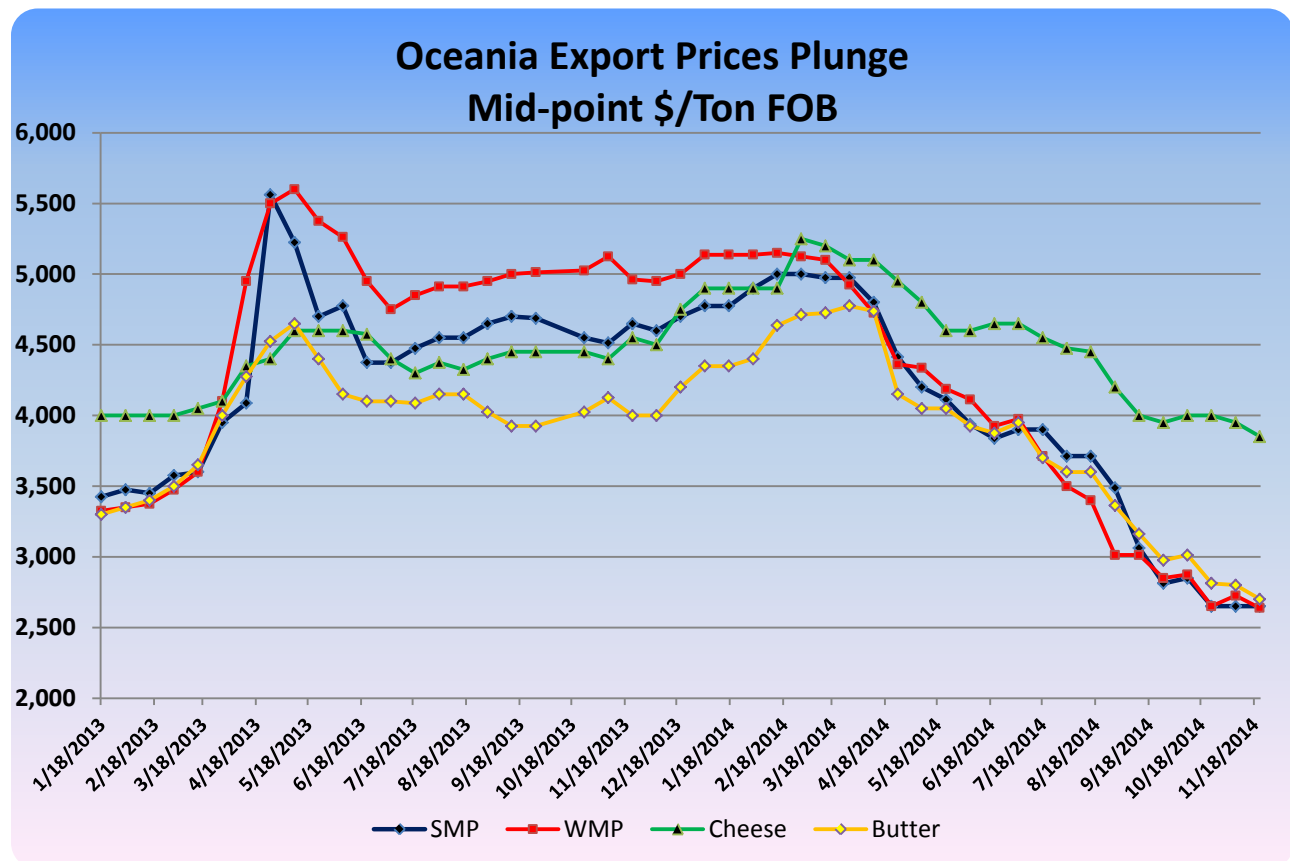


Dairy: World Markets and Trade

December 2014

International dairy prices have plummeted due to increased global milk production, lower import demand, the Russian ban on imports of dairy products from several major producers, and a strengthening dollar. This precipitous drop was particularly evident in the price of whole milk powder (WMP) which after lingering at around \$5,000/ton fell sharply by over 50 percent since January 2014 and are now reportedly trading as low as \$2,300/ton FAS. A key contributing factor weighing on WMP markets has been the sudden drop in the pace of Chinese imports of WMP in the latter half of 2014. For 2015, China is expected to return to the WMP market but import demand will be reduced as significant internal stocks are drawn down. Cheese prices have been sliding moderately – down about 20 percent since early 2014 – despite the Russian ban on imports of European Union (EU) cheese that was expected to dramatically to increase global competition. Barring any adverse weather, the outlook for 2015 points to a continuation of lower prices until the oversupply imbalance is corrected. It appears likely that if current low dairy prices persist, producer margins will start to be severely squeezed which will translate into production cutbacks.



Source: AMS

Dairy Production and Trade Developments

Summary

The year has generally unfolded in a largely predictable path given that the high prices early in the year coupled with declining feed prices were expected to trigger a sharp jump in milk production as farmers eagerly sought to benefit from generous margins. Not surprisingly, 2014 milk output among major exporters is expected to grow by 4 percent over last year. This surge in milk production and accompanying products inevitably led to a decline in dairy prices. But the descent was accelerated by two events; the Russian ban on dairy imports particularly from the EU and China's steeper than anticipated drop in import demand for WMP.

For 2015, the forecasts are drawn on the basis that the Russian ban will be lifted in early August and that the Chinese will remain major purchasers of WMP albeit at a much more modest pace. In fact, the forecast calls for Chinese imports of WMP to decline by 12 percent as China's economic GDP growth is expected to slow from a projected rate of 7.4 percent this year to 6.5 percent in 2015. In addition, the anticipated demographic boom expected from the relaxation of the one-child policy that was to fuel import demand has thus far not materialized.

This suggests that dairy prices will be under pressure during 2015. Farmers will be facing reduced margins and milk production among major exporters is expected to slow and expand by only 1 percent. The speed at which dairy prices recover will depend on drawing down stocks that will have accumulated in exporting and importing countries.

The outlook for U.S. dairy farmers is mixed as shipments of dairy products are forecast at \$6.7 billion for FY 2015 – a 9 percent drop from the record \$7.4 billion in dairy exports registered in FY 2014. U.S. exports will face a more competitive environment as Oceania and the EU vie to maintain market share in the Asian markets. However, the U.S. economy continues to accelerate with GDP forecast to grow from 2.3 percent this year to 3.3 percent in 2015. Consequently, domestic demand is likely to remain fairly robust which to a certain extent will buffer U.S. producers from the sharp fall in global prices. In fact, although domestic milk prices are expected to decline, low feed prices will allow farmers to sustain margins (albeit at a lower level) that will allow for some growth in milk production.

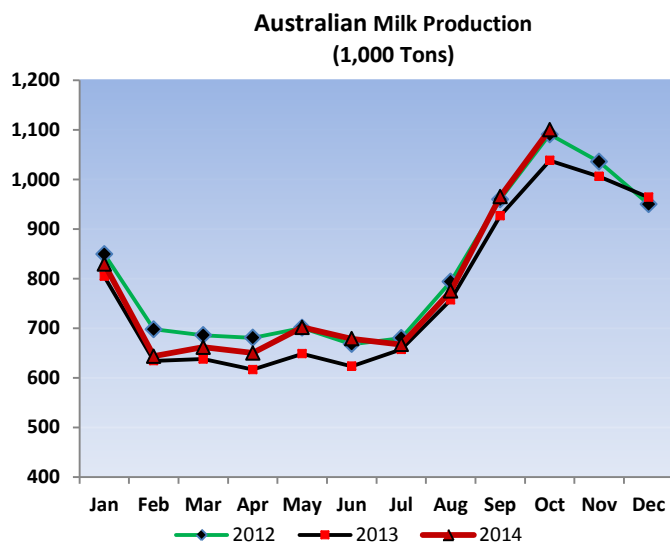
Milk Production: Forecast Summary

Milk Production Summary for Major Exporters (Million Metric Tons)

	2013	2014 Preliminary	2015 Forecast	2015 over 2014 % Change
Argentina	11.5	11.4	11.7	3%
Australia	9.4	9.7	9.8	1%
EU	140.1	146.7	147.0	0%
New Zealand	20.2	21.7	22.1	2%
United States	91.3	93.5	96.3	3%
Total	272.5	283.0	286.9	1%

- This year, milk production in **Argentina** was adversely impacted by heavy rains and floods during the fall and winter which negatively affected pastures and hindered access to dairy farms. As a result, the 2014 milk output projection was revised down 6 percent to 11.4 million tons – about 1 percent lower than 2013 production. For 2015, milk output is forecast to increase by 3 percent to 11.7 million tons. Farmers are currently benefitting from favorable margins and the sector continues to consolidate as small farmers exit leaving the more efficient medium and large producers. Most of the additional milk production is expected to be channeled into the increased production of cheese and WMP particularly since larger exports to Russia are anticipated. However, since September 2013 the Argentinian Government requires the use of export permits which are reportedly being used in an attempt to ensure that domestic markets are sufficiently supplied and price inflation is controlled. Exporters allege that these permits create delays which inject uncertainty when they are attempting to fulfill international contracts.

- In **Australia**, milk production for 2014 through October is up 4.5 percent in comparison to



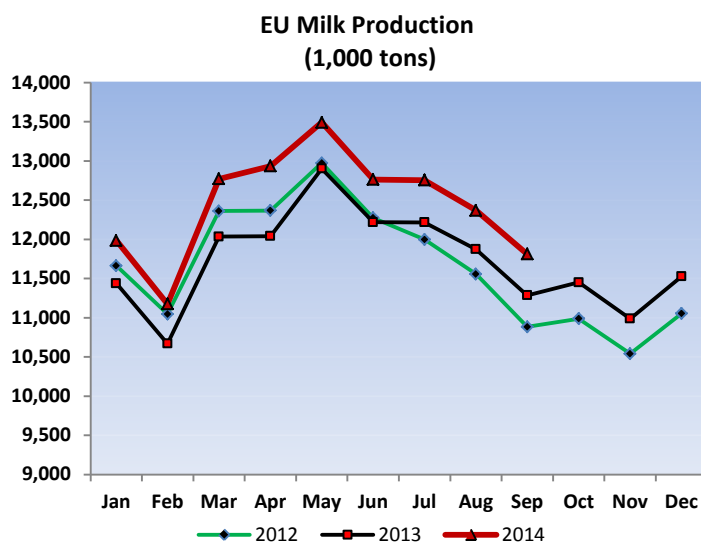
the same period last year; consequently, the forecast is revised up 3 percent to 9.7 million tons. Spring rains in such key areas as Victoria are reportedly running below average (as of Dec 1, 2014) but so far have not impacted on milk production. For 2015, although a weakening Australian dollar (versus the U.S. dollar) is expected to somewhat mitigate reduced export competitiveness due to low international prices, dairy farmer margins are nevertheless expected to be under pressure. As a result, the

herd size is expected to remain virtually unchanged at 1.7 million head; however, milk output in 2015 is forecast to register a small increase primarily from a slight rise in milk yields per cow.

Australian exports of fluid milk primarily in the form of UHT milk are expected to expand by 20 percent reaching 113,000 tons in part due to an increase shipments of fresh milk to China. China will be implementing new clearance procedures that could allow the shipment of fresh milk from Australia to Chinese supermarkets in 8 days.

- In the **EU**, a mild wet winter coupled with an early spring resulted in excellent pasture conditions. Low feed prices and high milk prices further contributed to a sharp expansion in the EU's milk output currently running nearly 6 percent ahead of last year's pace through

September. Consequently, the 2014 forecast is revised up by 5 percent to 146.7 million tons.



Source: Eurostat

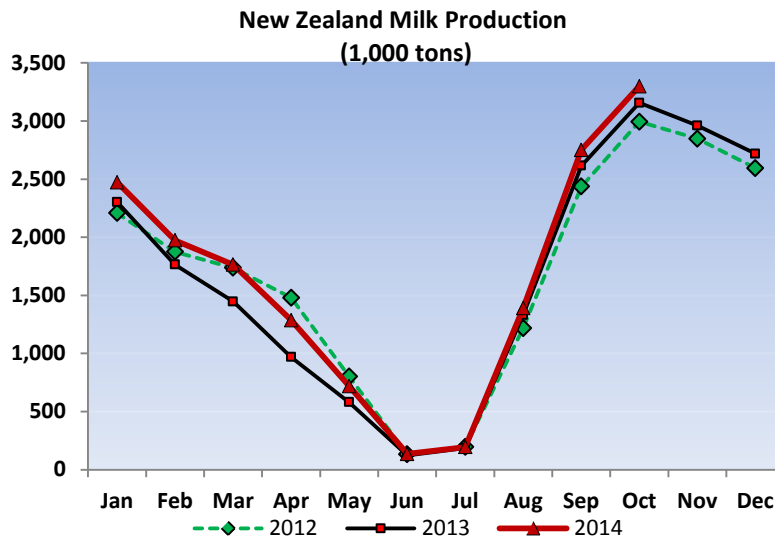
For 2015, the dairy cow herd is expected to expand as production quotas are scheduled to be eliminated by end of March 2015. However, milk production will likely be tempered by low world market prices that will translate into lower farmer milk prices and tighter margins.

Already in the third quarter of 2014, gross margins as reported by the EU Commissions have dropped by 9 percent from the previous quarter. In addition, although for the 2013/14

(April-March) EU milk deliveries were 4.6 percent below the quota volume limit, farmers in major EU milk producing countries such as Germany, Ireland, Denmark, and Poland, face significant fines for exceeding their quota levels. These farmers may be required to buy additional quota in the current 2014/15 year or reduce production to avoid the fines. For these reasons, 2015 milk output is only expected to expand marginally to 147.0 million tons.

- **New Zealand** milk production has been surging ahead of last year's drought impacted pace – nearly 16 percent higher year-over-year through July 2014 – due to a mild winter, favorable spring weather, and increased use of supplementary feed. Although the pace of milk output has recently moderated as farmers face the prospect of lower prices, the milk production forecast for 2014 is nevertheless revised up by 1 percent to 21.7 million tons – an 8 percent increase over 2013. The outlook for 2015 points to a slowdown in the growth rate as milk production is slated to expand by 2 percent to 22.1 million tons. Farmers will be under increased pressure as the record NZ \$8.40/kg milk solids farm-gate price received in 2013/14 is expected to drop steeply to less than NZ \$5/kg milk solids for the 2014/15 season. Given this price scenario, plus the additional environmental constraints (such as nitrate leaching limits) that farmers are facing, there are likely to be fewer conversions to dairy from other

land uses.



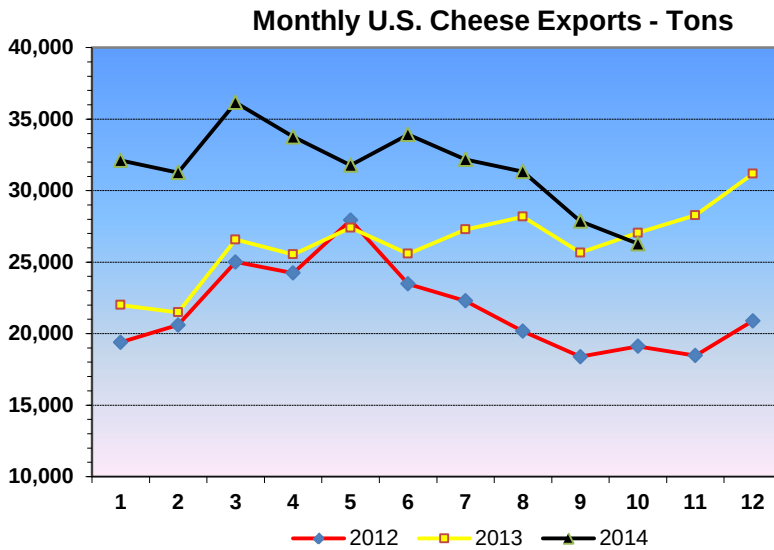
Source: DCANZ

- In **Russia**, milk production has been trending down since 2010 and is expected to decline by 2 percent in 2015. Small-scale farmers which account for about 50 percent of Russian milk output, face increasing competition from larger more efficient farms. These smaller operations are less financially capable of dealing with high interest rates for long-term loans, delays in state subsidies, and the increased input costs associated with the recent sharp depreciation of the Rouble. Despite lower supplies of milk available for processing, the production of such dairy commodities as cheese, butter, and skimmed milk powder (SMP) is expected to expand as a result of increased supplies of imported milk primarily from Belarus.

Cheese:

- The **EU** cheese export forecast for 2014 is revised down 9 percent largely due to the import ban on EU dairy products implemented by Russia in early August 2014. In 2013, the EU-28 shipped 257,000 tons of cheese to Russia and this year shipments through August totaled 133,000 tons. Russia announced a one year ban and thus EU cheese exports in the second half of 2015 are expected to rebound. In the meantime, in an effort to provide relief to EU-28 farmers, the European Commission opened the Private Storage Scheme (PSA) temporarily for the period September 5 to December 31, 2014. This was, however, suspended in late September after accumulating 101,000 tons to avoid rapidly reaching the maximum volume of 155,000 tons. Consequently, 2014 carry-out PSA stocks are forecast at 100,000 tons but are expected to be halved in 2015 due to a combination of increased domestic consumption and growth in cheese exports pegged to expand by 10 percent to 790,000 tons.

- The global downturn in dairy markets has been affecting **U.S.** cheese exports and the pace of shipments has been trending down since June 2014. However, as strong sales early in the

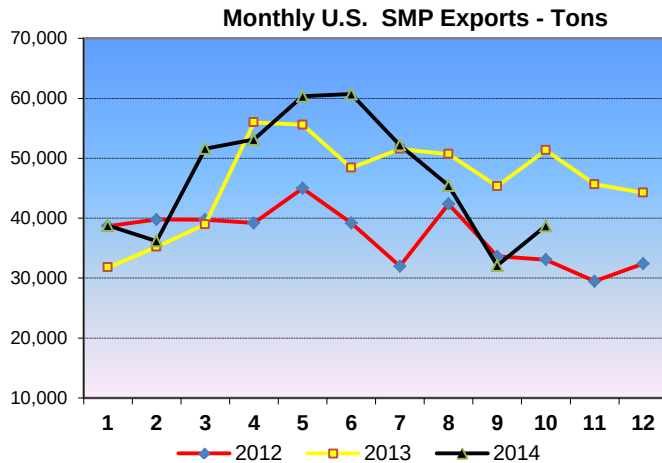


year will partly offset weaker later-year exports, the 2014 forecast is revised down by 2 percent to 367,000 tons, which nevertheless represents a 16 percent gain over 2013 levels. The fastest growing categories have been the fresh cheese and cheese “all kinds” categories which through October 2014 are both up by one third over the same period last year. For 2015, increased competition on global markets is expected to negatively impact U.S. cheese sales and the forecast is set at 347,000 tons – a drop of 5 percent over 2014.

- New Zealand** cheese exports through October 2014 have been lagging slightly behind last year’s pace and the 2014 forecast is revised down by 5 percent to 275,000 tons – just 2,000 tons below total cheese exports in 2013. Shipments of cheeses under the category that includes cheddar through October are down 6 percent primarily due to disappointing sales to Japan and Australia. For 2015, cheese exports are expected to grow by 5 percent to 290,000 tons.

SMP:

- Increased milk production and the addition of new drying plants in the **EU** boosted the production of SMP. Production is estimated to be up 26 percent in the Jan-Sep 2014 period in comparison to the same period last year. As a result, the 2014 forecast production of SMP is raised by 11 percent to 1.55 million tons. During this same period, SMP shipments were up 58 percent year-over-year and the 2014 export forecast is revised upwards by 14 percent to 610,000 tons. As in 2013, Algeria and China are the leading destinations; however, this year sales to Algeria have surged with shipments through September increasing by 176 percent to 58,000 tons in comparison to the same period last year. Despite strong competitive pressures, exports are forecast to grow in 2015 by 8 percent to 660,000 tons.
- Following the strong pace of exports in the first half of the year, **U.S.** shipments of SMP have been weakening and the 2014 export forecast is revised down by 4 percent to 545,000 tons. Next year, U.S. shipments will face strong competitive pressures on world markets particularly in Asia, and the forecast is pegged at 516,000 tons – down 5 percent from 2014.



- Despite growing SMP production, **India's** exports have been lagging from last year's record setting level. Traditionally, India has shipped to Bangladesh, Pakistan and North African markets, but it appears that available exportable supplies have been constrained due to strong domestic consumption as growing incomes and a rising population is generating demand for dairy products. Consequently, the 2014 export forecast is cut by one third to 80,000 tons. This situation is likely to persist and an equal volume is forecast to be exported in 2015.
- The 2014 SMP import forecast for **China** is increased slightly by 4,000 tons to 334,000 tons. For 2015, imports are expected to grow by 8 percent to 360,000 tons which represents a more moderate pace in comparison to previous year's growth rates.

WMP:

- After an unprecedented period of aggressive purchases which totaled 535,000 tons of WMP in the first half of 2014, **China** has dramatically cut back imports which are now projected to reach only 145,000 tons in the second half. It appears that this massive inflow of product has led to an accumulation of stocks while concurrently domestic consumption has eased as a result of slower economic growth. For this reason, the 2014 projection is cut by 30 percent to 680,000 tons. For 2015, imports of WMP are forecast at 600,000 tons on the basis that substantial carry-over stocks will be available to meet demand in the first half of the year.
- **New Zealand** exports of WMP in 2014 are up 12 percent year-over-year through October 2014 in large part due to increased early-year shipments to China and the United Arab Emirates. While the pace of shipments is expected to moderate in the last quarter, the export forecast is revised up 5 percent to a record 1.45 million tons. In past years, New Zealand has benefitted significantly from the accelerating Chinese demand for WMP. In 2010, approximately 30 percent of New Zealand's exports were shipped to China; in 2013 this expanded to nearly 50 percent. For 2015, New Zealand will face the challenge of lower import demand from China, although domestic production will be constrained by a slowdown in the growth of milk production. Consequently, 2015 exports are slated to

expand moderately by 3 percent to reach 1.5 million tons.

- **EU exports of WMP** through September have been running ahead of last year's pace largely due to the strength in shipments to Algeria – up 176 percent over the same period last year. This is expected to continue in 2015 as the EU-28 remains competitive in the North African and Middle Eastern markets and total exports are pegged to reach 450,000 tons – an increase of 13 percent over 2014.

Butter:

- As a result of increased milk supplies and strong returns from the production of butter/milk powder, the **EU** butter production forecast for 2014 was raised by 5 percent to 2.2 million tons. This growth is expected to continue through 2015 growing to 2.3 million tons as domestic demand is anticipated to remain strong. Consumers appear to be favoring butter both due to health concerns over the use of vegetable oil as well as low butter prices. Exports have been faring well this year with shipments through September up 22 percent in comparison to the same period last year. The Russian ban on imports of EU dairy products is expected to have a smaller impact on butter than on cheese and butter exports for 2015 are projected to grow by 11 percent over 2014 to reach 150,000 tons. The PSA support scheme for butter was opened by the EU Commission in response to the Russian ban from early September through December. At the end of November, PSA butter stocks totaled around 21,000 tons.

Additional Resources:

For additional information, please contact Paul Kiendl at 202-720-8870 or Paul.Kiendl@fas.usda.gov

Subscription services for FAS circulars can be obtained at:
<https://public.govdelivery.com/accounts/USDAFAS/subscriber/new>

Individual FAS country reports covering dairy are available at:
<http://gain.fas.usda.gov/Pages/Default.aspx>

The USDA Production, Supply and Demand database is available at:
<http://www.fas.usda.gov/psdonline>

A monthly “Livestock, Dairy, and Poultry Outlook” for the United States published by the Economic Research Service is available at:
<http://www.ers.usda.gov/publications/ldpm-livestock,-dairy,-and-poultry-outlook/>

U.S. trade data is available on the Global Agricultural Trade System (GATS):
<http://apps.fas.usda.gov/gats/default.aspx>

The next publication of this circular will be in July 2015