

Market Matters

Deforestation Pledges Could Affect Dairy Markets

Achieving net zero carbon by 2050 has become a major priority for global governments to ensure future sustainability of the planet. The global dairy sector has signed up to that accord, and country and corporate strategies are taking shape.

Agriculture, forestry, and land use account for about 23% of greenhouse gas (GHG) emissions, according to the United Nation's Intergovernmental Panel on Climate Change's (IPCC) 2020 report. Deforestation has major implications for GHG-reduction targets because trees absorb about a third of carbon emissions produced worldwide but release carbon when they rot or are burned.

More than 100 countries (with 85% of the world's forests) signed a pledge at the recent 2021 United Nations Climate Change Conference (COP26) to end and reverse deforestation by 2030. The World Resources Institute found that ending forest losses by 2030 in all signatory countries would avoid 33 million hectares of deforestation, a land area roughly equivalent to Malaysia. It would also avoid 19 gigatons of carbon dioxide equivalent emissions, about twice China's annual emissions. And ending these practices would preserve fragile biodiversity and water quality.

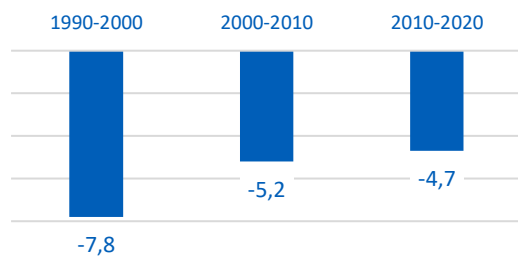
The Impact on Dairy

The effect of ending the clearing of rainforests has strong relevance to future dairy markets. Deforestation has expanded production of several commodities critical to supply and demand of the dairy complex, including cocoa, soy, corn, palm oil, and beef.

The largest countries in focus—those that are COP26 agreement signatories—that dominate oilseed production are Brazil (largest soybean producer) and Malaysia and Indonesia (largest palm oil producers). Soybean production has both supply and demand ramifications for dairy; soybean oils compete with butterfat, and soybean meal is included in dairy rations. While palm oil is primarily relevant to demand-side competition, it is also vital in blended ingredients used in nutritional products and commodity milk powders.

Addressing deforestation is a major challenge of climate

Average forested area lost each year by decade (million hectares)



Source: United Nations Food and Agriculture Organization

change, but deforestation pledges have failed before. World leaders in 2014 pledged to end deforestation by 2030 but failed to even slow it.

A big change this time is that Brazil has signed the accord. COP26 commitments include public and private money to assist developing countries. Thirty leading financial institutions have also pledged to remove funding for deforestation activities from their portfolios by 2025. In addition, 28 countries engaged as chief traders in products from vulnerable regions agreed to reduce their use of outputs from deforested land. This group, however, excluded China, which dominates soybean trade.

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Did You Know?

A 2014 United Nation's declaration promised to halve tropical deforestation by 2020 and end it by 2030, but deforestation rose by 12% year-over-year in 2020 alone.

Land-use change, including deforestation and degradation, accounts for about 10-12% of global emissions, according to the United Nation's IPCC.

Indonesia and Malaysia are expected to export 90% of the world's palm oil in 2022, according to USDA. Brazil's soybean production increased by 83% in the decade to 2021 as its crop area expanded more than 60%.



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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	4.145	1,88	Firm	4.275	1,94	Firm	4.350	1,97	Firm
FCMP/WMP	4.630	2,10	Firm	5.450	2,47	Stable	4.675	2,12	Firm
Butter	6.505	2,95	Firm	6.950	3,15	Firm	6.750	3,06	Firm
Cheddar	4.300	1,95	Firm	6.600	2,99	Stable	5.950	2,70	Firm
SWP	1700	0,77	Stable	1.600	0,73	Stable			

U.S. prices stated ex-works/including expected CWT subsidy where applicable; world prices stated FOB main port; EUR/USD: this week \$1,135

→ An increase in commitments at a country level will be required both in terms of regulatory and non-regulatory measures. However, the “devil is often in the details,” and implementation is far harder than mere words alone.

Little detail is available on how signatories plan to achieve their goals, or how implementation will be transparently measured, tracked, and enforced if countries fail to meet deadlines. If governments are serious about stopping forest destruction, pledges must be backed by strong and binding national legislation that makes it illegal for companies and financial institutions to fuel deforestation.

COP26 isn't the only effort to halt deforestation. Significant corporate sustainability alliances address improved sustainability in production of palm oil, cocoa, and beef.

Time will tell whether this initiative will be different. The practical barrier to eliminating deforestation is the challenge of feeding the world's expanding population. Limiting future farmland could substantially lift prices, and when food prices are elevated for extended periods, governments are pressured to improve affordability—removing impediments to production is often the easiest solution. If more land can't be added to food production, major improvements in productivity will be essential.

Bring it Home

Future Impacts of Land Constraints

The fragility of crop supplies in several of the countries that signed the COP26 deforestation pledge has been patently obvious over the past year and will continue to influence dairy markets for at least the short term.

Soybean prices neared historical highs last year after dry weather limited growth in the Brazilian crop. Strong demand from China to improve animal feed security to restore pork stocks and build vegetable oil inventories has tightened the

World Comment

Milk production still paints the world mostly red, even though the farmgate price keeps increasing. NZ, Western Europe, Argentina and the US all saw red recently while Eastern-Europe is getting green. Ireland and Italy seem to be doing fine but at one point ever increasing farmgate milk prices should overcome increased costs of labor, feed, fertilizers and/or gas and should be an incentive for farmers to produce more milk in other regions of the world as well. That may not be the case for the Netherlands anytime soon as Dutch farmers face significant herd size restrictions by environmental policies. The production of milk powder was relatively low in both the US and the EU. Which was influenced by the surge of natural gas prices. This was disrupting the usual valorization-sheets, another reason to watch the conflict between Ukraine and Russia. Cheese production increased overall, more milk went to cheese to meet increased demand, while European SMP exports were down due to lack of availability. Retail milk sales continue to fall in the US while food service sales are up. A reflection of easing Covid-restrictions in the US and Europe.

world's balance sheet for soybeans. Increased production in the United States is expected in 2022, but price developments in soybeans will be highly dependent on the Brazilian crop, which has suffered another damaging dry spell.

Soybean oil prices last year surged along with the improving crude oil market, which benefits biofuel demand, but soybean oil prices have been strongly influenced by the palm oil market. Palm oil prices have been elevated since the fourth quarter of 2020 and remain near all-time highs due to acute production and supply chain challenges in Malaysia and Indonesia, partly the result of weather but also a reflection of COVID's impact on labor availability. These production constraints will gradually lessen in the first half of 2022.

Current trends in vegetable oil markets will remain supportive for butterfat and whole milk powder at least into the second half of this year. These elevated price levels provide a glimpse into the potential future impact that additional constraints on new farmland could have on downstream food prices.



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