BATORY FOODS

Dairy Newsletter

Dairy Commodities

June 2015

Global Overview

The "plenty of milk" narrative continues. Earlier in the year, forecasts showed an abundant milk supply. It also showed waning demand. Taken together, those trends conspire to tell a story of ample milk on the global market.

While New Zealand production period is over, its overall results were a sound 2.2% growth. The EU is finally operating quota free, allowing dairy farmers to produce what they want. Early in the year, while the quotas were in effect, dairy production in Europe was restricted to avoid quota overruns and the imposition of fines. Post-quota production indications, however, show building supplies. Certainly, herd numbers are building, with the majority of dairy countries adding head. US milk product expanded a healthy 1.7% in the first quarter of 2015. There was some pull back in March but output remained robust as we passed through the traditional peak production period of spring flush.

Continuing to lead the way in production growth is the Midwest. There was also recorded growth in the Northeast and Northwest. The West and Southwest continued in negative numbers. Herd growth also continues with numbers up 78,000 head on a year-over-year basis in March. USDA also reports a large supply of heifers available that could enter the barns soon.

Interestingly, Russia—likely as a response to their embargo of Western dairy products—is investing in its own domestic production capability. Through February, its output is up 2%. This does not directly impact the major production regions, as they are currently not sellers to Russia. When this embargo inevitably ends, Russia may not be as big an importer as it once was.

China remains the big influencer. It has remained out of the buying arena, and the markets have taken notice. GlobalDairyTrade results have shown decreasing world prices for skim milk, whole milk and butter/fat. Many believe that a combination of improvements in China's domestic supply—albeit small improvements—and aggressive buying in 2014, gave China inventories that have sustained them so far in 2015. The question is what will happen when China returns.

Some analysts predict that China will reenter in the fall of 2015 with a huge dairy craving. Milk producing countries would love to see that, as a hungry China would go a long way in reversing the global oversupply of milk. Others believe that China, with its slowing economy and subsequent reduction in dairy consumption, would leave them out of the market in a meaningful way for the remainder of 2015.

In reality, we believe that China is working off inventories, which should last until early fall when it returns to the market. Its return, however, will be measured—tempered by its domestic production and aforementioned slower economy. China will return but not sufficiently to abate what appears to be a 2015 milk oversupply year.

The only suggested scenario that would substantially alter this would be if New Zealand has a rocky start to its new production year. An El Niño is developing in the equatorial Pacific region. El Niños bring winds from the west in the summer, which often results in drought conditions. New Zealand is China's major dairy supplier. If it does enter the market when New Zealand's production is questionable, then all predictions are off. China will need to enter the world market for its dairy needs.

Dairy Commodity Markets

As we would expect, the abundance of milk and continued weak demand are keeping global prices down. Since February, GDT results have been in a decline. The recent close on GDT for June 16 held SMP at $0.90/lb, WMP at $1.06/lb and butter at $1.23/lb. In the US, we have mixed results with whole milk powder and nonfat—both trading near numbers seen on the GDT while butter steadfastly refuses to fall into line.

US exports of SMP and WMP continue to lag, providing ample opportunity to build supplies in the US. This in turn has resulted in some spectacularly low CME and DMN prices. The CME spot weekly average for NFDM has fallen below $0.90/lb, which equates to six-year lows. High heat still commands a premium over low heat.

Sweet whey continues to build stocks throughout the US. Strong cheese manufacturing continues to produce a whey stream for the dryers. Record low prices for WPC and WPI have forced manufacturers to move whey solids away from premium whey protein production to sweet whey dryers with room. With no real change to domestic demand and a tepid export market, there appears to be nothing on the horizon that will change this trend.

WPC and WPI have not seen numbers in years. These items, too, are seeing excess inventory build in the US. Several factors are coming into play. First, over the last couple of years, new capacity for whey protein production has come on line. As demand increased rapidly for high protein products by an increasingly informed consumer base, dairy companies broke ground on either new plants or plant expansions. Next, existing plants were overhauled and re-tuned to run more efficiently. Finally, the port issues bottlenecked a lot of product earmarked for export. For months, processors could not move product to overseas customers. During this period, European producers worked feverishly to fill that void. The net result is an evaporating international customer base and excess product.

The exceptions to this glut of proteins and depressed prices are WPC, Instant WPC and WPI from grass-fed cows. As this is product not available from US suppliers, a premium price is still in place for any supplier with foreign-made (primarily New Zealand) WPC/WPI. Because of its premium nature, that is not likely to change.

Butter remains strong among all dairy commodities. Butter production has been down each month versus prior. Also, Easter was early this year, which pushed production to focus on retail needs. The net result was poor stocks growth in the first three months of 2015. The market reacted by keeping the price high, with periods in excess of $2.05/lb on the CME; this is true despite a falling world market. April showed a rebound with a stocks increase of nearly 25% compared to March. This hasn't resulted in a lot of movement in the price yet, which we wouldn't expect at this point. With what appears to be a steady supply of cream to churns, we might expect sustained growth in butter inventories for the near term.

Going Forward in the US

We don't see anything in the dairy fundamentals that would change our outlook. There will continue to be weakness in the nonfat and whey markets, and butter will stay firm.

The outlook for whey continues to be small, steady decline. In some quarters, people believe that the recent price declines could create a floor, which spurs increased domestic use and export opportunities. But that is a very optimistic outlook. In reality, with elevated prices keeping cheese production strong and WPC values record low, whey solids will continue to make their way into the sweet whey production pipeline.

Nonfat has stalled at very low CME prices. This will spur some interest as buyers will pull here and there to fill gaps. There have been no reports of wholesale contracting, however, as many of the large buyers are content to remain on the sidelines. California's weak production numbers will have some impact. They are the largest milk-producing region in the country. Reduced powder production will eventually have an impact.

We have a similar outlook for butter: little change. A steady cream supply will allow producers to continue to stock butter away for the fall. April's cold storage report supports that. Buyers in the market remain nervous. 2014 was a brutal year for spot or short-term contract buyers of butter. The $3+ butter is not yet a distant memory. California's weak production numbers play on these concerns as well. It is not unreasonable to assume that these numbers will stay supported through the remainder of the year.