How much export supply is still required for the global dairy market?

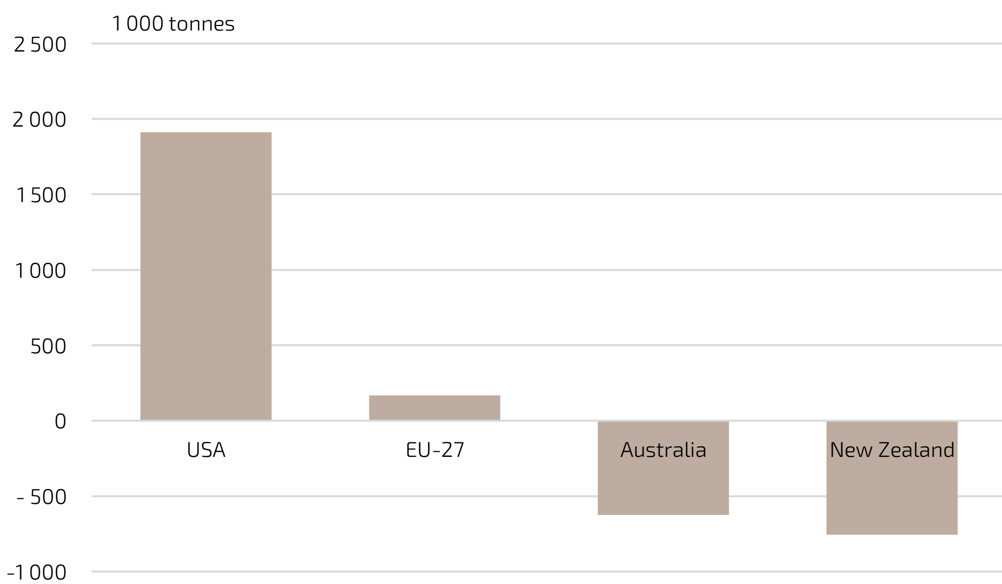
Traditional dairy export regions are reaching their limits

Over the last couple of years it became clear that the growth potential of milk production in both the EU and Oceania may be limited going forward. Both regions are faced with policy related sustainability constraints that will keep their milk surplus that is available for exports stable at best, but may even cause their export positions to diminish. Amongst the two of them they control about 55% of global trade. So the question which we will try to answer in this Dairyntel Market Insight is: will we see a new trade balance develop which will be much more constrained on the supply than in the past? Or can we expect a similar slowdown in import demand in years to come.

The price turbulence that dairy markets witnessed in the years 2021 – 2023 taught us that minor changes in the market balance can cause very strong price volatility when supply chain buffers are as low as they tend to be these days.

In 2021 it was China that challenged the sensitivity of the global market balance when its import demand reached record levels. The resulting price increase in dairy commodity markets in 2021 and 2022 would normally have triggered a strong supply response in the export markets of the EU, the US, and Oceania. However if we take a closer look at the level of milk production in 2022 compared to 2020, then only the US managed to grow its milk output in the last two years.

Figure 1. Growth of milk production in the 3 main export regions, 2022 compared to 2020



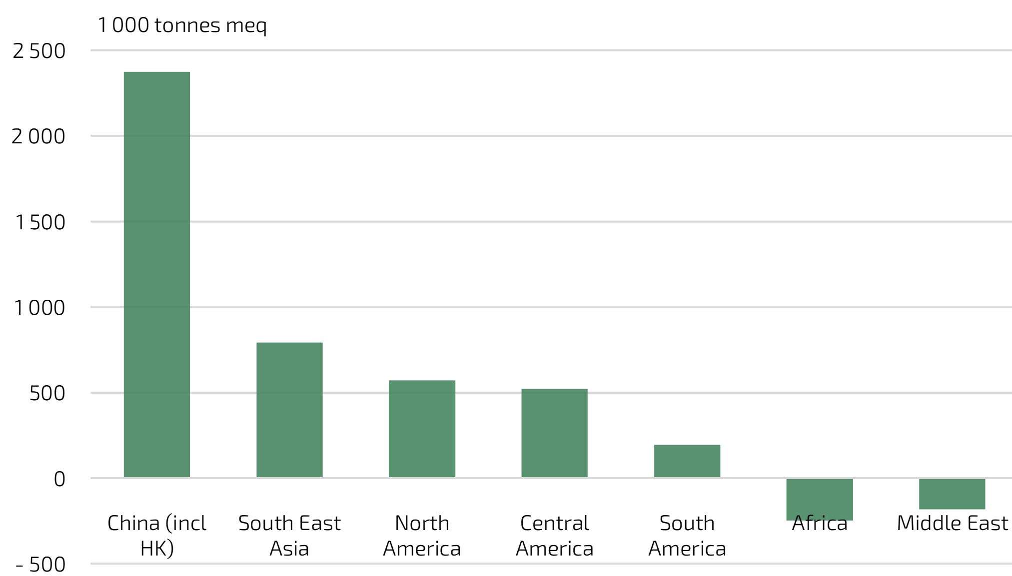
Source: Dairyntel analysis, 2023

As interesting as these supply side developments are, it is the demand side that will be the focus of this article. After all, the tightness of the global market due to these disappointing supply developments proved to be short lived when Chinese import demand in 2022 dropped back to the 2020 level. Prices of most dairy commodity products fell back into their long term average band width. At that moment the question came up whether we had seen the best of Chinese import demand by now and whether the main engine of global demand growth has come to a standstill. If that is the case, then the global market may no longer need the strong growth in export supply that the EU, Oceania and the US delivered in the past.

Apart from China, how much import demand growth is still out there

It is clear that global growth in dairy trade volumes in the last 15 years was mainly driven by China. As we now seem to be entering a phase where China's import demand may grow only marginally or not at all, the focus in terms of business development of export oriented processors and traders will inevitably shift towards new geographies. So which are the other markets that require growing imports to balance their domestic markets. Figure 2 provides an overview of the main other growth regions in terms of dairy imports next to China.

Figure 2. Increase in import volumes by growth region between 2018 and 2022



Source: Dairyntel analysis, 2023

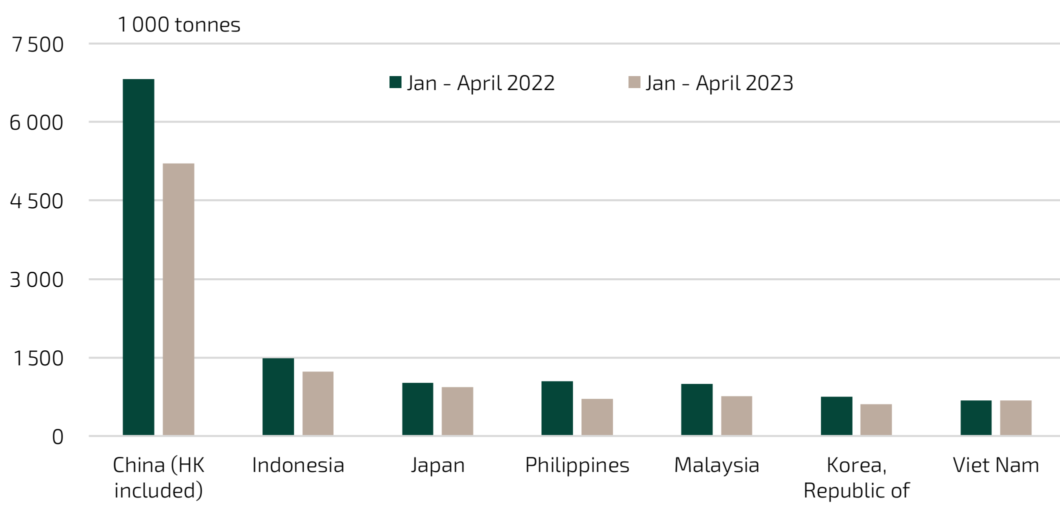
The first conclusion is that it will be difficult to continue the historic pace of growth in global imports without China pushing things forward. All other significant growth markets combined – essentially SE Asia and the Americas – increased their imports just as much as China alone in the 2018 – 2022 period. Secondly, imports in Africa and the Middle East are on

a stable path at best. Africa is often referred to as one of the future growth markets for dairy, but the 2018 – 2022 period provides very little evidence that supports this scenario.
So if we assume for now that China's import demand will no longer grow at the 1 – 1.5 bn kilograms of milkequivalents per annum that we came accustomed to in the 2010 – 2020 era, then the anticipated slowdown – or possibly even reduction - in export supply in the EU and Oceania may not be the threat to global availability of dairy that one may expect. The volumes required by the other net import regions for dairy are simply a lot more modest, so the risk of structural shortages and structurally higher prices appears to be limited.

What does this imply for the market balance in H2 of 2023?

Although the risk of immediate supply shortages appears to be limited at this point in time, it is difficult to shake the notion that supply is hardly ready for positive demand surprises in the remainder of the year. Milk production in all of the export regions combined is only some 0.5% above last year's level and 2022 was not a particularly strong year in terms of milk production. Dairy commodity prices took quite a dive in the first 6 months of 2023, so supply growth – despite being as fragile as it is - seems to be sufficient for now. If we take a look at import demand in the Asian regions in the first 4 months of this year, then imports in all of the key export destinations are significantly below 2022 comparable numbers. For China this was expected as the usual spike in January imports was absent due to the termination of the reduced tariff quota this year. What the cause is of the subdued imports in the rest of Asia is less clear however. Weak end consumption due to the combined impact of food price inflation and economic headwind is often heard as the main reason.

Figure 3. Changes in import volumes in the main Asian dairy markets
(January – April 2023 import volumes versus the same period last year)



Source: Dairyntel analysis, 2023

Going forward the main question is whether the weak import performance in Asia will sustain. Dairy commodity prices have come down to more favorable levels from a consumer point of view so if the global economy recovers, Asian dairy imports have significant room for improvement in the second half of 2023. If we add to the equation the unpredictability of China's import behavior then the remainder 2023 may have some surprises in store. Especially because global export supply does not seem to be ready for a possible recovery of global import demand.

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