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Dairy enters protracted bear market – Rabobank

All signs suggest a prolonged period of low dairy prices will be required in order to soak up the current international dairy market surplus, according to Rabobank in its latest **Dairy Quarterly** report.

The report, released this week, indicates the orderly decline in global dairy prices that became evident in the second quarter of 2014 well and truly set in during the third quarter of the year.

Milk production continued to expand strongly in global export regions while China pulled back from buying on the international market as it concentrated on digesting stock accumulated in early 2014, with other import buyers proving unable to take up the slack.

Rabobank senior dairy analyst Michael Harvey says international market prices are now well below the level that Rabobank believes are sustainable in the medium term.

"However, while a bottom appears to have been reached, market rebalancing will be a slow process and price recovery looks some way off," he said.

Australian dairy

In Australia, a strong finish to the season across the southern export region saw national milk production finish marginally higher at 9.2 billion litres. The new season has started with growth of 1.5 per cent in July, the Rabobank report shows.

Export volumes for the 2013/14 season totalled 740,000 tonnes, representing a decline of seven per cent.

Mr Harvey says these figures suggest dairy exporters are carrying inventories into the new season – over the past three months, dairy exports (179,000 tonnes) have trailed the previous corresponding period by three per cent.

"Current weak global market conditions have forced Murray Goulburn to revise its full year forecast for the southern milk region to AUD6.00/kilogram milk solids," Mr Harvey said.

"This is down from the previous guidance of AUD6.15-6.30/kilogram milk solids and is 12 per cent below the 2013/14 close. As is the case across the Tasman, prices will need to rise or the Australian dollar to fall to meet this forecast."

The outlook for 2014/15 remains broadly positive for most dairying regions.

Mr Harvey says seasonal conditions have been favourable in the period leading up to the spring flush, however many dairy producers will be looking for normal rainfall in the coming weeks.

"This risk of El Niño remains possible, but the threat has weakened in recent months and we're seeing purchased feed market dynamics remain favourable for dairy producers," he said.

As a result, Rabobank expectations are for national production to expand in the vicinity of two per cent over the full season despite the weaker price signals.

One positive for dairy export returns has been signs of the stubbornly higher Australian dollar starting to drift lower on concerns regarding Chinese commodity demand.

Rabobank expects Australia's exportable dairy surplus to remain very strong through the second half of 2014 due to the ongoing expansion in milk flows, however the numbers will be inflated by poor comparable results the previous year. Mr Harvey says the exportable surplus will continue to grow in the first half of next year, albeit at a lower rate.

Global expectations

Exceptional milk production growth in export regions has outstripped weak local domestic consumption, boosting supply on international markets just as China reduced its forward purchases.

Milk production growth in the 'Big Seven' export regions – the EU, US, New Zealand, Australia, Argentina, Brazil and Uruguay – will slow considerably in the coming six months (from 5.1 per cent in the first half of 2014 to 2.7 per cent in the second half to 1.6 per cent in first half of 2015) as lower prices are passed to producers, exceptionally favourable weather normalises and prior higher growth rates become tougher to exceed.

Mr Harvey warns, however, that the pace of the slowdown in global dairy production will be constrained by falling feed costs, the removal of quotas in the EU from April 2015 and the fact many farmers have not yet even received the signal that the international market is amply supplied.

On the consumption side, Mr Harvey says, domestic dairy consumption in export regions will slowly improve on the back of higher incomes, employment growth and falling retail prices.

"The combination of these production and consumption factors will see growth in exportable surpluses slow from around 4.5 billion litres in the first half of 2015 to 2.2 billion litres in the second half – a six per cent year-on-year rise – with a similar rise factored in for early 2015."

The gradual nature of the supply slowdown, and the absence of a strong buying base for surpluses, is likely to ensure a protracted period of low prices on the international market place.

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