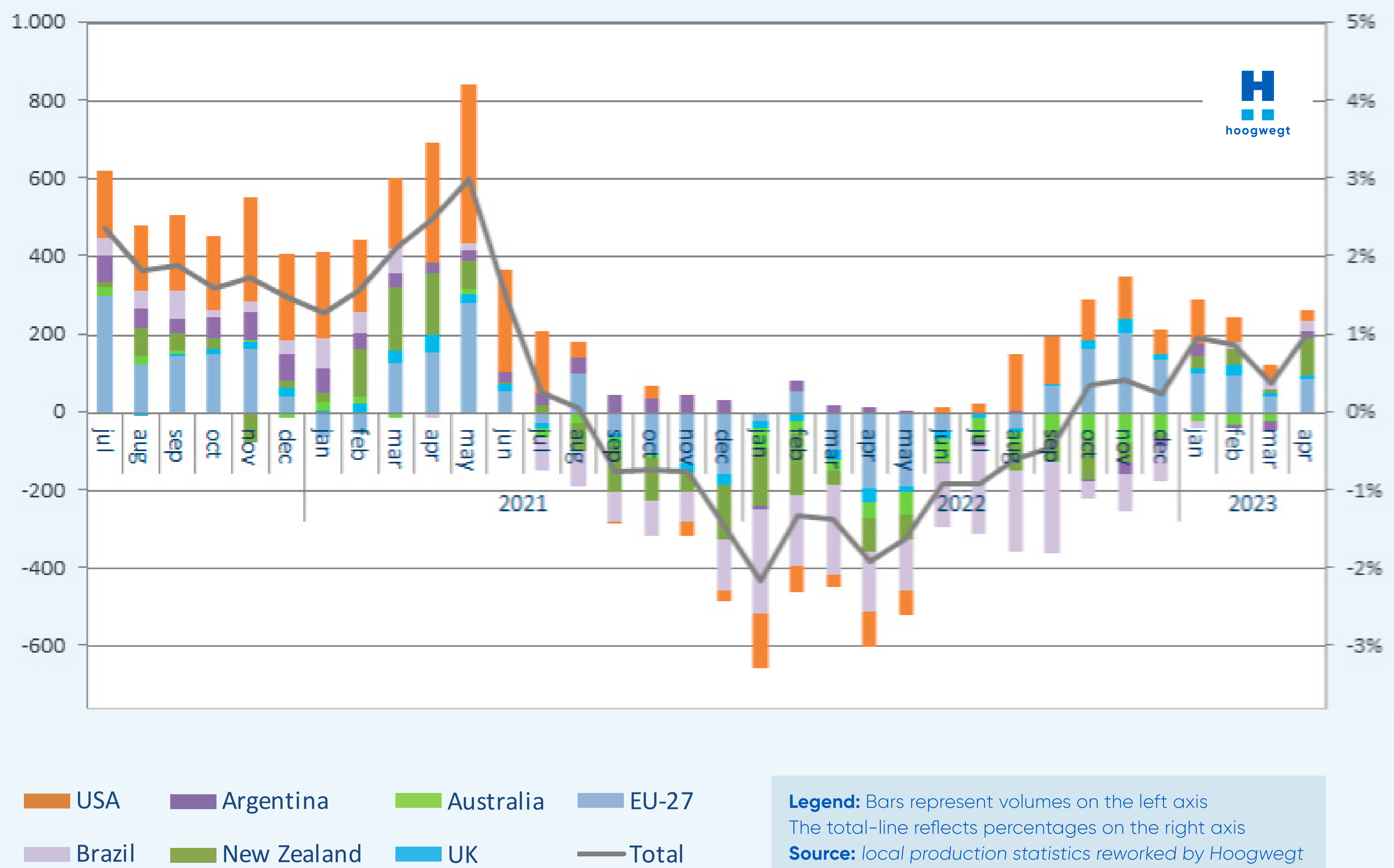
Market Direction

Southern hemisphere milk production recovers

At a moment that the Northern hemisphere peak production is weakening due to falling milk prices, milk output in the Southern hemisphere is starting to improve. Weather in South America has improved since early April which allows for some recovery in the shoulder of the season. There is still some concern about how the drought in Q1 might affect feed supplies in H2, but for now production data are positive again. New Zealand is also going through a relatively strong ending of the current season, be it against weak 2022 comparable numbers. The strength of the start of next season will be more relevant, but Fonterra's forecast for next season gives farmers little incentive to push for higher productivity.

The combined growth rate of the Northern hemisphere continues to fall and hoovers around 0.5% since the start of Q2. With Southern hemisphere volumes falling seasonally, the Northern hemisphere growth only just about compensating for last year's decline and culling rates in both the US and the EU reportedly going up, the global market balance is going for an interesting couple of months from a supply perspective.

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*

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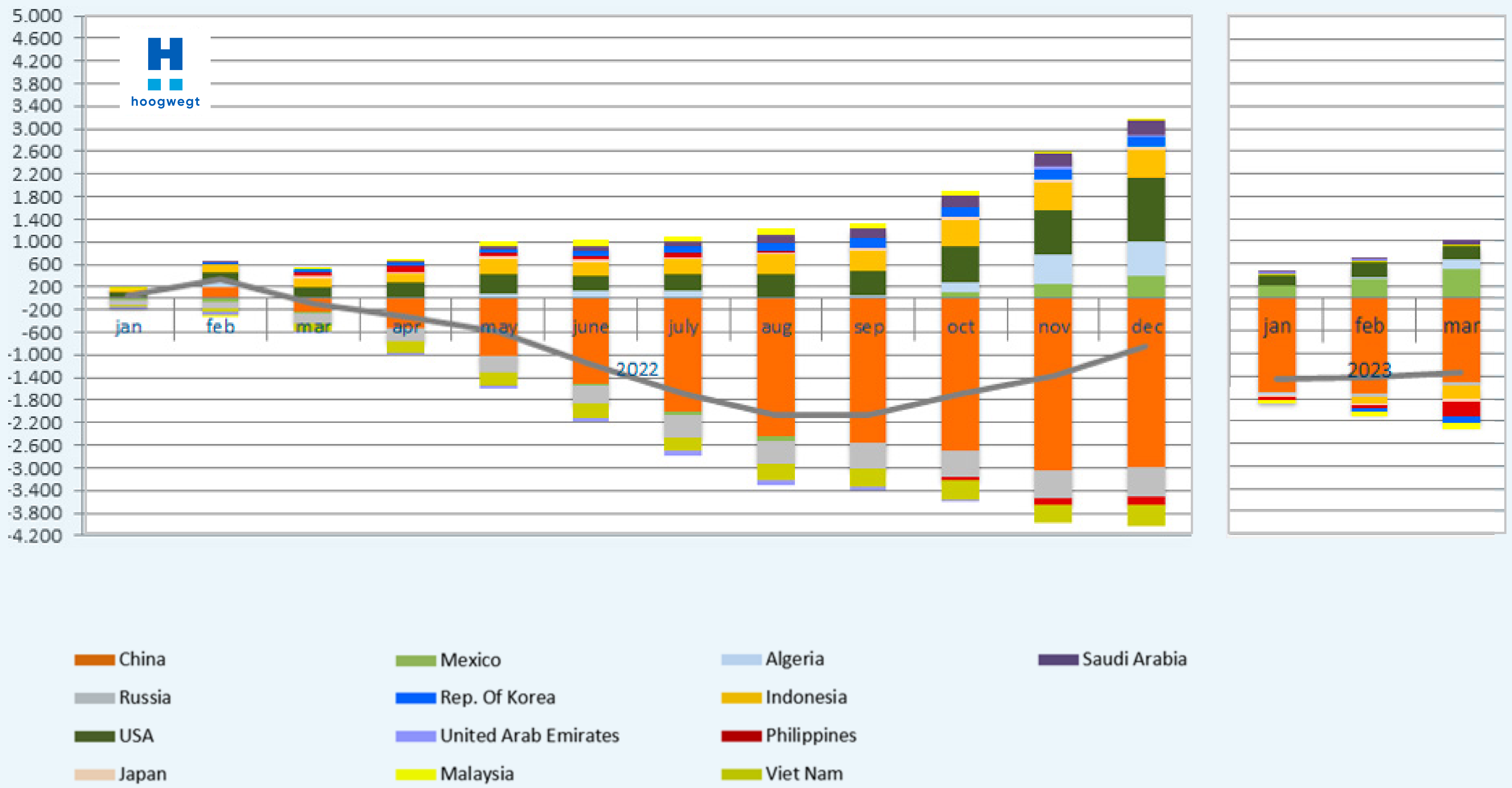
Imports by the big-13 importing countries (cumulative change compared to previous year, total imports in 1000t of MEQ)



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 countries combined
Source: *Dairyntel trade data, reworked by Hoogwegt*

→ continuation

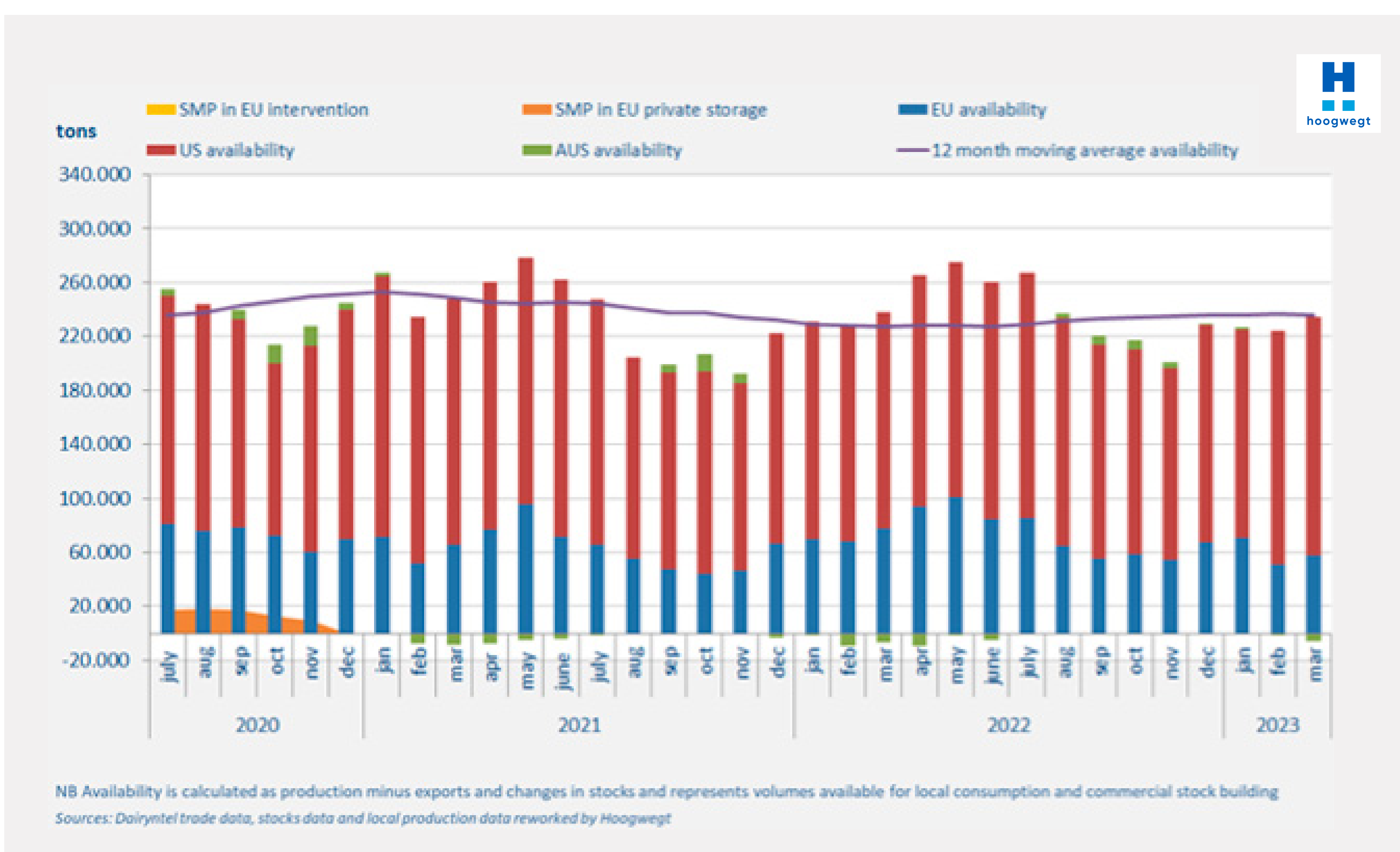
While China is gradually catching up with last year's H1 imports, other Asia remained significantly behind on 2022 import volumes in the first quarter of this year. The scenario that China's previously very strong January imports would this year be spread out more gradually over H1 in 2023 seems to unfold as expected. Both March and April imports were stronger than last year. What is also becoming clear is that China's import portfolio may have structurally changed going forward, with dried whole milk imports requirements falling rapidly – minus 58% in January to April compared to last year – and SMP, whey derivatives, casein and cheese increasingly getting prioritized. Imported consumer-ready infant nutrition is also making something of a come-back after a couple of weak years (+35% in the first 4 months).

Virtually all single countries in the rest of Asia however remain behind on their normal volumes. The US, Algeria, Saudi Arabia and Mexico are the key importers on the positive side in the comparison with last year.

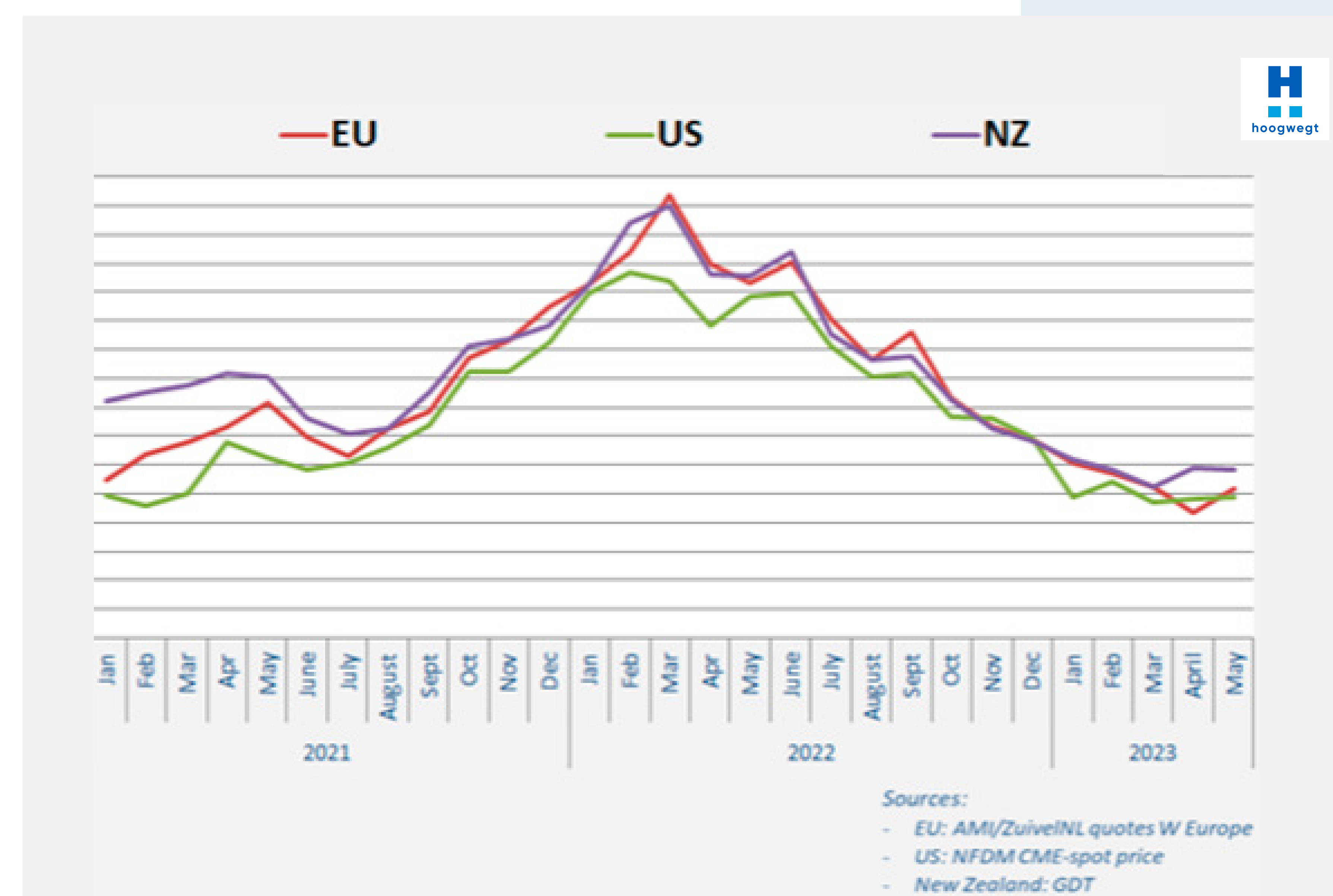
SMP/NFDM: EU peak supply limits price recovery

Export availability follows the seasonal patterns towards peak levels in the May – July period. EU export activity has been dynamic recently as processors appear to prioritize a balanced cheese market and consequently allocate peak surpluses towards the drying towers and butter lines. Still, the combined volume by the three origin regions monitored here seems to be slightly lower than last year but it is no secret that New Zealand more than compensates for these lower availability levels by the EU, US and Australia in 2023. The relatively elevated price levels for NZ SMP suggests that the pressure to sell is now apparently diminishing in New Zealand. After all, the season is coming to an end and both SMP and butter exports have been very strong. So we may assume that most of the surpluses resulting from China's weak WMP imports have been absorbed by the market.

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



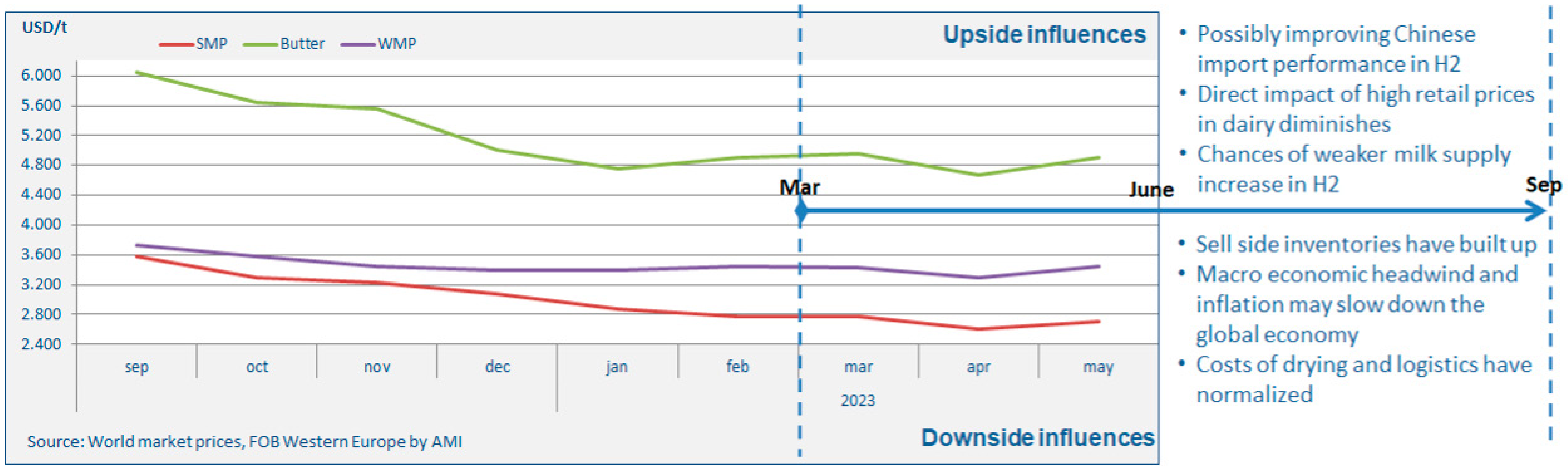
Monthly SMP prices in the main export markets



Looking forward

Price movements in the dairy market are gradual rather than dynamic at the moment. The current upward momentum appears to be a correction for some overshooting in Q1 but it goes to far to assume any kind of meaningful recovery in the near term. Northern hemisphere peak supply is anything but impressive but it is sufficient to keep prices mostly range bound. It is hard to identify material downside risks in the near term though, while upside risks seem to be abundant as Q2 progresses. Further strengthening of Chinese import demand, adverse summer weather in Europe and the US and improving overall dairy consumption due to consumer prices easing are all quite obvious market risks that can direct prices upwards only. Anecdotal evidence suggests that the buyside has not yet considered stock building a sensible option in this market situation, but it seems safe to assume that any acceleration of upward price momentum will attract further interest by buyside operators that are afraid of being too late to benefit from the current favorable commodity price levels. ■

Market Outlook for June - August 2023



Dairy Deep Dive

SMP Import Demand Back on Track

While SMP import demand has picked up good numbers in March, we're seeing strong European Exports while the Kiwi's aren't doing bad either. US March Exports are behind in SE Asia, but they can afford to rely on Mexico. Alternative sources from LatAm, India or Turkey do not seem as competitive. At the time of this article, NZ has published their April figures, the others are still pending (see figure 1).

While the domestic market in Europe is struggling with food inflation and dropping volumes, global import demand for SMP is rather strong. March numbers came in at around 240Kt, from global demand perspective, this is considered strong and in fact, stronger than it has been in quite some years. Europe could profit from this demand, and reported quite a strong number March at SMP 83Kt (EU-27+UK) +42% YoY, +10% MoM, +35% YTD.

While we expected European Exports to be strong, and stronger than last year, Northern African demand at 33.5Kt, were even stronger than our expectations, boosting European exports (figure 2).

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SMP (Food) (HS:040210) Imports in World per exporting area in 2022 and 2023 (Ktonnes)

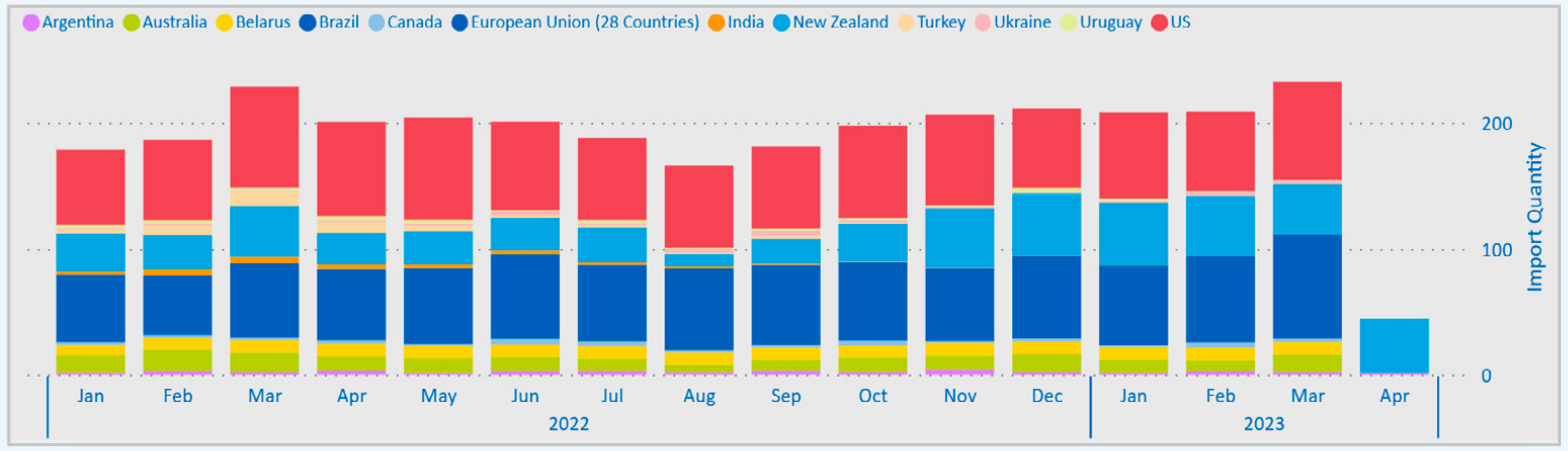

Figure 1

SMP (Food) (HS:040210) Exports in European Union (27 Countries) in 2023 (kg)

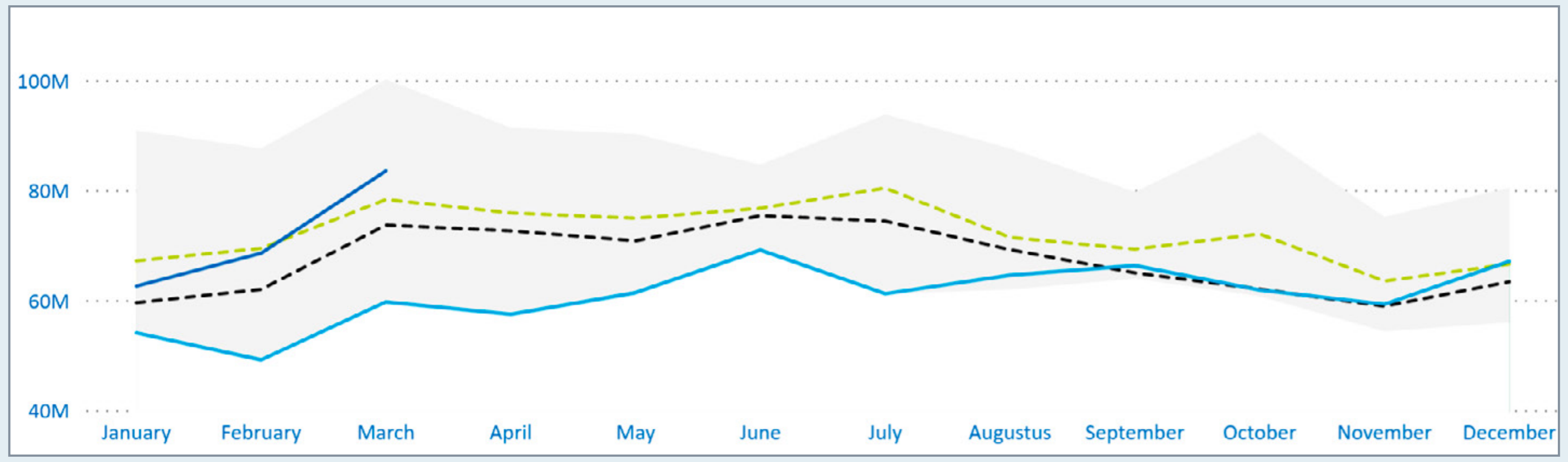

Figure 2

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New Zealand SMP Exports (fig. 4) took a relatively small hit when March 2023 could not beat the record high of March 2022, however, March 2023 could still be qualified as strong, and in the NZ April exports, we saw a continuous strong NZ.

In Figure 3, you can see where Europe exports found homes; most of EU powder went to North-Africa (green), China (light blue) asked for more European SMP than 12 months prior, and the Middle-Eastern and South-East Asian demand for European SMP was average in March. The US (fig. 5) lost market share into SE Asia in March, with exports at a 15Kt loss. Fortunately for the US, they have a strong Mexican demand as an outlet.

The **Middle-East** saw just under 20Kt import demand for SMP in March, close to the average. 70% of that came from Europe.

The only region that seems to be really struggling from the European perspective is **Sub Saharan Africa**, with a sub 5Kt of import demand as domestic consumption still seems lacklustre and people are still struggling with food inflation.

Conclusion

NZ does a good job to ship their 'extra' produced skimmed, with 40+ Kt of SMP shipped in April, into the usual suspects China and SE Asia but also some good volumes into North Africa. Which leaves a question mark if Europe's exports for April will come out as fantastic as their number in March. The good news for the US: while they lost volumes in SE Asia, Mexico has written some pre-Covid-like demand in the past months.

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SMP (Food) (HS:040210) Exports from European Union (28 Countries) in 2022 and 2023 (kg)

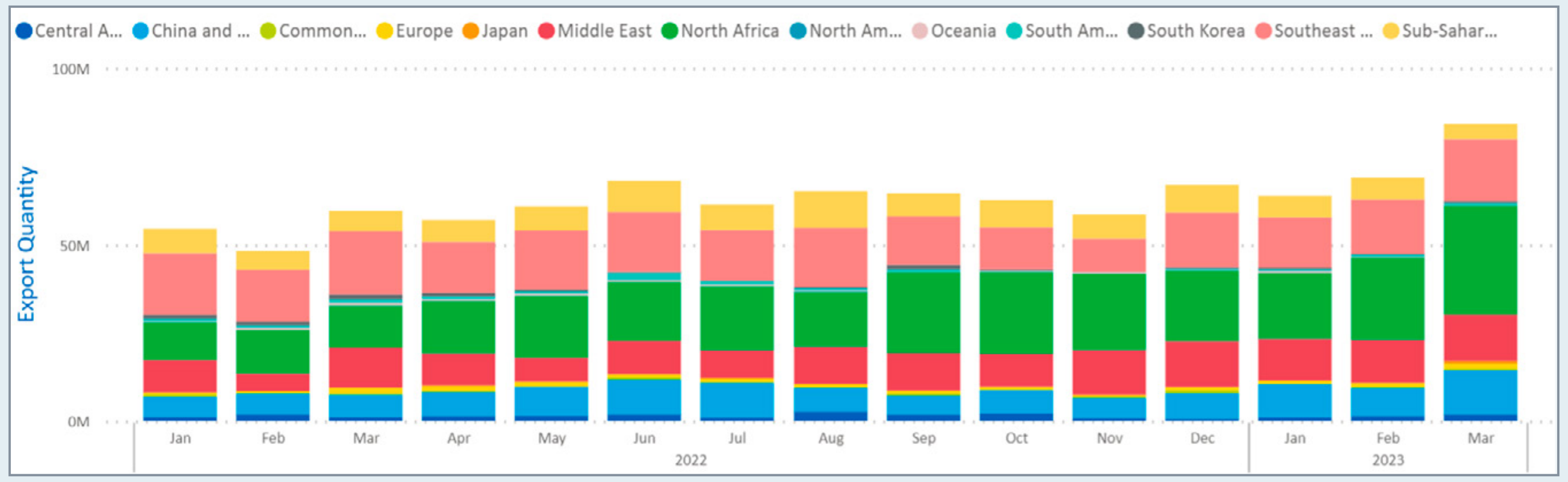

Figure 3

SMP (Food) (HS:040210) Exports in New Zealand in 2023 (kg)

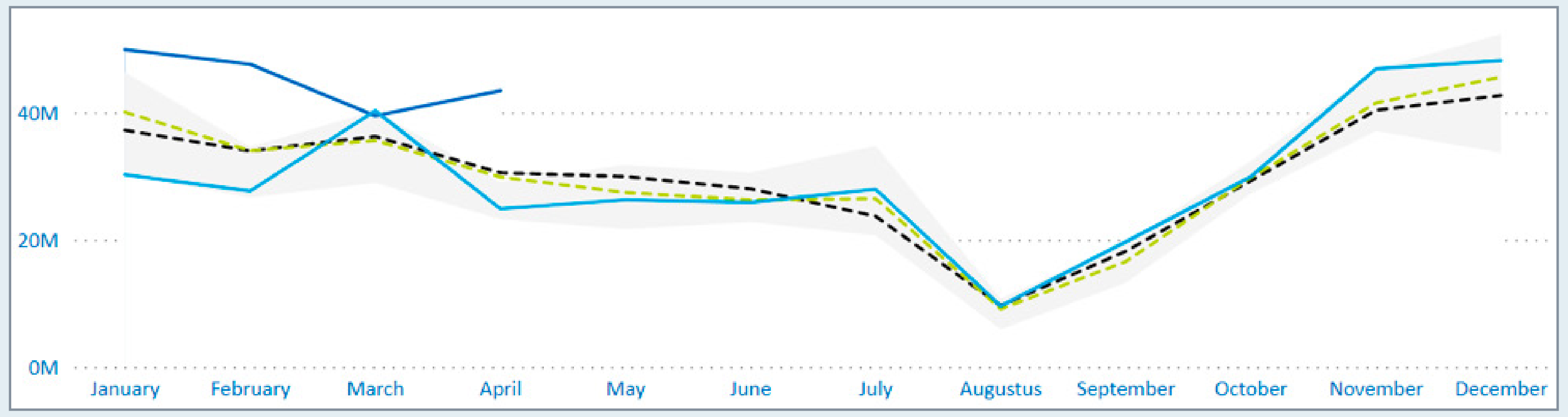

Figure 4

SMP (Food) (HS:040210) Exports in US in 2023 (kg)

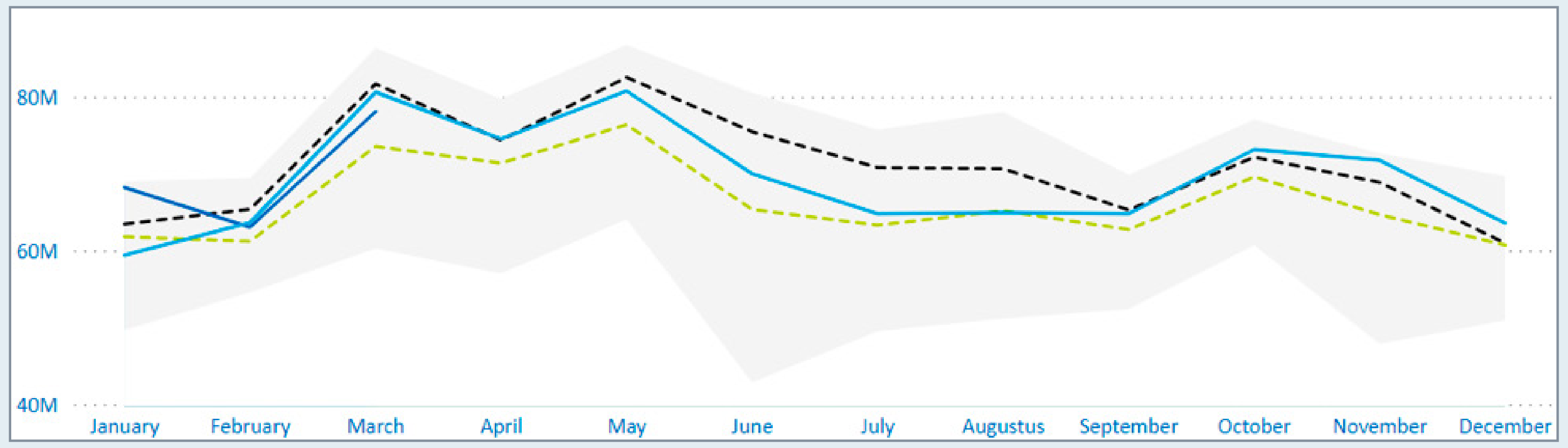

Figure 5

→ continuation

Bulls vs Bears...

On the bullish side:

- A struggling Southern America and Australia in terms of milk production. And we might add the Northern Hemisphere to the list for H2, while margins are dropping.
- Unlike WMP; China's demand for SMP is quite strong.
- Prices dropped; this should attract some buyers.
- Money isn't free anymore and stricter loans could limit farmers in their investments leading to scarcity.

On the bearish side:

- Domestic consumption in Europe is still struggling.
- Recessions, inflation, leading to drops in demand.
- SE Asian demand seems to be low. While others who bought might have enough for now.
- Fresh consumption closer to pre-pandemic levels leading to better availability of the milk flowing into commodities.
- Chinese milk production is still good, while import demand for WMP is still low.

Things we watch:

- NZ next season; Cows, slaughter, payout prices and product mixes as analyst's projections are pretty broad on both the positive and negative side of milk production for next season.
- Volatile forex skewing trade shares. Volatile input costs.
- Geopolitical turmoil shifting away from free trade.

A Quick Note on...

Whey

By John Kramer, Global Head – Whey, Lactose & Permeates

As always, we take a first brief glance on the underlying health of global milk markets:

- Both USA and EU continue to provide higher milk output levels compared to 2022 albeit it at slower pace than previously. NZ ended the season stronger than the full milk year pattern.
- Focusing on EU, we see the aggressive milk price cut back coming to a hold with now stagnating pay out prices. At the same time, input costs for farmers went down with friendlier compound feed prices, energy and fertilizer levels. So for now, we can assume farmers will push their herds to produce as much milk as possible.
- The seasonal peak in Europe was dampened by unfavorable cold weather, at the same time plentiful rain fell in NW Europe which is supportive for coming weeks. With weather improving, the peak may be flattened but extended this season.
- So fundamentals are showing ongoing good milk availability, where the next and perhaps more important question is **how will global demand develop?**
- For now, we see Food Inflation levels cooling off. However, this has not influence retail prices yet, and will likely take some time before it will.
- As for the whey complex, we still see this as the weakest link in the dairy chain. Where other commodities left the previous lows in recent weeks, whey powder and permeate stabilized but struggle to firm up. One of the reasons behind this is the still relatively high volumes of whey products incorporated in Feed – especially when compared to other commodities.
- Whey Powder (and related Delactosed Whey Powder) are historically and still are valuable components in Calf Milk Replacers as alternatives for Skim or Buttermilk powders. Especially after the production subsidies on (Intervention) SMP were abolished, the CMR industry switched massively to these cheaper ingredients.
- Permeate and Lactose are used as carbohydrates in Piglet Feeds (where the proteins are plant based). For Permeate, it's safe to say that the Feed outlet is still leading majority of usage volumes.
- So with that in mind, the whey complex is dependent on the health of the Feed markets in establishing the overall market price.
- Comparing the demand destruction in Food (where whey powders are part of many formulations and applications) it is clear that the demand from Feed is weak.
- In the piglet industry, we see ongoing decline in the European pork industry with lowering numbers of animals and China as primary consumer painting a highly volatile picture. At the same time, the Calf Milk Replacer (CMR) industry suffers from low consumption figures for quite some time both in the Fattening as in the Rearing sections.
- Fattening (Integrations setting up calves for slaughtering at maximum 30 weeks for Veal or later stage for Pink sectors) is confronted with low meat prices and as a reaction, limited number of calves are being set up. Also, earlier slaughtering ages occur to decrease kilos of weight (i.e. decrease the amount of feed needed).
- Therewith, consumption of milk replacers and thus whey products is much lower than historical patterns. Furthermore, the Rearing industry (CMR for raising female calves to milk cows) is at low intake numbers since farmers do not want to set up large numbers of young animals instead preferring to maintain older cows in production.
- This situation is not likely to change in the foreseeable future and will continue to play a negative role in demand for the whey complex.

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Futures: EEX

By Adnan Mikati, Director HTM Americas

- CME NFDM futures have faced a challenging 2023. As of May 31st, 2023, the downward trend has plateaued, although significant signs of recovery remain elusive. Prices have shown choppy behaviour within a 7-cent range since reaching a 2-year low at the start of April (with CME Spot dipping to $1.12/lb).
- Looking forward, this will serve as a critical support level, while $1.20/lb continues to act as a formidable resistance. Converging and flattening moving averages further mirror this slowing momentum.
- Market activity and liquidity have clearly been impacted, with trading volume of CME NFDM futures falling 40% over the past three months. Concurrently, open interest is trending lower than last year's and the 5-year average, typically indicative of waning confidence in the current trend or a potential trend reversal.
- The forward curve transitioned into a contango (carry) structure in Q4 2022 and has been widening since. This is the most pronounced contango in the past 2.5 years, reflective of rising and substantial stock levels paired with weak demand. Indeed, March 2023 registered the second-highest stock levels for March in the past five years, surpassing the 5-year average. Higher prices post-Q3 represent the market sentiment anticipating a tightening of milk supplies during and following the summer. With increasing cow slaughter rates and farmers reducing their feed rations, milk production is projected to experience a slight year-on-year decline.
- International dynamics play a critical role in NFDM price movement. Although NFDM remains notably discounted to the EEX SMP and SGX SMP markets, these discounts align with traditional averages and the 3-year mean. This structure should attract international buyers and lend support to the US NFDM/SMP market moving forward.

World Comment.

Gert-Jan Willemse
Commercial Director
Dairy Essentials – Europe

Hoogwegt is part of the vast majority of my working life, I am proud to state. Over the years, my roles and responsibilities changed, new challenges within the organization kept me on my toes and allowed me to help shape Hoogwegt as you know it.

The latest and possibly most daunting challenge I have accepted is to lead our CSR working group on Environmental Impact. For most people, global warming is evident beyond any doubt. The Paris Climate Accords of 2015 are forcing governments, companies and organizations around the world into action. At Hoogwegt, we take our responsibility in the supply chain seriously; we need to work with all stakeholders to reduce the emissions of greenhouse gasses. The reality in the dairy supply chain is that cows emit a lot of methane, which is a very strong GHG (25x more potent than CO2). In fact, studies show that the majority of GHG in dairy products are created at the farm-level.

Consequently, we want to reach out to our suppliers and help them work with their farmers :

- → to reduce the methane gas their animals produce,
- → use more sustainable feed,
- → ensure better care for their pastures.

Many customers have climate goals like: to reduce emissions 20-25% by 2025 and even 50% by 2030, leading to ultimately net zero by 2050.

It is our goal to offer our customers a portfolio of products with a calculated carbon footprint (CO2 equivalent) by this year, and by 2024, also have products available with a reduced footprint and even carbon-neutral (off-set). This will require lots of effort, innovation (e.g. climate feed) and investment throughout the supply chain. Clearly there is also a lot to learn for all of us.

In association with our partner A-ware, we are preparing a multi-year program for a multinational customer to reduce the carbon footprint of the Avalac brand SMP and cream by 50% by 2030. A small group of 20-30 farmers will be requested to participate and change their feeding, land and manure management to make a tangible difference.

Hoogwegt joined the SAI platform this year and its related Sustainable Dairy Partnership (SDP) in order to drive change in our industry further.

Lastly, the Hoogwegt organization itself is working hard to reduce actual emissions by creating awareness in business travel and buying green electricity where available. For 2023, we have off-set our emissions with voluntary carbon certificates.

Get free access to MyHoogwegt Portal

Some exciting updates on MyHoogwegt Portal!
Currently this service is available to most of our export customers only. But soon, MyHoogwegt will be available to all of our customers! Coming soon, we will be rolling our new features. Stay tuned!

You can find out more here. →

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