

Dairy market outlook

Short term headwinds won't spoil the long term story

- Global dairy prices have proved volatile over the past five years, but values remain historically elevated.
- In 2010 the global Whole Milk Powder (WMP) prices ranged between USD3,000-4,000/t before moving higher in Q1 2011 to peak at USD4,650/t in March. Prices have lost ground since March, with the WMP market now at USD3,500/t, 25% below the peak. Still, dairy prices are 15 - 20% above the 2004-2011 average in USD terms.
- We believe global dairy prices will remain historically high over the next few seasons. Prices should remain supported by strong Asian demand and constrained northern hemisphere production. But the worsening global economic outlook presents a substantial risk to dairy prices. During the GFC, world WMP prices slumped 65% from USD5,000/t to USD1,850/t. GFC Mark I caused a sharp contraction in global dairy consumption.
- ABARES, in its September 2011 edition of the Australian Commodities report, forecast:
 - Australian milk production will rise 2.2% to 9.3 billion litres in 2011/12 following the 0.9% rise in 2010/11.
 - Cow numbers will increase 0.6% in 2011/12 and yields will rise 1.5%, influenced by the favourable price and seasonal outlook.
 - Australian dairy exports will be \$2.25 billion in 2011/12, down 4% from the \$2.35 billion export program of 2010/11, but still 8% higher than 2009/10 exports.
 - Farm-gate milk prices will average 42.5 cents per litre in 2011/12, down slightly from 43.4 cents per litre in 2010/11, but up sharply from 37.3 cents per litre in 2009/10. Farm gate milk prices averaged 35.3 cents per litre during the 2000s.

Figure 1: ABARES dairy outlook

		2009	2010	2011	% change
		-10	-11	-12	
Cow numbers	'000	1,596	1,610	1,620	0.6
Milk yields	L/cow	5,653	5,654	5,741	1.5
<u>Production</u>					
Total milk	ML	9,023	9,102	9,300	2.2
– market sales	ML	2,269	2,316	2,354	1.6
– manufacturing	ML	6,754	6,787	6,946	2.3
Cheese	kt	349	338	345	2.1
Farmgate milk price	Ac/L	37.3	43.4	42.5	-2.1
Value of exports	A\$m	2,088	2,346	2,254	-3.9
<u>World prices</u>					
Butter	US\$/t	3,477	4,683	4,200	-10.3
Cheese	US\$/t	3,748	4,221	4,250	0.7
Skim milk powder	US\$/t	2,948	3,392	3,390	-0.1
Whole milk powder	US\$/t	3,221	3,771	3,770	0.0

Source: ABARES Australian Commodities (September 2011)

Figure 2: Oceania dairy product prices (USD/t)

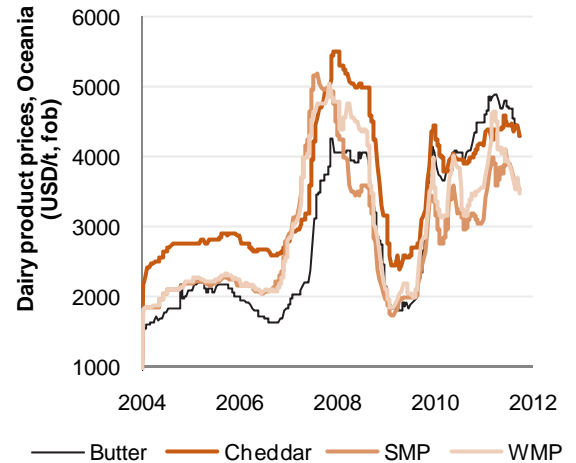


Figure 3: Oceania WMP prices (USD, AUD, NZD)

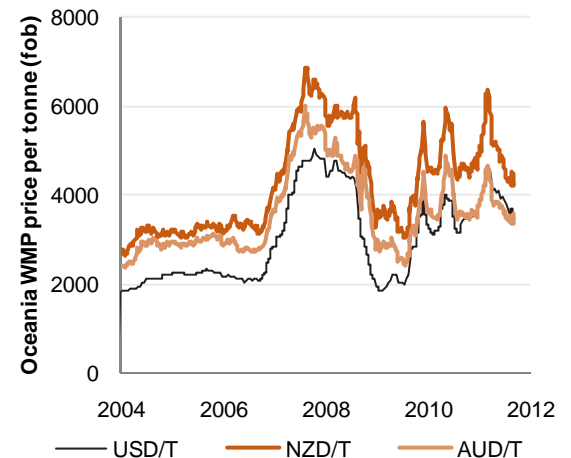
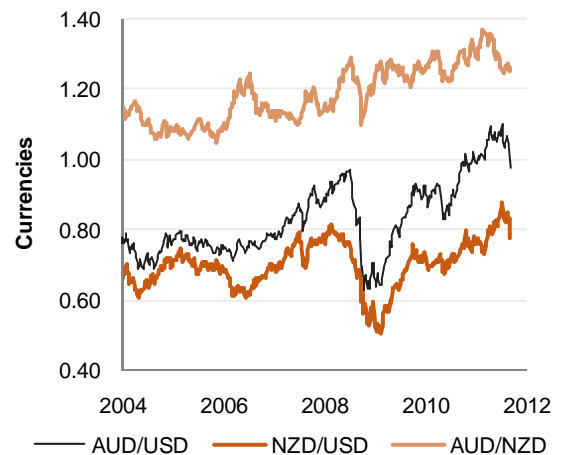


Figure 4: Currencies



Source: Bloomberg and CBA



Global Supply and Demand Outlook

Global consumption outlook

Global dairy consumption suffered during the GFC but recovered during 2010 in-line with the economic recovery. Global trade in dairy products also recovered.

Strong Chinese and Russian dairy imports during the first half 2011 provided an encouraging signal for future consumption, but mounting risks of another global recession imply dairy consumption may soon waver. After all, GFC Mark I caused a sharp contraction in global dairy consumption. Global fluid milk consumption fell 2.8% from 2007 to 2009, WMP consumption fell 2.4% and cheese consumption fell nearly 2%. We will closely monitor global indicators to determine if the current financial market uncertainty is having an impact on real dairy consumption.

Despite the near term uncertainty regarding global dairy consumption, we consider the medium/longer term demand outlook particularly strong, driven by emerging market demand, most notably in China. We believe the structural adjustment in Chinese diets (to include a higher proportion of dairy products) will underwrite global dairy demand over the longer term.

Global production outlook

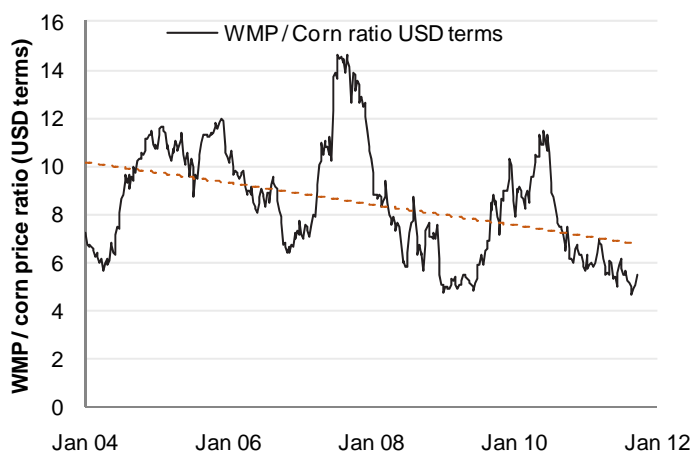
High global grain prices, falling milk prices and an uncertain future contributed to reduction of the global dairy herd just prior to, and during the GFC. This reduction in productive capacity contributed to the improvement in dairy prices throughout 2009. Global dairy producers have sought to rebuild herds and increase supply in 2H09 and 2010 following the post-GFC price recovery. This increase in production has contributed to the ranging price action observed during 2010.

The most pronounced production increases have occurred in New Zealand, Australia and Argentina, aided by favourable seasonal conditions. The European and US production response has been held back by difficult seasonal conditions and exceptionally high feed grain prices. ABARES has noted that grain and feed supplements account for one third of the cash costs incurred by Australian dairy farmers, and feed costs are a more important cost of production for northern hemisphere producers.

Global feed grain prices soared by nearly 140% to record high levels in the year to June 2011, driven by exceptionally tight grain supplies. But dairy product prices are only flat to modestly firmer, causing a deterioration in the relative profitability of grain-fed dairy production. CBA's 'Dairy Feeding Indicator' has recorded negative readings since September 2010, suggesting a future slowdown in global dairy production is probable.

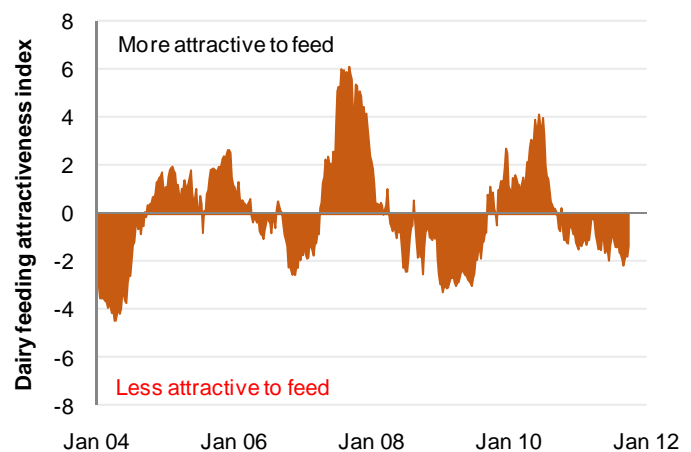
ABARES, in their September 2011 Agricultural Commodities report, forecast New Zealand dairy production to rise 5% in 2011/12, following the 5.2% expansion in 2010/11. But US milk output is expected to increase by only 1.6%. ABARES noted that "higher grain prices [will lead] to increased culling of dairy cows [in the United States] over the remainder of 2011 and into 2012".

Figure 5: WMP vs corn price ratio (USD terms)



Source: Bloomberg, CBA

Figure 6: Dairy feeding attractiveness indicator



Source: Bloomberg, CBA



Australian dairy outlook

Australian dairy production is heavily influenced by prevailing seasonal conditions and the availability of irrigation water supplies. To this end, abundant rainfall across eastern Australia throughout 2010 supported herd rebuilding following the drought-induced culls of past seasons. Improved irrigation water availability and favourable Victorian rainfall in 2011 (despite flooding in many regions last summer) has supported further herd rebuilding this year.

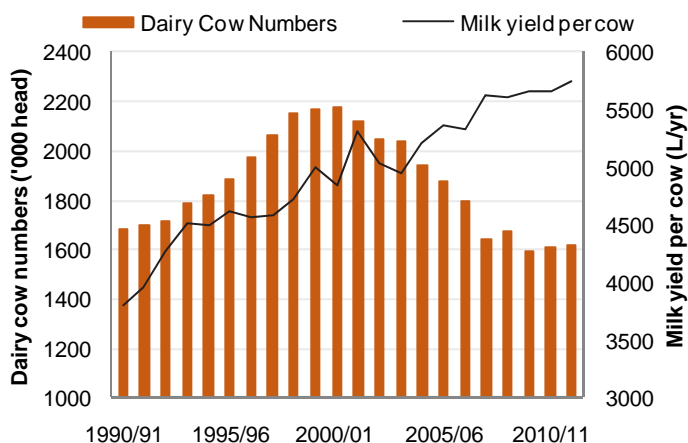
ABARES, in its September 2011 edition of the Australian Commodities report, noted that “favourable winter conditions in most dairying regions of south-eastern Australia are expected to ensure good supplies of pasture and fodder.” They also noted that irrigation “water levels in the main storage dams have improved considerably over the past year”, with dams at 87% capacity at the beginning of September versus 52% a year earlier.

ABARES forecast that:

- Australian milk production will rise 2.2% to 9.3 billion litres in 2011/12 following the 0.9% rise in 2010/11. Cow numbers are forecast to increase 0.6% in 2011/12 and yields are expected to increase 1.5%, influenced by the favourable price and seasonal outlook.
- Australian dairy exports will be \$2.25 billion in 2011/12, down 4% from the \$2.35b export program of 2010/11, but still 8% higher than 2009/10 exports.
- Farm-gate milk prices will average 42.5 cents per litre in 2011/12, down slightly from 43.4 cents per litre in 2010/11, but up sharply from 37.3 cents per litre in 2009/10. Farm gate milk prices averaged 35.3 cents per litre during the 2000s.

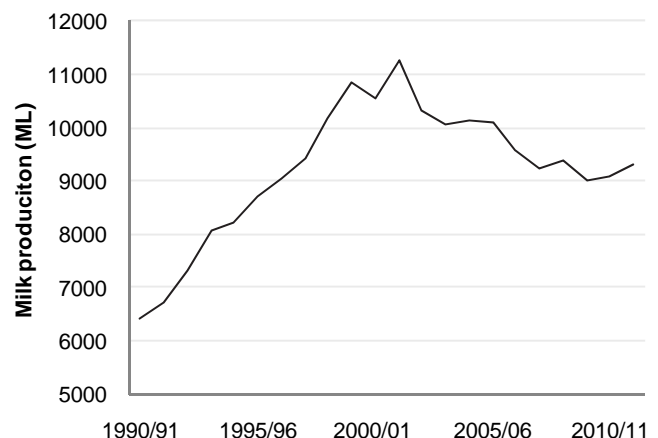
Finally, ABARES forecasts that Australian consumption of market milk may rise by 1.6% in 2011/12 following the impressive 2.1% expansion in 2010/11. Price discounting by supermarkets appears to have boosted volume growth in 2010/11. Fresh milk sales rose 3.6% the five months ended June 2011 compared to the same period a year earlier. Between January and June 2011, the share of private label milk sold through supermarkets rose 5% points to 54%, with branded milk's share falling to 46%.

Figure 7: Australian dairy cow numbers and milk yield



Source: ABARES and CBA

Figure 8: Australian milk production



Source: ABARES and CBA



Figure 9: Global dairy price summary

		This week 22 Sep 11	Last week 15 Sep 11	Last month 23 Aug 11	Last year 22 Sep 10	Weekly Chg %	Monthly Chg %	Annual Chg %	Avg since 2004	Current vs. Average %
Butter, Oceania	USD/T	4300	4300	4450	4100	0.0%	-3.4%	4.9%	2859	50.4%
Cheddar, Oceania	USD/T	4300	4300	4450	3975	0.0%	-3.4%	8.2%	3495	23.0%
SMP, Oceania	USD/T	3525	3525	3550	3175	0.0%	-0.7%	11.0%	2876	22.6%
WMP, Oceania	USD/T	3488	3488	3530	3400	0.0%	-1.2%	2.6%	3021	15.4%
Butter, Oceania	NZD/T	5540	5173	5409	5646	7.1%	2.4%	-1.9%	4019	37.8%
Cheddar, Oceania	NZD/T	5540	5173	5409	5474	7.1%	2.4%	1.2%	4955	11.8%
SMP, Oceania	NZD/T	4541	4240	4315	4372	7.1%	5.2%	3.9%	4058	11.9%
WMP, Oceania	NZD/T	4493	4195	4290	4682	7.1%	4.7%	-4.0%	4259	5.5%
Butter, Oceania	AUD/T	4396	4144	4262	4372	6.1%	3.1%	0.6%	3356	31.0%
Cheddar, Oceania	AUD/T	4396	4144	4262	4239	6.1%	3.1%	3.7%	4173	5.3%
SMP, Oceania	AUD/T	3604	3397	3400	3386	6.1%	6.0%	6.4%	3424	5.3%
WMP, Oceania	AUD/T	3566	3361	3380	3626	6.1%	5.5%	-1.7%	3583	-0.5%
US Corn Prices	USc/bu	639	692	711	513	-7.7%	-10.2%	24.4%	381	67.8%
NZD/USD		0.7762	0.8313	0.8227	0.7262	-6.6%	-5.7%	6.9%	0.6999	10.9%
AUD/USD		0.9781	1.0377	1.0441	0.9378	-5.7%	-6.3%	4.3%	0.8304	17.8%
AUD/NZD		1.2602	1.2484	1.2691	1.2914	0.9%	-0.7%	-2.4%	1.1852	6.3%

Source: Bloomberg and CBA



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