Chutes and Ladders in Dairy

A few more ladders than chutes

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Food & Agribusiness Research and Advisory

Rabobank’s unique global team of 94 analysts – supporting knowledge based banking
Upfront summary

The global dairy market faces more upside in months to come, but there are some chutes.

Six out of seven major dairy exporting regions currently have milk supply contracting.

Global exportable surplus is now tighter than any time since 2009.

Intl dairy prices have responded accordingly with 35% increases in prices.

Production will be slow to respond to higher prices.

Intl prices will have upward pressure for months to come.

But, US butter and cheese prices have some headwinds due to inventories.

Global inventories are also very weighty on prices, but less of a concern.

The strong USD will affect affordability in already struggling oil dependent markets.
Section 1: Current market status

Section 2: Downward pressure on prices – ‘chutes’

Section 4: Upward pressure on prices – ‘ladders’

Section 5: Price forecasts and alternative scenarios
Prices have rocketed upwards. 

In the last 3 months prices have increased 35%.
New Zealand milk supply is now falling.

Tough margins, bad weather, and fewer cows are biting into NZ supply.

New Zealand annual milk production

Source: DCANZ, Rabobank
EU milk supply also has taken a hit.

Very low margins and new incentives to draw down supply making an impact.

Source: Dairy Australia, Rabobank

**EU quarterly milk supply growth**

![Chart showing EU quarterly milk supply growth from H1 2007 to H2 2016.](attachment:image.png)
US milk supply is still growing.

High prices for butter and cheese and low feed costs have driven growth.

Source: Rabobank, USDA
Note: Mar to Jun 2013 breakdown is an est (due to govt shutdown)
Growth is slowly moving back east.

At current trajectory, Wisconsin will become the US’ largest producer by Oct 2019.

US milk supply growth 3 months to Aug 2016.

Cali vs. Wisconsin

Source: Rabobank, USDA
Milk supply from the big exporters is falling.

The bottom line, global supply is shrinking.

**Big 6 milk supply growth**

Source: Rabobank

Note: includes EU 27, USA, NZ, Australia, Brazil, Argentina, and Uruguay
Most farmgate prices have moved up.

Farmer margins are starting to look a little better.

Source: Rabobank
We have passed the import hump.

Global import demand is looking healthy again.

Exports from the Big 6

Source: Rabobank, GTIS
Global import growth is diverse.

A diverse list of markets have shown solid import growth.

Global import growth – 3 months to July

Source: Rabobank, GTIS
Inventories remain heavy.

Estimated excess stocks in select regions 6,700k tonnes of LME equivalent.

Source: Rabobank

Probably circ 6,700k mt excess inventory in LME terms in key trading regions

1 month of international trade

'Second tier' importers

1 mil mt

4.4 mil mt

700k mt

600k mt
US has realigned with international prices. Stocks for cheese and butter are weighing on domestic prices.

Source: Rabobank, USDA
US retail demand continues to grow.

*Commercial disappearance was up 2.6% through 1H 2016.*

Source: IRI
US exports are picking back up, despite USD.

Source: Rabobank, GTIS, OANDA
Summary of current market status.

1. 6/7 export markets’ supply contracting.
2. Significant inventory overhang remains.
3. Developed market demand growing.
4. US prices have realigned with the world.
5. China back in the market.
6. Buyers are shrugging the strong USD.
Section 1  Current market status

Section 2  **Downward price pressure – ‘chutes’**

Section 4  **Upward pressure on prices – ‘ladders’**

Section 5  **Price forecasts and alternative scenarios**
Low feed prices helping boost milk supply.

Prices to remain low, keeping US dairy margins manageable.

Source: Rabobank
US production will continue to grow.

Low feed prices and an uptick in milk prices should boost US milk supply.

Source: Rabobank, USDA
Note: Mar to Jun 2013 breakdown is an est (due to govt shutdown)
Strong USD to keep pressure on prices.

Affordability will be a major factor for many developing markets moving forward.

USD vs. WMP

Source: Rabobank & OANDA
The global economy is still a little ‘wobbly’.

Continual GPD growth downgrades and rising debt a big concern for economists.

Global Economic Growth Forecasts (WEO)

Worrying Debt Levels

BRICS and "developed world" private non-financial and public sector debt as a % of "world" GDP*

Source: Rabobank & WEO

*Data collated from 13 economies accounting for 68% of world nominal GDP
Buyers know the market is still long milk.

*Estimated excess stocks in select regions 6,700k tonnes of LME equivalent.*

High stock levels. Makes higher prices a tough argument.

Source: Rabobank
US cheese and butter stocks a little too high.

High inventories in the US will mean discounting and promotions to clear product.

Source: Rabobank & USDA
Section 1  Current market status

Section 2  Downward pressure on prices – ‘chutes’

Section 4  Upward pressure on prices – ‘ladders’

Section 5  Price forecasts and alternative scenarios
EU milk production will continue to contract.

The biggest part of the recovery is the rapid decline in EU supply.

Source: EU commission, Rabobank
Production growth to continue slowing.

We have another 6 months of supply contraction ahead of us.

Milk production growth of Big 7 exporters combined

Source: Rabobank
Note: includes EU 27, USA, NZ, Australia, Brazil, Argentina, and Uruguay
But US supply not keeping up with demand.

Source: Rabobank & USDA
Market will remain under pressure.

Source: Rabobank
Government Intervention.

It is unclear how effective the proposed measures will be.

EU Supply Reduction

- 150 m EUR to be spent paying premiums to farms who reduce supply.
- Could theoretically remove 1 billion liters from the market.
- Some markets will match the buy back prices.

US Cheese Buy Backs

- US allocated $20 million to purchase cheese.
- The purpose is to support the milk prices for farmers.
- The $20 can only buy 5k MT of product – less than 1% of US production.
- Unlikely to be effective – but signals a renewed willingness of the US government to intervene in price support.

California FMMO Litigation

- Will California be brought under the FMMO?
- Proposal to be announced late 2016/ early 2017.
- Then farmers provide feedback.
- The objective is to raise farmgate milk prices in Cali.
Section 1  Current market status

Section 2  Downward pressure on prices – ‘chutes’

Section 4  Upward pressure on prices – ‘ladders’

Section 5  Price forecasts and conclusion
Rabobank dairy price forecasts: FOB Oceania

<table>
<thead>
<tr>
<th>World (fob Oceania)</th>
<th>Q2 - 2016</th>
<th>Q3 - 2016e</th>
<th>Q4 - 2016f</th>
<th>Q1 - 2017f</th>
<th>Q2 - 2017f</th>
<th>Q3 - 2017f</th>
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<tr>
<td>WMP USD/tonne</td>
<td>$2,067</td>
<td>2,485</td>
<td>3,200</td>
<td>3,200</td>
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<td>SMP USD/tonne</td>
<td>$1,788</td>
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<td>Butter USD/tonne</td>
<td>$2,702</td>
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<td>3,850</td>
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<td>Cheese USD/tonne</td>
<td>$2,663</td>
<td>3,131</td>
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<td>SWP USD/tonne</td>
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WMP prices fob Oceania: Historic and Rabo forecasts

Source: Rabobank & USDA
Rabobank dairy price forecasts: US Wholesale

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<th>Q2 - 2016</th>
<th>Q3 - 2016e</th>
<th>Q4 - 2016f</th>
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<td>US (AMS announced)</td>
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<td>NFDM USD/lb</td>
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<td>AA Butter USD/lb</td>
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<td>Block Cheddar USD/lb</td>
<td>1.43</td>
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<td>Whey Powder USD/lb</td>
<td>0.25</td>
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<td>Class III Milk USD/cwt.</td>
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<td>Class IV Milk USD/cwt.</td>
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**Class III: Rabo Forecast V CME Curve**

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**Class IV: Rabo Forecast V CME Curve**

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<th>Q4f</th>
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<td>2016</td>
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<td>2017</td>
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Source: Rabobank, USDA, CME
Producer margins.

An improvement in margins, but still uninspiring.

IOFC Benchmark
Corn and Soy future prices as at Sep 30 2016

Source: Rabobank & USDA
Summary.

While generally improving, the dairy market still has some ups and downs in it.

Chutes

- Significant inventory overhang remains.
- Global economy is still wobbly.
- USD remains strong.

Ladders

- Massive supply adjustment underway.
- Global demand expected to continue to chug along.
- US still isn’t producing enough milk to meet needs.

Government intervention good or bad, won’t move the dial too much.
So what does it mean for dairy in the US

1. While profitable, milk prices will remain uninspiring for producers for the next 6-12 months.
3. The move back east. Producers and processors.
5. More pressure on government to help farmers.
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