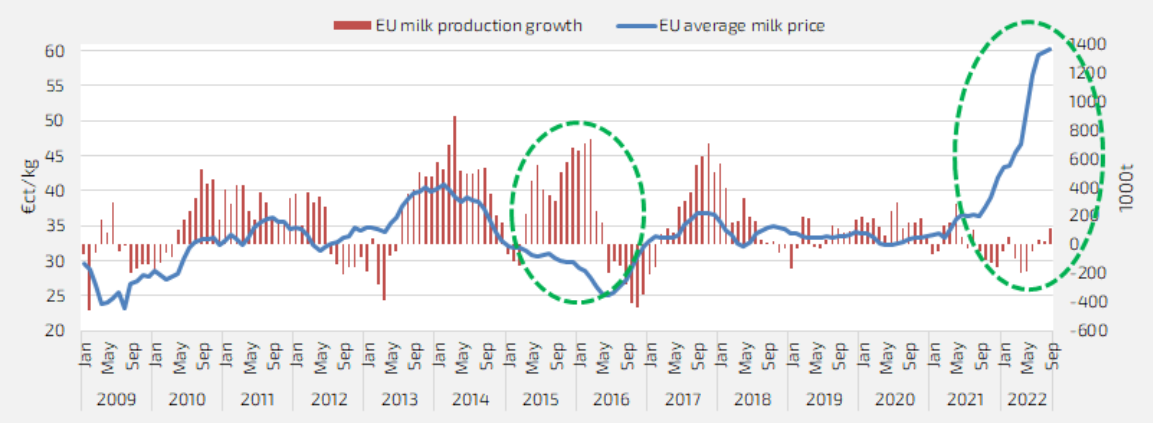
Are we at a long term turning point for milk revenues?

Sky high milk price – still no milk

The purpose of this free article is to provide a longer term view on milk production and market developments going forward. The reason is that the dairy market seems to be at a turning point. If we take a closer look at the example of EU milk production in figure 1 below, then the conclusion seems justified that the usual cycle of rising milk prices followed by a flood of milk and quickly deteriorating milk prices no longer applies. The graph clearly shows that except for the post quota phase of growth acceleration in 2015, milk production growth – the red bars – normally strongly correlates positively with milk price levels – the blue line. When milk prices fall, milk production growth comes to a standstill and when milk prices increase then milk production growth accelerates. The second time that this correlation got disrupted started in the second half of 2021 and actually lasts till this day (early August 2022). After May 2021, milk production growth evaporated and eventually turned negative despite milk prices continuing to climb to higher and higher levels.

Figure 1. EU milk production growth compared with the average EU milk price
(2009 – September 2022)



Source: Dairyntel analysis, 2022

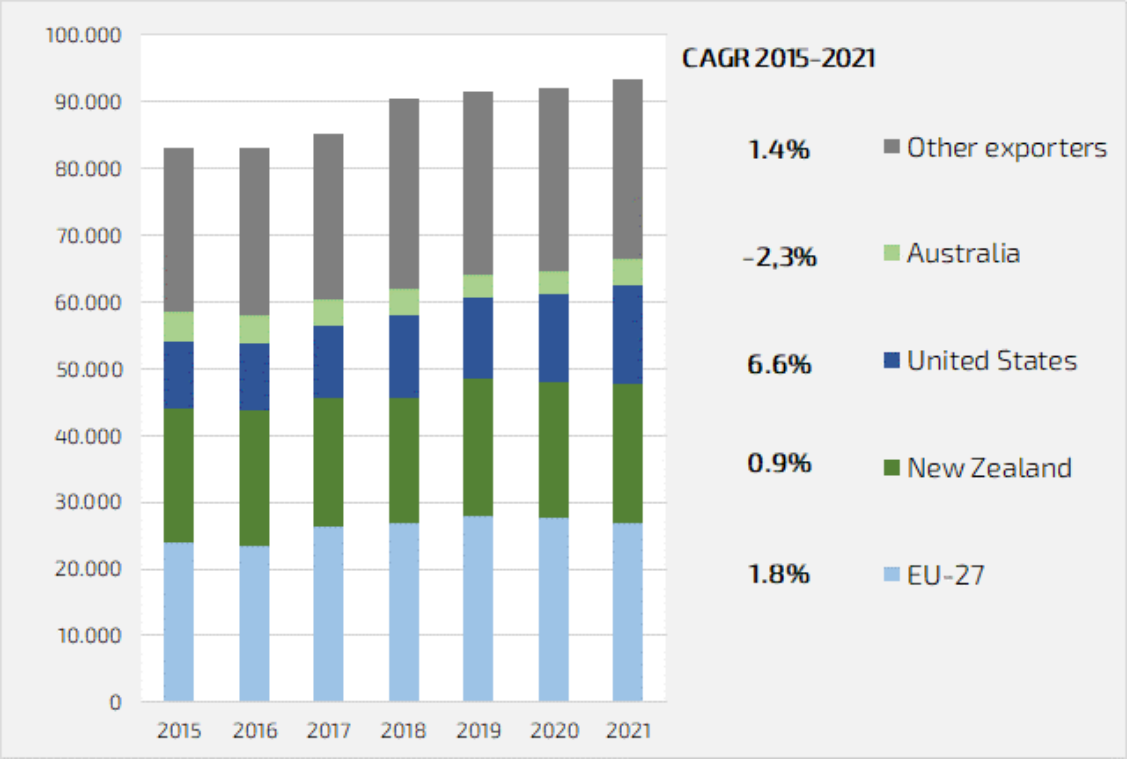
What can we expect going forward

Is the recent stagnation of milk production despite record high milk prices a temporary phenomenon? Some market commentators suggest that it is mainly due to elevated input costs following the post pandemic restart of the global economy and the subsequent escalation of the Ukraine-Russia conflict. It seems safe to assume that the issues concerning the availability and prices of the main dairy farming inputs – feed grains, energy and fertilizer – will remain for at least another 6 months and will therefore push the moment of a return to meaningful growth for milk production further into the future. No matter what the prevailing farming system is, the high prices of feed grains, energy and fertilizer continue to absorb a significant part of the elevated milk prices.

However, even beyond the next 6 months it is difficult to see milk production accelerating again and pushing milk prices back down to levels below €0.40. The global dairy market seems to be transitioning to structurally higher levels of milk revenues, not only for the next couple of months but possibly for years to come. Even when the input side of the cash flow on dairy farms starts to normalize, we may no longer return to the normal cycle of milk production growth accelerating and milk prices falling back to 2017-2020 levels.

The title of the article refers to a couple of longer term milk production challenges having to do with sustainability and reaching the physical limits of how many animals can be sustainably maintained within a certain region. These limitations will restrict the volume of milk available for exports out of the traditional export regions of the EU and Oceania. If we take a look at figure 2 and look back at how exports by the key export regions developed then the conclusion is justified that New Zealand and the EU-27 played an important role in growing global dairy trade in the past 7 years. Going forward it will be difficult – if not impossible - to sustain annual growth rates of 0.9% and 1.8% respectively for these regions. Especially as most of the total growth in exports happened in the first 4-5 years. After 2019 very little was added.

Figure 2. Regional shares in global dairy trade (2015-2021, 1000t of MEQ)



NB: In order to have a stable region definition, UK was taken out of the EU-data for the full 2015-21 period
Source: Dairyntel analysis, 2022

Global dairy trade still grows by about 1.7 billion kilograms of milk equivalent (MEQ) each year. The question is whether the US and the other exporters will be able to fill the gap that will be left open by the stagnant exporters EU and Oceania. The US has achieved an impressive growth rate of 6.6% in exports in recent years, but it was from a low base. The US and the other exporters together added about 1.1 bn kgs of MEQ in exports each year on average. So, they will have to add an additional 0.6 bn kgs each year when the EU and Oceania remain stagnant. This is quite a challenge.

A change in political objectives?

This looming shortage will most likely push dairy commodity revenues and subsequently milk prices structurally to new and higher levels. This is probably good news for anyone making a living in dairy farming. One of the likely many additional new dairy dynamics that this will generate is that agricultural policy targets will be revised. Already now, we are observing some of the Green Deal targets in the EU being watered down in the light of the current concerns about food price inflation and food security. The target of organic

farming ambition of 25% by 2030 has recently been abandoned and the crop rotation rules are also being waived.

Another implication of the potential scenario of structurally higher milk prices is that it facilitates the inclusion of all past and future efforts on sustainability, the environment and animal welfare into the "real price" of milk, without eroding the margins for farmers. It will be interesting to monitor how the new market reality of limited global milk supply and higher milk revenues changes the perspective of Brussels' policy makers in years to come.

If you are interested in our in-depth market insights or data underlying this analysis, please feel free to contact us.