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Market Matters

Slowing Milk Supplies to Drive 2022 Markets

Global milk production grew strongly into the second quarter of this year, as excellent pasture conditions benefitted producers in New Zealand and South America. However, output has since slowed appreciably in Europe and Oceania due to rising input costs that have cut into farm margins.

EU-27 milk production fell slightly in the third quarter, according to Eurostat, the result of summer heat and rising feed and input costs. Milk collections further worsened in the final quarter of 2021, and high fertilizer costs could limit application rates, affecting next year's spring flush. As milk supplies slowed, EU cheese demand remained robust, which limited output of skim milk powder and butterfat, driving prices to multi-year highs.

Milk availability through spring 2022 will be critical to protein and butterfat pricing. The European Commission (EC) expects 2021 volumes to exceed last year's by 0.3% and 2022 output to be up 0.6%, compared to this year, due to higher per-cow yields.

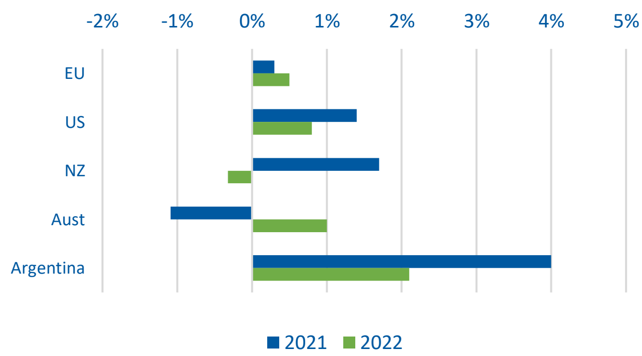
U.S. Milk Herd Shrinks

U.S. milk production slowed quickly in late 2021 as farm margins tightened, convincing producers to cull the low-end of their herds. Some large farms in the Southwest even ceased operating. Elevated feed costs spurred a reduction in concentrate use, which weighed on per-cow output. The dairy herd will likely remain smaller than the prior year through much of the first half of 2022 until farm margins improve.

U.S. dairy markets have been volatile, the result of COVID-cautious consumers, and that has led to inconsistent cheese demand. High logistics costs and delays continue to plague major West Coast ports, which could intermittently impact dairy markets throughout next year. For 2022, USDA predicts a 0.8% year-over-year increase in milk output.

In New Zealand, cool, wet conditions have slowed output, with production for August through October down 4% from the same period in 2020. The La Niña pattern will likely bring warmer weather to both islands, with many regions expected to remain drier. This year's strong comparables for the February to April period will be very hard to beat. Farm margins will be larger with milk prices projected to finish near $9/kg of milk solids (NZ), or $24.10/cwt. (U.S.), yet high fertilizer costs and labor shortages could limit production. USDA forecasts New Zealand milk production in 2022 will drop 0.5% below 2021 output.

Year-over-year milk production growth



Source: EC, USDA, NZX, Dairy Australia, Freshagenda

In Australia's southern regions, La Niña produced cool, wet conditions that stalled production in early spring. Summer will bring excellent pasture conditions, yet milk production will remain in decline. Excessive rainfall that will reduce both quality and quantity of feed grains, a steady stream of farm exits, and a robust heifer export market will limit milk collections. USDA expects a 0.8% improvement in 2022 production.

Milk output in Argentina grew strongly in early 2021 as producer margins remained favorable. Year-over-year growth slowed to 3-4% in the third quarter and is expected to advance at a slower rate in 2022, as La Niña brings dry conditions. A gradual recovery in cheese demand has slowed production of whole milk powder. Brazil's dairy markets have been lethargic, reducing import demand in the region. This is expected to change as the Brazilian government provides more support to low-income households and conditions in Brazil's southern milk-producing regions remain dry. USDA projects Argentina's milk output will grow 2% in 2022.

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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	3.640	1,65	Firm	3.850	1,75	Firm	3.700	1,68	Stable
FCMP/WMP	4.410	2,00	Firm	4.630	2,10	Firm	3.850	1,75	Stable
Butter	5.180	2,35	Firm	6.800	3,08	Firm	5.900	2,68	Stable
Cheddar	4.080	1,85	Stable	5.080	2,30	Stable	5.250	2,38	Stable
SWP	1610	0,73	Firm	1.425	0,65	Firm			
Lactose	840	0,38	Weak						

U.S. prices stated ex-works/including expected CWT subsidy where applicable; world prices stated FOB main port; EUR/USD: this week $1,129

Did You Know?

Year-over-year milk output in the top-five dairy exporting regions slowed by 0.3% in the third quarter of 2021, the first quarterly contraction since early 2019.

The two most recent La Niña events to impact New Zealand milk production occurred in 2016-17 and 2017-18, and each one caused a sharp year-over-year decline in summer milk collections.

The U.S. dairy herd shrank by 103,000 head in the four months to October 2021, the fastest drop in cow numbers—driven by exists of large dairies in the Southwest—in more than a decade.

World Comment

Europe and NZ already had a streak of red milk production numbers, we can add the US with their 0,4% decline. South-America overall had a good season but their YoY's will be lower from now on. Propelling costs of feed, energy, labor and fertilizer made dairy farmers struggle. On the plus-side we're seeing higher milk prices for farmers so perhaps we've seen the worst. In Europe, a lower share of less milk has been going towards powder production. Before the highs in natural gas we saw a low powder production already, which decreased even further over time. The September and October months were around -10% YoY for WMP. Considering valorization, it isn't likely that a greater share of milk will flow to WMP soon. Yet WMP really isn't as tight as SMP with its stock levels at their lowest in Europe. Recent SMP and Butter price increases gave a bit more incentive to produce, but expect tightness going into Q1. Cheese in Europe is still firm. In the Mid-West, US we saw increased cheese capacity. Things to watch are farmgate prices and -costs, the Chinese economy and spill-overs, logistical issues and new Omicron-fears and policies.

Bring it Home

Demand to Hinge on Economic Recovery

The 2022 outlook for the global economy remains complex. The Organization for Economic Cooperation and Development (OECD) predicts that global gross domestic product (GDP) this year will rebound by 5.7%, compared to 2020, and then grow another 4.5% next year.

Recovery from COVID still has a way to go, though. At the end of November, 30% of the combined U.S. and EU populations were unvaccinated, but less than half of the population of the Association of Southeast Asian Nations and only 4% in Sub-Saharan Africa were fully vaccinated, according to Bloomberg.

Developed economies will continue to recover as restrictions ease and caution abates. Increases in international travel, commuting to work, and dining out will continue to shift dairy demand back into foodservice, boosting overall demand. Macro-economic uncertainty, however, will remain an issue. COVID produced two major variants in 2021—the second still not fully understood—and likely will produce others, which could delay full recovery especially if new variants cause more severe illness.

Inflation surged in the second half of 2021 due to an increase in the money supply and shortages of labor, energy, and resources as lockdowns ended and supply chains gridlocked. Inflation in consumer goods will remain a major factor through much of 2022 and potentially slow growth in developed economies if central banks lift interest rates. Supply chain disruptions will take months to clear, but the dairy trade has still managed to move product to markets, nonetheless, with some rearrangement of market share.

The pace of economic recovery in developing regions will have a major bearing on dairy trade. Elevated dairy commodity prices that persist well into 2022 due to supply-side constraints will likely meet resistance in some markets. Despite this, suppliers will be challenged to provide affordable dairy nutrition to countries that struggle to emerge from the pandemic.

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