



Global Dairy Farmers article

Dairy: shaken, not stirred

Introduction

As the dust settles after the dairy commodity price boom/bust cycle, many players in the dairy industry are wondering which long-term direction the industry will take. One of the main questions is how to cope with the expected higher volatility throughout the supply chain.

Price development : A Roller-Coaster Ride

After the global financial crisis and ensuing demand fall out, prices started to stabilise in 2009 and hereafter took an upwards course once again. A closer look reveals the following:

- Demand fall out caused downwards price pressure. As the global financial crisis hit and dairy products on retail shelves were still at a high price level, demand fell back. The melamine crisis dented confidence in dairy products in South East Asia and the drying up of trade credit did nothing to improve the situation.
- Hereafter, stabilisation of prices occurred, caused by:
 - The EU and US government stepping in and opening up their intervention programmes, providing a floor to dairy commodity prices
 - The melamine crisis in China. Consumer confidence in domestically produced product was obliterated and consumers turned towards imported product. China became a large buyer of powder on the international market again, and we have not seen this demand fall back yet.
- Just as milk prices started to decrease and farmers' reaction worldwide was to scale back production, demand slowly and tentatively came back to the market, mainly buyers replenishing stocks. Also in terms of milk fat there was some overshoot in intervention buying. All this caused upwards price pressure.

A look towards the future: demand fundamentals still mainly intact

Dairy demand growth continued worldwide, albeit not at the level we had seen before, amounting to around 1.8% growth over 2009. Taking a look at the future, the demand fundamentals for dairy demand growth are still largely in place. We see population growth, the urbanisation trend, westernisation of diets and government stimulus of dairy consumption as part of a healthy diet all contributing to that demand growth. However, a large part hinges on economic development. Dairy demand growth is primarily expected in China, the Indian subcontinent, South East Asia and the Middle East. Although some of these countries already have a high self-sufficiency ratio (i.e. China once the effects of the melamine crisis fade out and India) there is still an extra need of around 2 billion litres per year in the import regions.

Supply growth: limited in low-cost regions

The main low cost regions such as Australia, New Zealand, Argentina and Brazil are limited in production expansion possibilities. This means the world will logically need to turn to the EU and US for the production of that extra milk. The market will need to meet the costs of the most efficient milk producers in these regions. In the EU, combining this with the fact that the quota system will be abolished by 2015, Rabobank expects a shift in milk production towards the North Western part of Europe. The extra milk produced, will mainly flow into cheese production, with Russia and the US as main export destinations.

Implications along the value chain

The above described developments have an impact on all players throughout the dairy supply chain. European milk production appears to be insensitive to milk price changes. The overall performance of the value chain can be improved by stronger and quicker supply adjustments in primary production and a lower level of fixed costs would help to achieve that goal. Traders thrive in a volatile environment but at the same time the risks have increased. The dairy market has become more transparent and closer ties between producers and buyers continue to lead to thinner trade. Intervention stocks will need to be sold down some time.

Processors will need to take a good look at reaction time, flexibility and strategic structures providing resilience to market volatility. Concluding one could state that this year will prove to be a challenging one for all dairy players.

Marina Rebello, February 2010