# ABARES' Dairy Industry Outlook

Global dairy prices are forecast to remain strong through 2011/12, reflecting constrained milk production growth in key exporting nations, and sustained import demand, particularly from China, Russia, Middle East and developing Asia.

World skim milk powder prices are forecast to average US$3,180/tonne in 2011/12, up 2% from the 2010/11 price, and 40% above the GFC-affected 2008/09 level. Further gains in milk powder prices are expected through to 2013/14, and thereafter prices are expected to moderate in-line with increasing global production, particularly in key exporting countries. However the influence of increased export supplies on prices will be largely offset by continued strong gains in emerging market demand, reflecting income growth and changing diets. China will lead this demand growth.

## Recovery in global dairy production

Global herd liquidation during the 2007/08 grain price spike and GFC constrained dairy production in recent years.

However strong dairy product prices are forecast to induce a positive global production response in 2011/12, although the planned growth in output may be tempered by current high grain prices. EU27, US and Oceania dairy output is forecast to increase in the coming season. Further increases in these regions is expected over the 5-year forecast period, while solid gains in emerging regions, chiefly South America and Asia (China and India), will add to medium-term production growth. An expansion in the NZ dairy herd, combined with higher yields, is forecast to drive a 2% per annum increase in NZ production over the forecast period. Most of this increased NZ production will be destined for the export market.

## Growth in global dairy consumption and imports driven by China

Dairy consumption in China has risen dramatically over the past 15 years. Despite the recently rapid growth, further strong gains in Chinese dairy consumption are likely over the medium term. Higher disposable incomes, increasing health consciousness, a growing middle class and expanding retail outlets are the primary factors supporting growth in Chinese milk consumption. Per person dairy consumption in China remains well below the rates observed in other developed economies. ABARES believes that the continued expansion of Chinese dairy consumption, and increased import needs, will underwrite future dairy prices. We agree with this outlook.

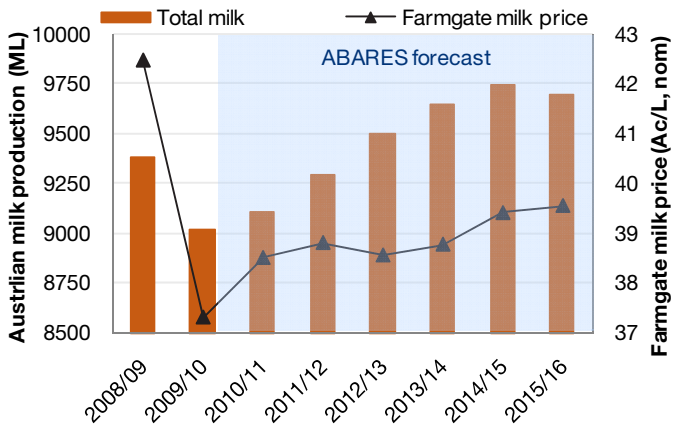
Outside China, large gains in dairy consumption are expected in Russia (particularly cheeses), while Indian consumption is forecast to grow strongly because of population and income growth.

## Outlook for the Australian dairy market

Improved irrigation water supplies and strong global dairy prices are assumed to boost Australian milk production by 2% in 2011/12 to 9.3 million litres. Further gains in local milk production are forecast over the next 5-years because of further herd-rebuilding and productivity improvements.

Australian farm-gate milk prices are forecast to average Ac38.8/L in 2011/12, up 4% from the 2009/10 lows. Farm-gate prices are expected to range around this level for the next 5 years.

Figure 1: Aust milk production and farm-gate milk prices




*Source: ABARES and CBA*

**Luke Mathews** Agri Commodities T. +612 9118 1098 E. luke.mathews@cba.com.au

## Impact of supermarket price discounting for home-brand milk

ABARES provide an overview of the possible consequences of the current retail-milk price discounting. Some key facts, which help influence the current debate include:

- One-quarter of Australia's milk production is used domestically as market milk (drinking milk).
- Around half of Australia's drinking milk is sold through the supermarket channel (by volume).
- Home-brand milk and branded milk is not identical, but there is a high degree of substitution.
- The latest discounting by supermarket has widened the price discount of home-brand milk versus branded supplies. Coles Brand 2 Litre milk has been reduced to $2, while the price of a certain branded milk (2 litre) was priced a $3.89.
- QLD (94%), NSW (66%) and WA (70%) have a significant bias toward the local market milk industry. Only 9% of VIC milk and 8% of TAS milk is used as domestic market milk. The remainder is used in the manufacturing milk market.
- Around 60% of manufactured milk production is exported.
- VIC produces around two-thirds of Australia's farm-gate milk supply.

ABARES believe that lower home-brand milk prices will cause a decline in the market share of branded milk. However total drinking milk sales are forecast to increase because of lower prices.

The likely response by dairy processors – who supply retailers with both home-brand and branded product – will depend on the relative processor-margins across the various products. Under a scenario where processor's profit margins for branded supplies are higher than the home-brand product, the reduction in branded milk sales will reduce overall profit levels for processors. Under this scenario, processors could seek to protect profit margins by reducing the farm-gate milk price.

Should processors seek to offer lower farm-gate milk prices, the extent of the price declines would vary between regions:

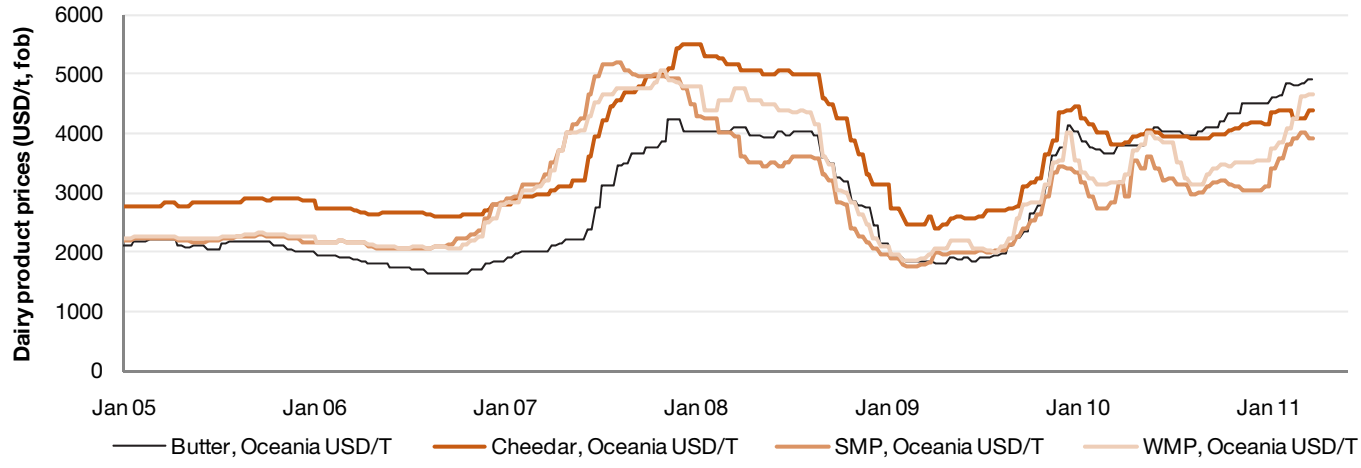
- Regions that supply a greater proportion of their product to the manufacturing milk segment will observe a comparatively small decline in farm gate prices. The buoyant export market for manufactured milk products will place a floor under farm gate milk prices in those regions.
- However, for regions heavily exposed to the domestic drinking milk market, the potential downward pressure on farm-gate price could be significant. Thus the geographies most susceptible to farm-gate price pressure include QLD, northern NSW and WA.
- However, ABARES noted that the current total cost of milk production in northern NSW and Qld is already near, if not at, the current milk price. This means that a decline in farm-gate milk prices would ultimately result in a rationalisation of dairy farms in those regions. Unless, of course, farm productivity improved. Therefore, outside VIC and TAS, dairy processors will be forced to absorb a greater proportion of the margin compression.

## Figure 3: ABARES' dairy outlook

| | unit | 2008 –09 | 2009 –10 | 2010 –11 | 2011 –12 | 2012 –13 | 2013 –14 | 2014 –15 | 2015 –16 |
|---|---|---|---|---|---|---|---|---|---|
| **World** | | | | | | | | | |
| **Indicative price** | | | | | | | | | |
| Butter | | | | | | | | | |
| – nominal | US$/t | 2 485 | 3 477 | 4 325 | 3 900 | 3 600 | 3 400 | 3 300 | 3 200 |
| – real b | US$/t | 2 539 | 3 517 | 4 325 | 3 833 | 3 469 | 3 212 | 3 056 | 2 905 |
| Skim milk powder | | | | | | | | | |
| – nominal | US$/t | 2 333 | 2 948 | 3 120 | 3 180 | 3 250 | 3 280 | 3 200 | 3 120 |
| – real b | US$/t | 2 383 | 2 982 | 3 120 | 3 125 | 3 131 | 3 098 | 2 964 | 2 833 |
| Cheese | | | | | | | | | |
| – nominal | US$/t | 3 281 | 3 748 | 4 040 | 4 100 | 4 140 | 4 180 | 4 100 | 4 000 |
| – real b | US$/t | 3 351 | 3 791 | 4 040 | 4 029 | 3 989 | 3 949 | 3 797 | 3 632 |
| **Australia** | | | | | | | | | |
| Cow numbers c | '000 | 1 676 | 1 553 | 1 570 | 1 580 | 1 600 | 1 605 | 1 605 | 1 585 |
| Yield per cow | L | 5 602 | 5 810 | 5 803 | 5 886 | 5 938 | 6 011 | 6 075 | 6 120 |
| **Production** | | | | | | | | | |
| Total milk | ML | 9 388 | 9 023 | 9 110 | 9 300 | 9 500 | 9 650 | 9 750 | 9 700 |
| - Market milk | ML | 2 229 | 2 269 | 2 300 | 2 333 | 2 371 | 2 410 | 2 450 | 2 492 |
| - Manufactured milk | ML | 7 159 | 6 754 | 6 810 | 6 967 | 7 129 | 7 240 | 7 300 | 7 208 |
| Butter d | kt | 148 | 128 | 122 | 125 | 121 | 120 | 121 | 119 |
| Cheese | kt | 342 | 349 | 348 | 353 | 361 | 370 | 377 | 375 |
| Skim milk powder | kt | 212 | 190 | 191 | 196 | 189 | 187 | 190 | 186 |
| Wholemilk powder | kt | 148 | 126 | 137 | 139 | 143 | 144 | 143 | 141 |
| **Farmgate milk price** | | | | | | | | | |
| – nominal | Ac/L | 42.5 | 37.3 | 38.5 | 38.8 | 38.5 | 38.8 | 39.4 | 39.5 |
| – real g | Ac/L | 44.7 | 38.4 | 38.5 | 37.7 | 36.4 | 35.7 | 35.4 | 34.7 |
| **Export volume** | | | | | | | | | |
| Butter c | kt | 70 | 74 | 62 | 62 | 58 | 56 | 54 | 52 |
| Cheese | kt | 146 | 168 | 164 | 167 | 174 | 180 | 184 | 178 |
| Skim milk powder | kt | 162 | 126 | 130 | 137 | 128 | 125 | 129 | 127 |
| Wholemilk powder | kt | 116 | 91 | 102 | 107 | 110 | 111 | 109 | 106 |
| **Export value** | | | | | | | | | |
| – nominal | A$m | 2 679 | 2 066 | 2 240 | 2 220 | 2 221 | 2 294 | 2 308 | 2 276 |
| – real g | A$m | 2 819 | 2 125 | 2 240 | 2 154 | 2 097 | 2 114 | 2 075 | 1 996 |

*Source: ABARES*

## Figure 3: Historic global dairy product prices




*Source: Bloomberg and CBA*