

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

## Market Matters

# Inflationary Pressures Hit Dairy Farms and Processors

The world continues to be mired in a period of strong pandemic-related inflation that's higher than it has been in decades in most parts of the world. This period of inflation is also more persistent than expected. However, central banks in the United States and Europe have started to respond.

Last month, the European Central Bank announced it would end its pandemic-era bond-buying program in March 2022 and pledged additional support for the eurozone economy but stopped short of saying it would raise interest rates. Earlier, the Bank of England voted to raise its interest rate by 15 basis points to 0.25%, while the U.S. Federal Reserve signaled it would end its pandemic-era bond purchases and raise interest rates three times this year to slow inflation.

### Inflation to Persist

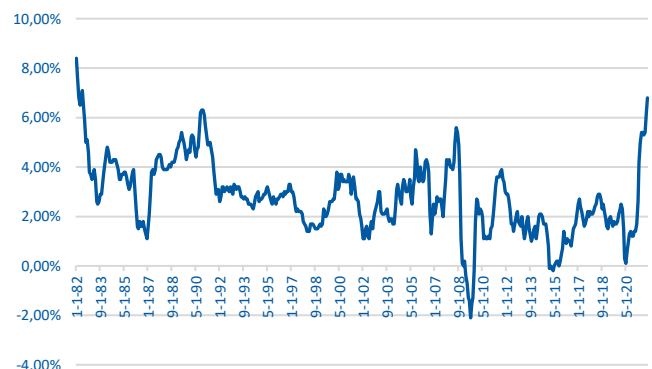
Despite these moves, inflation is expected to persist through much of 2022 due to the many factors pushing prices higher. Everything from labor shortages to supply disruptions to shortages of various products and inputs to a recovering world economy that has driven energy prices skyward have inflated prices on gas, consumer goods, and food, including dairy.

Monetary policy early in the pandemic pumped trillions of dollars into world economies, and consumers in the developed world responded by shifting funds typically spent on travel, restaurants, and other forms of entertainment to tangible goods, including extra food for their pantries. At the same time, manufacturers and suppliers who lacked an adequate labor force, whether due to illness, retirements, or fear of the virus, have been unable to keep pace with demand.

Along with other commodity prices, milk and dairy product prices have been marching higher as milk supplies slow worldwide and both processors and producers face a tightening labor force. The Food and Agriculture Organization's Food Price Index has been mostly climbing since the pandemic began. The December 2021 food price index surged 23.1% year over year to levels, while the Dairy Index gained 17.4%. December 2021's international price

quotations for butter and milk powders rose sharply, driven primarily by tight global export availabilities and depleted stocks.

U.S. Inflation



Source: U.S. Bureau of Labor Statistics

The rising cost of inputs—from fuel to feed to fertilizer—is also pushing up the cost of milk and dairy product production. At the start of this year, U.S. corn prices were 23% higher than at the beginning of 2021. Fertilizer prices had more than doubled, and diesel fuel prices were up 58%. Forage prices and the cost of labor were also rising. Packaging, like corrugated, and even cellulose used for shredded cheese were also more costly and in tight supply. This past holiday season, two U.S. firms paid some consumers to make holiday desserts with something other than cream cheese, which was in short supply due to lack of packaging.

Inflation has raised the bar on farm and dairy processing investments as well. With uncertainty over prices, investments are being postponed to avoid investing at the high. For instance, the cost to build a U.S. greenfield dairy in December was \$10,000 per cow, up from \$5,000 a few years ago. With investments on hold, no end in sight for the labor shortage, and input prices still rising, the trend for milk and dairy prices is likely higher for the foreseeable future.



# Hoogwegt Forecast

	U.S. average prices			EU average prices			Oceania average prices		
	\$/t	\$/lb	Trend	\$/t	\$/lb	Trend	\$/ton	\$/lb	Trend
SMP	3.970	1,80	Firm	4.000	1,81	Firm	4.200	1,91	Firm
FCMP/WMP	4.520	2,05	Stable	4.825	2,19	Stable	4.300	1,95	Firm
Butter	6.170	2,80	Firm	6.450	2,93	Stable	6.250	2,83	Firm
Cheddar	3.970	1,80	Stable	4.000	1,81	Stable	5.600	2,54	Firm
SWP	1720	0,78	Firm	1.525	0,69	Firm			
Lactose	882	0,40	Stable						

U.S. prices stated ex-works/including expected CWT subsidy where applicable; world prices stated FOB main port; EUR/USD: this week \$1,116

## World Comment

Europe and NZ are still seeing red milk production numbers. What stood out was the low figure from New Zealand. That December -5,5% will pull the NZ average for the season even lower. All while the US overall saw a small decrease (-0,1% for Dec) with positive numbers coming from California and the Mid-West. Overall though, the ever increasing milk payout prices aren't enough to paint a green picture as the global milk production is still red and close to -1%. In Europe, less milk is going to powders for a few month now, on top of that we've seen a lower production of milk in general. Valorization is now in favor of SMP and butter vs Cheese, especially if producers are producing on annual gas price contracts, that has been contracted before the price hike. WMP is giving the worst return, so producers will only produce if they have to. On the demand side we see a new Covid-paradigm in 'open' Europe due to the Omicron-variant and relatively high vaccinations while people wonder if China can maintain their zero-Covid policies with something as contagious as Omicron. And of course, there is inflation, and a 'geopolitical situation' involving Russia, NATO, and Ukraine.

## Bring it Home

# Inflation's impact on Dairy Yet to Come

Despite rising dairy prices, consumers have yet to pull back on dairy product purchases in the developed world. Even in the developing world, where dairy product demand fell following the initial lockdowns, demand is returning. And in China, a country that has largely escaped the worst of the coronavirus pandemic and where officials continue to tout dairy consumption to build strong immune systems, 2021 dairy product imports are expected to be either near-record or record high.

Dairy demand in many developing countries is returning after a COVID-driven slowdown that shocked local economies. For instance, in the Philippines, demand is expected to rebound this year as more businesses open to capacity, the vaccination rate increases, and diners return to restaurants. Other wealthier countries, such as Taiwan and Korea, continue to see an increase in per capita dairy consumption as Western food options gain in popularity.

However, if inflation persists or worsens and food prices continue to climb, countries in both the developing and developed world could see consumption of higher-value dairy products soften as demand for lower-valued products increases. For instance, developing countries could shift from whole milk powder to fat-filled milk powder or from liquid milk and cream supplies to powdered and condensed versions.

In the developed world, consumers could forgo high-priced artisan cheeses for commodity-style cheeses, including cheddar and American varieties. Still others could stretch their food dollars further by shifting from cheddar to processed cheeses or forgo cheese altogether. Even so, demand for dairy will likely remain strong despite this limited type of substitution occurring as consumers, once again comfortable in their kitchens, continue to cook more meals at home while increasingly venturing out to restaurants, known for cheese and butter laden meals.

## Did You Know?

The U.S. annual inflation rate for 2021 was 7%, the highest in four decades, according to the Bureau of Labor Statistics.

The annual inflation rate through November in the eurozone was 4.9%, and while that rate is expected to be lower in upcoming years, it is not expected to return to 2019 levels through at least 2026, according to the International Monetary Fund.

China's inflation rate of less than 2% is expected to remain relatively flat over the next five years, according to IMF, well below the country's target rate of inflation at 3%.

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