

Dairy Market Update

Key points

- Global dairy prices have stabilised after falling in Q2 and Q3 2011.
- Softening demand and rising supplies contributed to the lower prices.
- Australian dairy production to rise 3% in 2011/12 because of favourable seasonal conditions.

Summary

Global dairy prices firmed over the past month in USD terms, driven by stronger butter and cheddar prices (up 4% and 5% respectively), although SMP and WMP powder prices continued to ease lower (both down 0.7%).

The recent stabilisation in dairy prices contrasts to the sharply falls observed in Q2 and Q3 2011. After posting 3-year highs in the first half of the year, SMP prices fell 17½%, WMP prices fell 23%, Cheddar cheese prices fell 14 %, and butter prices fell 19%.

Nonetheless dairy product prices remain strong when compared to average levels since 2004, particularly in USD terms. Our dairy product composite price¹ is currently 22% above its medium term average in USD terms. In NZD terms, current prices are only 10% above their averages, while AUD prices are less than 1% stronger.

Softening global demand for dairy products, owing to the deteriorating global economic growth prospects, increased dairy product supply from key producing regions, and general weakness in other commodity markets weighed on dairy prices in Q2 and Q3 2011.

ABARES, in their December 2011 Australian Commodities report, say world dairy products prices in 2012 should be supported by continued growth in dairy demand in Asia, North Africa and Middle East and Russia. But slowing economic growth in Europe, which may slide into recession in 2012, provides a further risk for dairy demand, particularly for cheese.

Figure 1: Oceania dairy product prices (USD)

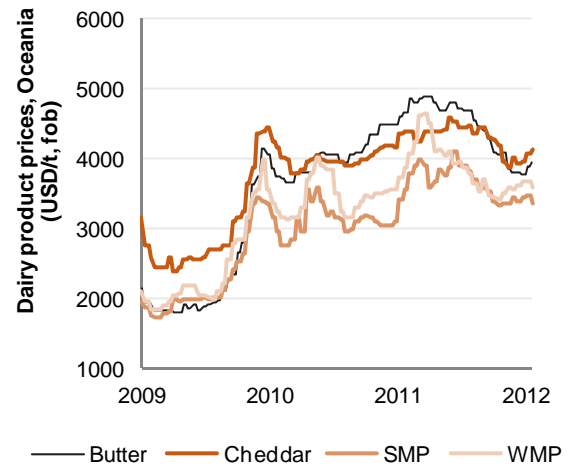
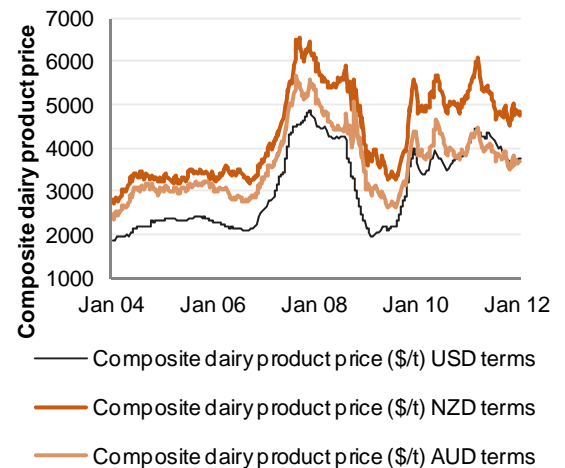


Figure 2: Oceania dairy price



Source: Bloomberg and CBA

Figure 3: Global dairy price summary

		This week 19 Jan 12	Last week 12 Jan 12	Last month 20 Dec 11	Last year 19 Jan 11	Weekly Chg %	Monthly Chg %	Annual Chg %	Avg since 2004	Current vs. Average
Butter, Oceania	USD/T	3950	3875	3800	4600	1.9%	3.9%	-14.1%	2902	36%
Cheddar, Oceania	USD/T	4138	4088	3938	4350	1.2%	5.1%	-4.9%	3517	18%
SMP, Oceania	USD/T	3375	3475	3400	3425	-2.9%	-0.7%	-1.5%	2897	16%
WMP, Oceania	USD/T	3600	3663	3625	3738	-1.7%	-0.7%	-3.7%	3043	18%
US Corn Prices	USc/bu	606	600	583	649	1.1%	3.9%	-6.6%	390	55%
NZD/USD		0.8029	0.7922	0.7610	0.7693	1.4%	5.5%	4.4%	0.7032	14%
AUD/USD		1.0418	1.0287	0.9951	0.9901	1.3%	4.7%	5.2%	0.8380	24%
AUD/NZD		1.2975	1.2984	1.3075	1.2870	-0.1%	-0.8%	0.8%	1.1899	9%

Source: Bloomberg, USDA and CBA

¹ The dairy composite price reflects a simple moving average of Oceania SMP, WMP, Cheddar and Butter prices.



Global dairy consumption hurt by slowing Eurozone economy

Despite the improvement in Eurozone confidence over the past few weeks, our economists believe a recession in Europe is almost unavoidable. CBA forecast Eurozone economic growth over 2012 of just 0.3%, following forecast 1.0% growth over 2011. Both results are well below trend rates of ~2%pa. The weak Eurozone is expected to weigh on global growth in 2012, which is expected to be below trend at 3.5%. Weaker economic growth dampens the demand for dairy products.

The USDA, in their December 2011 market report, said that a factor contributing to the pressure in dairy prices in the last half of 2011 was “undoubtedly a growing caution by buyers as the increasingly volatile financial situation in the EU grew to dominate the financial outlook”.

For 2011, the USDA currently forecasts EU27 fluid milk consumption at 33.87 million tonnes, down 0.4% from their July estimate of 34.00 million tonnes. This is despite a 0.9% upward revision to 2011 European milk production over the period. Similarly, global fluid milk consumption for 2011 was revised lower by 0.4% to 170.8 million tonnes, despite a 0.8% upward revision in output. The USDA also revised 2011 global cheese consumption lower by 0.6% compared to their July forecast, and WMP demand was revised 0.5% lower.

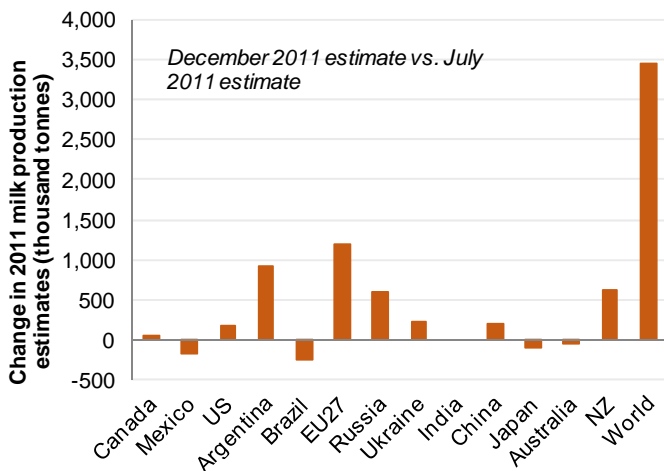
We believe that dairy demand in 2012 may be constrained by a subdued global economic growth outlook. However we acknowledge that dairy product prices are currently 15%-25% below their 2011 peaks, which, ceteris paribus, supports dairy demand and helps offset the impact of subdued consumer income growth.

Global milk production in 2011² exceeds expectations

Global milk production in 2011 exceeded expectations, rising 2.4% YOY according to the USDA compared to their mid-year estimate of 1.7% YOY growth. For 2011, the USDA made upward revisions to US milk production (+182 thousand tonnes, +0.2%), Argentinean milk production (+920 thousand tonnes, +8.3%), Russian production (600 thousand tonnes, +1.9%), EU27 production (1.2 million tonnes, +0.9%) and NZ production (632 thousand tonnes, +3.5%). High dairy prices in the first half of the year and favourable seasonal conditions, particularly in the southern hemisphere, contributed to the increase in world milk production in 2011.

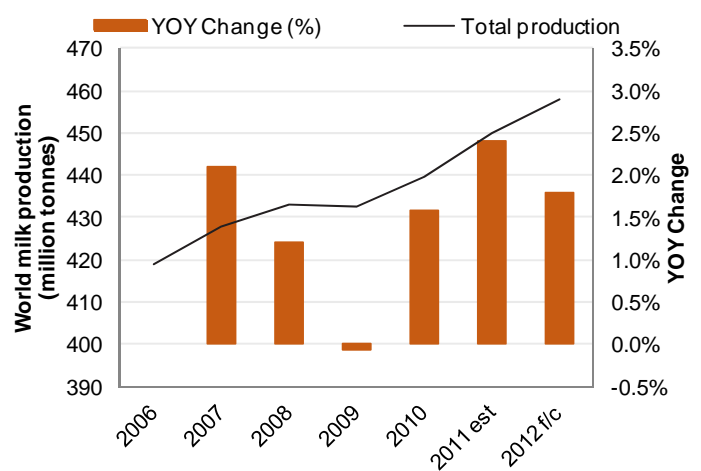
A sizable downward revision to Japan’s 2011 milk production (-100 thousand tonnes to 7.45 million tonnes, -0.7%), linked to the tsunami and nuclear disaster earlier in the year, provided a partially offset to increased production elsewhere. As a result of lower domestic production, Japanese butter imports from April to October 2011 trebled compared to a year earlier, while cheese imports increased 9% over the same period.

Figure 4: Change in 2011 milk production estimates



Source: USDA and CBA

Figure 5: World fluid milk production



Source: USDA and CBA

² USDA projections refer to calendar years, not local marketing years for individual countries.



For 2012, the USDA forecasts world milk production to rise 1.8% YOY to 458.1 million tonnes. The forecast slower rate of growth reflects (1) a more subdued expansion in Argentina output (4% in 2012 vs 13% in 2011) because of contracting local profit margins; (2) slower NZ growth (2.4% in 2012 vs 9% in 2011); (3) slower EU27 output growth because of higher production costs, lower consumption and financial market uncertainty; and (4) slower US output because of higher feed costs. For most regions, the USDA expects improvements in cow milk yields to help limit the slowdown in global milk production.

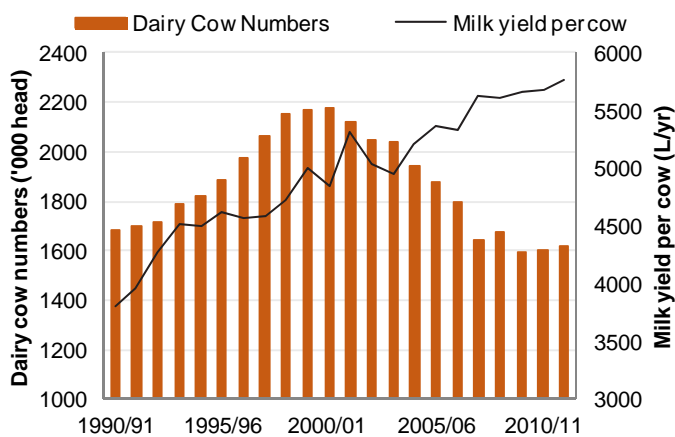
Australian dairy output boosted by favourable seasonal conditions

ABARES, in their December 2011 Australian Commodities report, forecast a 3% lift in national milk production to 9.35 billion litres in 2011/12 because of favourable seasonal conditions. Virtually all of the increased production is expected to occur in Victoria, Tasmania and southern NSW – with improved irrigation water availability in northern NSW and southern NSW being a key driver. ABARES expects the size of the herd to expand 1% in 2011/12 and milk yields to rise 1.7%.

The manufactured milk segment (milk used for processed dairy products) continues to be the major growth avenue for the Australian sector. Manufactured milk production is forecast to rise 3% YOY to 7 million litres while market milk (fresh milk) output is expected to increase 1.8% to 2.4 million litres. Within the manufactured milk segment, cheese and WMP production is expected to rise significantly, outweighing a comparatively small decline in butter and SMP.

Australian consumption of market milk is forecast to lift by nearly 2% in volume in 2011/12, boosted by cheaper retail milk prices. ABARES reported that between February and September 2011, the share of home brand milk sold through supermarkets lifted by 5% to 54%.

Figure 6: Australian dairy cow numbers and yields



Source: ABARES and CBA

Figure 7: ABARES dairy outlook (December 2011)

		2009	2010	2011	%
		-10	-11 s	-12 f	change
Cow numbers	'000	1 596	1 604	1 620	1.0
Milk yields	L/cow	5 653	5 675	5 772	1.7
Production					
Total milk	ML	9 023	9 102	9 350	2.7
- market sales	ML	2 269	2 316	2 357	1.8
- manufacturing	ML	6 754	6 787	6 993	3.0
Butter	kt	128	122	121	-0.8
Cheese	kt	349	338	350	3.6
Whole milk powder	kt	126	151	156	3.3
Skim milk powder	kt	190	222	215	-3.2
Farmgate milk price	Ac/L	37.3	43.2	41.5	-3.9
Value of exports	A\$m	2 088	2 346	2 270	-3.2
World prices					
Butter	US\$/t	3 477	4 683	4 200	-10.3
Cheese	US\$/t	3 748	4 221	4 190	-0.7
Skim milk powder	US\$/t	2 948	3 392	3 350	-1.2
Whole milk powder	US\$/t	3 221	3 771	3 600	-4.5



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