



Overview

The global dairy markets strengthened in November but eased in the second half of December during the holiday lull. Production remains heavy yet demand has been resilient and little stock has accumulated. Still, buyers are cautious. Traders expect China to buy more aggressively after the first of the year, and others will likely purchase on cheaper prices, though it remains to be seen if this activity will be enough to absorb growing supplies.

While suppliers wait for China's next move, shipments into Southeast Asia, the Middle East and North Africa and Latin America remain good. Dairy imports into Brazil and Venezuela are up about 40% this year, helping take up the growing supply in Argentina and Uruguay.

In mid-December Fonterra increased its payout price NZ20c to NZ\$6.50/kg MS, reflecting steady demand in the fourth quarter.

Total Russian import volume in the first three-quarters of 2011 was down 6% vs. 2010. EU shipments were down 17% as European suppliers lost share to Ukraine, New Zealand and Argentina. In addition, if European internal demand slows due to economic problems there, it could lead to further inventory build-up in the first quarter of 2012.

Processors in Thailand are expected to resume production in January after closing for

several months due to flooding. The region has seen a shortage of recombined milk – and higher prices – since October.

India remains a wild-card. They prefer not to import (to protect their domestic industry) but they've had to reduce tariffs on butter and milk powder in two of the last three years as domestic supply has been unable to keep up with burgeoning demand.

Future market direction should be revealed after the New Year. Expectations are for prices to trade within 10% of current ranges, subject to short-term volatility and shifts driven by tactical buying and selling.

Milk Production Trends

Milk production from the five major exporters (EU, U.S., New Zealand, Australia and Argentina) has been heavy this year – up almost 3% in August-October, and up about 2.8% in the January-October period. ... In the **EU-27**, production growth was up about 1.5% in September. Milk deliveries in the first nine months of the year were up 2%, an additional 2.1 million tons vs. last year. Production is rising seasonally. High farmgate milk prices and favorable weather should encourage output, though some countries are pulling back to avoid quota super-levees. The EU Commission forecasts growth of 0.3% in 2012, though many analysts feel production growth will be greater. ... **New Zealand** milk

production hit record highs in recent months, with output up 10% in the August-October period. December production was said to still be 10% ahead of last year, keeping manufacturing plants full.... **Australia** milk production was up 4.6% in the September-November period. ... **Argentina** milk production was up 13.7% in August-October. ... **U.S.** milk production in the September-November period was +1.8% and in the first 11 months of the year it

Dairy Product Prices

(dollars/metric ton; F.O.B. ship)

-- mid DECEMBER 2011 --

	Europe	Oceania
Skim milk powder	2975-3175 (-100)	3050-3450 (NC)
Whole milk powder	3750-3925 (-125)	3400-3700 (+100)
Cheddar cheese	4575-4900 (-13)	3750-4150 (NC)
Butter	4650-4950 (-200)	3550-3950 (-150)
Butteroil	5100-5500 (-200)	3900-4300 (-100)
Dry whey	1250-1350 (+50)	1475-1600 (+50)
Whey protein concentrate (34%)	NA	2950-3150 (NC)
Lactose	NA	1625-1700 (+113)

(change from a month ago in parentheses)

was up 1.6%. The size of the U.S. dairy herd decreased in November. USDA projects a production increase of 1.2% in 2012.

World Dairy Product Markets

SMP – Price indications were softer from mid-December. Buyers are waiting for the results of an Algeria tender; however, Algeria was said to have rejected the initial round of bids in hopes of purchasing at lower prices. This reflects the common dynamic right now: buyers are purchasing hand-to-mouth and holding out for better prices in the New Year.

As a result, there is some inventory build-up. EU shipments were strong up until the early part of the month, but slowed over the holiday lull. Oceania still has heavy production on the shoulder of the flush.

On Dec. 16, the EU had 53,573 tons left in intervention stock, which is being held for next year for domestic feeding programs.

NZX futures are lower. Settling prices are \$3,285 in January and February, then \$3,350/ton on the rest of the board.

Prices were lower at the Dec. 20 Global Dairy Trade (GDT) event, an auction platform primarily for Fonterra product. U.S. product from DairyAmerica averaged \$3,081/ton for January delivery and between \$3,005 and \$3,130 for February delivery. Arla Foods will begin offering SMP on the GDT platform in April.

The U.S. powder market is steady to weaker, pressured by lower international prices and heavy production. In the August-October period NDM/SMP output was 197,630 tons, up 11% from a year earlier. In the same three months, U.S. NDM/SMP exports were 109,464 tons, down 15% from the historically high levels of last year. Inventories declined this autumn but are starting to rebuild. On Oct. 31, NDM stocks were 65,151 tons, down 22,414 tons (-26%) from three months earlier.

WMP – WMP prices are steady, though under pressure. Export orders were quieter over the holiday period. Weaker butterfat markets are weighing on WMP as well. Buyers are waiting

for the results of an Algeria tender for February-May delivery; however, Algeria was said to have rejected the initial round of bids in hopes of purchasing at lower prices.

Oceania production remains very heavy, but supplies are mostly clearing.

China imports came back in November (19,413 tons), though volumes were still below a year ago. In 2011, China imported 182,100 tons of WMP in the first four months of the year (+63% vs. 2010). It remains to be seen if they'll buy that much in early 2012. Traders still expect China to buy aggressively in January when tariffs on imports from New Zealand are cut to 5.8% (vs. 10% for Most Favored Nations).

NZX futures are slightly higher. Settling prices average \$3,513/ton in the first quarter 2012 and \$3,640-\$3,690/ton on the rest of the board. NZX launched options on WMP in November.

Prices were higher at the Dec. 20 Global Dairy Trade (GDT) event, an auction platform for Fonterra product.

Cheese – Cheese prices are generally steady, buoyed by recent Japanese purchases. Oceania production is heavy on the shoulder of the flush, but most is clearing.

EU sales are sluggish. The EU Commission estimates EU cheese consumption was up 0.8% in 2011, which would be flat on a per-capita basis. Meanwhile, higher whey prices are encouraging more milk to move to the cheese vat, where returns are now better than for butter/powder.

Prices for cheese (industrial cheddar) were higher at the Dec. 20 Global Dairy Trade (GDT) event, an auction platform for Fonterra product.

The U.S. cheese market is weaker this month. On Dec. 29, the benchmark CME Group spot cheddar block price was \$3,445/ton, down nearly \$1,000 since mid-November. Total cheese production in the August-October period was 1.194 million tons, up 0.3% from the prior year. Commercial cheese stocks decreased seasonally in the August-November period after holding mostly steady

the first seven months of the year. On Nov. 30 inventories were 440,250 tons, down 51,085 tons in four months. In the August-October period, U.S. cheese exports totaled 48,009 tons, up 9% from a year ago. Through Dec. 8, Cooperatives Working Together (CWT) had accepted bids to provide bonuses on exports of 41,501 tons of cheese this year, with deliveries starting to extend into 2012. The CWT export assistance program was renewed for 2012-13.

Butterfat – World butter prices are weaker. The Oceania market has eased back. Sales have been good and there is little evidence of inventory build-up. However, EU exports are down significantly as prices are not competitive. EU butter users are waiting for 30,000-35,000 tons of New Zealand butterfat to be available in the first quarter at prices well below current EU prices. This will likely put additional pressure on EU prices. About 3,000 tons of butter per week is coming out of PSA stocks. On Dec. 16, holdings were 35,204 tons, about 2,250 tons more than last year's level. Sales of new-crop butter into PSA holdings should begin in March.

This contrasts somewhat with the situation in Finland and Norway, where butter was drastically short this month. Both countries relaxed import quotas to avert continued tightness. In Finland, Valio cut exports to Russia by 20% to have more for the domestic market.

Higher futures prices suggest traders expect product shortfalls in mid-2012. Purchases from India may be anticipated.

Butter stocks in Japan are tight, necessitating additional imports. In the first 11 months of 2011, Japan imported 14,776 tons of butterfat, up from 2,607 tons in 2010. The local trade expects supplies to remain tight throughout 2012.

NZX futures for AMF are significantly higher. Settling prices average \$4,081/ton in the January-May contracts, then \$4,480/ton on the rest of the board.

Prices for AMF were higher at the Dec. 20 Global Dairy Trade (GDT) event, an auction platform for Fonterra product.

The U.S. butter market weakened in December. On Dec. 28, the benchmark CME Group spot butter price settled at \$3,516/ton, down \$160 from the end of November. Butter production in the August-October period was 188,902 tons, up 23% from the year before. Inventories are declining seasonally. Commercial butter stocks on Nov. 30 were 43,054 tons, less than half of what was on hand at the end of June. U.S. butterfat exports in the August-October period were just 11,040 tons, down 26% from 2010 levels.

Dry Whey – The global whey market remains firm. Stocks are low as production is easily committed. The protein-equivalent price of whey has moved above SMP as more whey is used in specific food applications where substitution isn't possible.

The U.S. dry whey market remains very tight. Manufacturers are often putting customers on allocation for 2012. Dry whey production in the August-October period was 105,475 tons, down 2% from the prior year. Whey inventories remain low. On Oct. 31, stocks were 19,054 tons, down 6,508 tons (-25%) in six months. Exports of dry sweet whey are tracking higher than 2010 levels. In the August-October period, shipments were 61,681 tons, up 6% from the prior year.

Whey Protein Concentrate – World markets remain firm. There is strong global demand for high-protein whey, and limited supply growth in the last year. The U.S. WPC-34 market is steady. The market for higher-protein concentrates remains tight. At the end of October, U.S. stocks of WPC were 17,307 tons, up 20% in five months. In the August-October period, U.S. exports of WPC and modified whey products were 47,105 tons, down 4% from last year. WPC production in August-October was 48,985 tons, up 1% from last year.

Lactose – Prices are higher from all sources. Demand from Oceania for use in standardization is driving the market. Product availability is low.

Lactose from Murray Goulburn will be offered on the Global Dairy Trade auction platform beginning in April.

The U.S. lactose market is steady/firm. Orders are good and contracting for 2012 continues. In the August-October period, production was 112,522 tons, up 6% from last year. A substantial portion of lactose continues to move overseas. In August-October, lactose exports were 80,392 tons, up 4%. Stock levels were steady in October. On Oct. 31, inventories were 31,688 tons, slightly higher than end of August.

Currencies in U.S. dollars			
	Nov. 29	Dec. 29	change
Euro	\$1.333	\$1.303	-2.3%
Australian dollar	\$0.988	\$1.015	+2.7%
New Zealand dollar	\$0.753	\$0.773	+2.7%

The U.S. dollar strengthened against the Euro in the last month, but weakened against the Oceania currencies.

Currency Exchange rates – vs. U.S. dollar

(Indexed to Jan. 1, 2011)

