

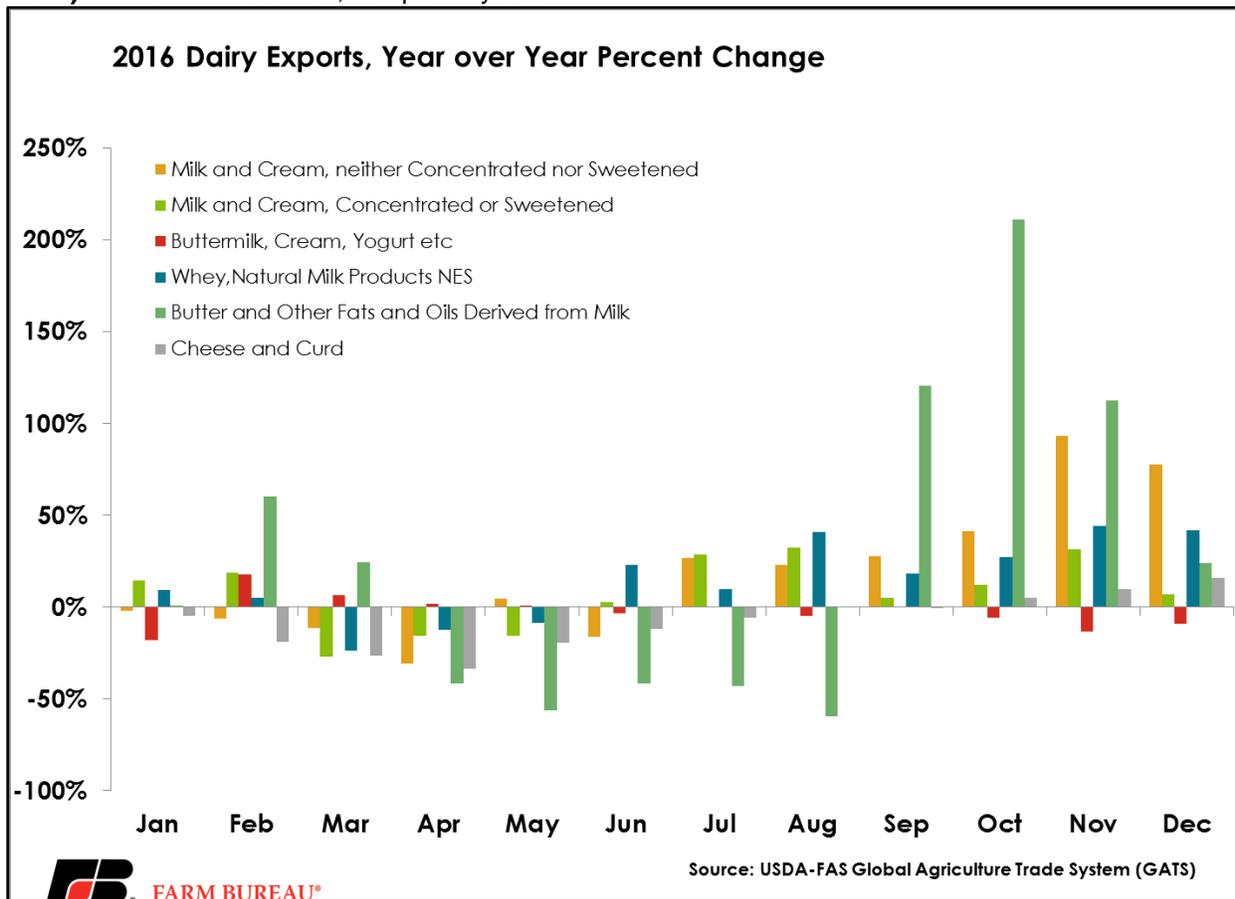


Dairy Exports Pop in Fourth Quarter

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Dairy exports were sluggish in 2016, with most major dairy categories struggling to post year over year gains consistently throughout the year. Liquid milk and cream exports had the strongest year, annually totaling 114 million liters, a 17% gain on last year's 98 million liters. Another bright spot on the dairy export front was the gain in products shipped under HTS code 0404, or whey products. This also had an annual increase of over 10% coming in at 488 thousand metric tons, and a 12% increase over last year. Both whey and fluid milk and cream products started 2016 with the first 6 months of the year showing lackluster gains, and some fairly substantial months of decline compared to 2015. Figure 1 displays the monthly year over year change in the six major product categories of USDA-FAS dairy export data.

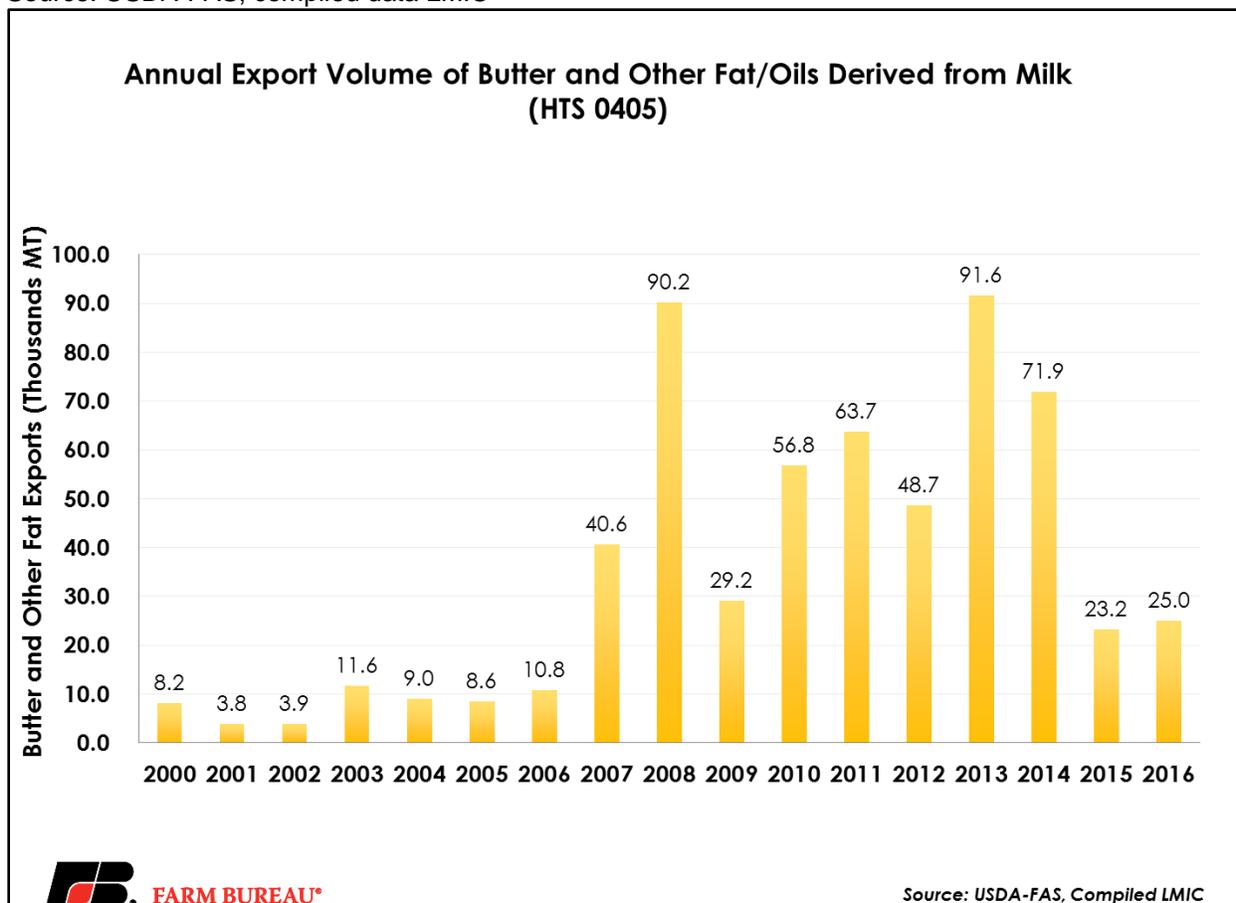
Figure 1: 2016 year over year Percentage Change in Dairy Export HTS Categories (0401-0406). Source: USDA-FAS, compiled by LMIC



Exports ramped up significantly September through December for all categories. Most notable was the increase in butter and fats derived from milk. This climbed over 200% in October, and over 100% from last year in November and September. Butter and dairy fat exports have struggled over the last two years, exporting volumes last similarly seen in 2006. Figure 2 shows the last 16 years of export volumes for butter and other fats derived from milk.

Figure 2: Annual Export Volume of Butter and Other Fat/Oils Derived from Milk

Source: USDA-FAS, compiled data LMIC

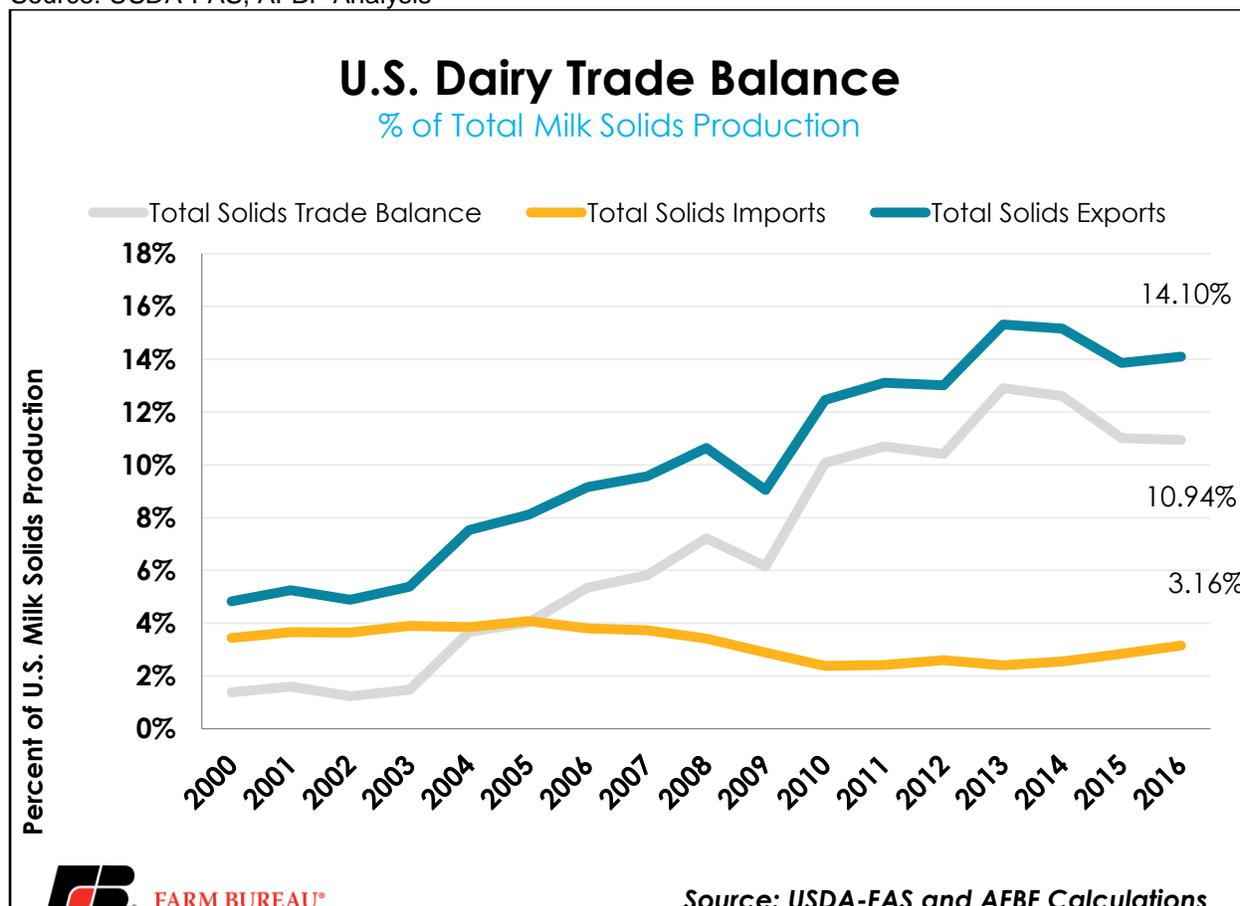


Butter and other fat/oils derived from milk encompass many products, but butter represents the lion share in this export category. U.S. butter exports are sensitive to competitors' prices. Prior to 2006, U.S. prices were much higher than Oceania and Western Europe, however, during the high export periods, butter prices inversed relative to other countries. Over the last two years, U.S. prices have been above world prices. More recently, U.S. prices have come more in line with world prices, and briefly dipped below EU butter prices in the fourth quarter, providing the opportunity for increased exports. Price isn't the only factor at play in these markets. Exchange rates have been a concern. Australian, New Zealand and the EU currencies have been depreciating relative to the dollar since the second half of 2014, which has also provided some headwind to exports and supported increased imports.

On the import side, the six major categories plotted in Figure one showed growth across the board. HTS 0403, or Buttermilk, Cream and Yogurt category had the largest jump, up 133% from 2015. It is also the smallest import category. A typical year remains well under 10 thousand metric tons, and in 2016 this number rose to 10.4 thousand metric tons. Fluid milk and cream also show large increases up 4.6 million liters from 2015, followed by butter, up 23% or 8 thousand metric tons. Although volumes of imports were higher in 2016, collectively dairy is still a net exporter by volume. Butter and oil products were the only category to show imports were greater than exports, a trend that has continued for the second year in a row. Figure 3 shows the dairy trade balance on a solids basis.

Figure 3: Dairy Trade Balance, Milk Solids Basis

Source: USDA-FAS, AFBF Analysis



Abundant global supplies of milk have also weighed on U.S. exports. Global milk production increased 1.9 million metric tons according to the PS&D database of USDA-FAS. The E.U. is the largest producer of cows milk, representing over 30% of global production in 2016. In comparison the U.S. produced nearly 20% of global milk production and increased by 2% this year. Table 1 shows the top ten producers of cow's milk in the world and the percent change from 2015. EU milk production has become a much bigger deal to the U.S. in recent years for a couple of reasons: 1). The EU dropped their quota system in 2015, which had effectively limited the amount of

increase and exposure to U.S markets. 2). The Russian agricultural trade ban prevents the EU from shipping many milk products to Russia, effective in 2014, which was one of their major export destinations. The U.S., although had limited direct exposure in dairy markets to Russia, the EU milk flow has landed in several U.S. markets increasing competition.

In 2017 exports are again going to be price sensitive. The U.S. is expected to increase milk production, based on margins improving from 2016. World production is expected to increase in 2017 according to FAS by about 1.5%. This could potentially mean greater competition for U.S. dairy products, but it will likely depend on conditions in other parts of the world, particularly those that export large volumes.

Table 1: Global Milk Production Increases: Top Ten Milk Producing Countries in 2016

Source: PS&D USDA-FAS

	Percent of World Production	Percent from 2015	Change	Change in Production (1000 MT)
World Production		0%		1,901
European Union	31%	1%		1,800
United States	19%	2%		1,723
India	14%	6%		4,000
China	7%	-5%		(1,850)
Russia	6%	-1%		(210)
Brazil	5%	-8%		(2,044)
New Zealand	4%	-1%		(212)
Mexico	2%	2%		198
Argentina	2%	-10%		(1,155)
Ukraine	2%	-2%		(204)
ROW	7%	0%		(145)