



Coronavirus Update

Global Dairy Markets
7 April 2020



Summary

- The dairy sector is in uncharted territory and is expected to experience three waves of market movement over the next 12 months before it returns to a 'new' normal. The first wave is characterized by a spike in domestic dairy demand driven by panic-buying during the first month of reduced mobility. Retail demand will offset a larger portion of declining foodservice demand.
- The second wave is characterized by more muted retail demand and increased logistical and financial challenges. Consumers are expected to return to stores on an as-needed basis to fill gaps in their pantries and refrigerators rather than large shopping occasions. The prolonged impact from lower foodservice sales, the seasonal peak in northern hemisphere milk production, and a significant slowdown in global trade will contribute to rising YOY stock levels, putting downward pressure on dairy commodity prices and hence farmgate milk prices. In addition, processing capacity, storage availability, and credit terms (liquidity) are expected to max out without government assistance.
- In the longer term, the third wave includes a likely global recession and widespread loss of income and savings, among other factors, that could keep dairy product prices and farmgate milk prices under pressure into 2021. Dairy products are nutrient-rich and historically part of government-aided feeding programs. A deep recession may result in greater use of dairy products as more people meet the programs' economic eligibility requirements.
- In recognition of rapidly-changing supply and demand conditions, Rabobank has adjusted its latest global dairy commodity outlook (*see Table 1*). The magnitude of adjustments reflects each region's product mix, channel sales, export reliance, and currency exposure, among other factors. However, given the magnitude of market disruption, current forecasts are often outdated before they are published.



Farm Level

- As anticipated, there is greater disruption in assembling and processing milk around the globe, as milk production seasonally climbs in the northern hemisphere. Increased milk-dumping, plant closings and force majeure are reported in Europe and the US. Dairy processors in France, Italy, and the US have asked producers to reduce milk deliveries by up to 5%. In the US, dairy processors with 'base' programs are reminding dairy farmers that any production in excess of their base will receive a significantly lower price.
- Dairy farmers may face potential limited supply of supplements, and other veterinarian-related products due to manufacturing issues in China, which is a significant producer of these products. Similarly, feed quality and quantity could be impacted as nearly 80% of active ingredients for crop protection products are made in China. As a result, there is a risk to the quantity and quality of feed, which could lead to lower milk production growth and higher costs of production for farmers.
- Rabobank revised its forecasts to reflect a more sustained economic impact, with some prices as much as 30% lower than their pre-Covid-19 price levels. It is estimated that between 40% and 50% of US milk production is covered by risk management programs that will provide some downside protection. In addition, proposed government-aid packages are likely to support dairy producers without coverages. Nevertheless, the negative market impact from Covid-19 could have a significant negative impact on producers and accelerate dairy farm consolidation.



Trade

- Global logistics are challenged by competition for containers and enhanced bio-security at ports. In addition, import certificates are being delayed due to workforce issues.
- The EU may face more significant intra-EU trade challenges due to border-crossing delays and, to a certain extent, also restrictions at borders, at the moment in particular in Hungary and Poland.
- Rabobank's Covid-19 base-case analysis foresees trade for key dairy commodities SMP, WMP, and cheese to fall by 11%, 13%, and 5% respectively in 2020 versus 2019.
- Led by a severe contraction in China, Chinese imports of SMP and WMP are forecast to decline by 28% in 2020.
- After China, the next largest YOY decline in dairy imports is expected from MENA (Middle East and North Africa) region. Plunging oil prices will reduce the purchasing power of import-reliant markets. For example, Algeria's dairy WMP and SMP imports are forecast to fall by nearly 20% for the year, equating to a shortfall of 45,000 mt and 24,000 mt, respectively.
- Southeast Asia SMP and WMP imports are estimated to retreat by nearly 8% over the same time, as slower economic growth and weaker currencies reduce affordability.
- Similarly, dairy imports to Latin America are expected to fall by 20% YOY as affordability become an issue due to weakened currencies. Mexico's imports of SMP/NFDM are forecast to decrease by nearly 74,000 mt for the full year compared with 2019, which could be higher were it not for expected food aid to support its import volumes.



Government Intervention



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- **US:** The USD 2 trillion Coronavirus Aid, Relief, and Economic Security Act (CARES) directs aid to farmers, rural communities, and business. USDA will control funding available to food and agriculture. The two largest US dairy trade National Milk Producers Federation and the International Dairy Foods Association have requested the following (and more) from USDA:
 - **Make additional government purchases.** In FY 2019, USDA purchased 390m pounds of product, largely cheese: Mozzarella 80m pounds; Natural American 73m pounds, of which 47m pounds in 500lb barrels; and processed cheese 59m pounds.
 - **Compensate dairy farmers for dumped milk.**
 - **Reopen enrollment in the Dairy Margin Coverage program.** This would make the risk management program available for those that did not sign up for it last fall.
 - **Implement a voluntary supply management program.** This pays producers USD 3/cwt, to reduce milk production by 10% based on March 2020's level, from April through September 2020 as long as the average of the Class III and IV milk prices remains less than USD 16/cwt.
 - **Establish recourse loan program** to supply working capital.
- **EU:** Several countries and dairy organizations have called on the EC to open Private Storage Aid for SMP, butter, and cheese.
- **EU Intervention:** The EU has an intervention program that operates from March 1 to September 30. The program is designed to purchase SMP and butter at EUR 1,698/mt and EUR 2,217/mt, respectively, to support the markets and farm-level milk prices. SMP and butter purchases are capped at 109,000 mt and 60,000 mt, respectively.
- Individual EU countries are implementing specific volume reduction and food aid programs (Italy, France, UK).

Key Highlights

China: China's import requirement of powder (SMP and WMP combined) could fall by 28% YOY to 758,000 mt in 2020, or 8% below 2018. In an extreme case of destocking, where China's year-end 2020 stocks remain unchanged from the year-beginning level, powder import requirement could then fall by 39% YOY, to 637,000 mt, or 23% below 2018 level.

Europe: Foodservice demand is weakening as many people avoid eating out. Roughly 20% of total volumes are sold via foodservice in Europe. Certain countries and products such as cheese, and especially processed cheeses and Mozzarella, are more exposed than others. Some large dairy companies can reallocate milk to products in retail channels and products with a longer shelf life. A number of smaller dairy companies with limited product portfolios, as well as distributors and wholesalers who specialize in the foodservice segment will be under more pressure.

US: Over 45% of US cheese production is used in the foodservice channel, and an estimated 50% of that volume has vanished (about 150m pounds or 68,000 mt per month). As a result, cash dairy markets are eroding quickly. The CME Cheddar block cheese price fell 37% in less than two weeks, to USD 1.15/lb on April 3, the lowest level since 2009.

Australia/New Zealand: Oceania benefits from entering the seasonal low point of their production cycle amid the Covid-19 crisis. Nevertheless, the financial outlook for the 2020/21 season is less certain. Dairy companies are working to ensure milk collections and processing. A number of companies have upgraded internal protocols, including protection of key operational processes and employees required to maintain food and beverage processing in the environment of stronger lockdowns.



Table 1: Dairy Commodity Prices (Historic and Forecast), Q1 2019-Q2 2021f, April 3, 2020



		2019				2020				2021	
		Q1	Q2	Q3	Q4	Q1e	Q2f	Q3f	Q4f	Q1f	Q2f
Butter											
Europe	EUR/mt	4,300	4,077	3,669	3,635	3,575	3,000	3,000	3,250	3,300	3,500
US	USD/mt	4,977	5,091	5,136	4,576	4,025	2,990	2,975	3,285	3,415	3,690
Oceania	USD/mt	4,482	5,354	4,227	4,075	4,150	3,100	2,700	2,600	2,600	2,600
Cheese											
Europe (Gouda)	EUR/mt	3,126	3,112	3,112	3,178	3,285	2,800	2,800	2,900	2,950	3,000
US (Cheddar)	USD/mt	3,174	3,700	4,083	4,551	3,900	3,050	3,065	3,250	3,375	3,475
Oceania (Cheddar)	USD/mt	3,688	4,154	3,896	3,796	4,250	3,300	2,800	2,750	2,800	2,850
Dry whey powder											
Europe	EUR/mt	822	781	683	735	793	700	725	750	750	750
US	USD/mt	990	834	808	717	795	730	675	750	770	825
Skim milk powder											
Europe	EUR/mt	1,867	1,994	2,101	2,430	2,511	1,800	1,700	1,750	1,900	2,000
US	USD/mt	2,124	2,221	2,296	2,547	2,650	1,835	1,795	1,925	2,095	2,205
Oceania	USD/mt	2,518	2,502	2,527	2,902	2,900	2,000	1,800	2,000	2,100	2,100
Whole milk powder											
Europe	EUR/mt	2,825	2,926	2,879	3,016	2,998	2,400	2,300	2,400	2,500	2,600
Oceania	USD/mt	2,982	3,206	3,157	3,240	3,050	2,200	2,000	2,200	2,500	2,600
South America	USD/mt	2,882	3,000	3,180	3,100	3,050	2,150	2,000	2,250	2,500	2,600

Source: USDA, forecasts by Rabobank 2020

RaboResearch Food & Agribusiness

Global Dairy Sector Team



Rabobank

Mary Ledman

Global Strategist

mary.ledman@rabobank.com

Michael Harvey

Senior Analyst, Australia

michael.harvey@rabobank.com

Andrés Padilla

Senior Analyst, Brazil

andres.padilla@rabobank.com

Sandy Chen

Senior Analyst, China

sandy.chen@rabobank.com

Saskia van Battum

Analyst, Europe

saskia.van.battum@rabobank.com

Richard Scheper

Analyst, Europe

richard.scheper@rabobank.com

Shiva Mudgil

Analyst, India

shiva.mudgil@rabobank.com

Emma Higgins

Senior Analyst, New Zealand

emma.higgins@rabobank.com

Tom Bailey

Senior Analyst, US

thomas.bailey@rabobank.com

Ben Laine

Analyst, US

ben.laine@raboag.com

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