

International Agri Insights

with Professor Bill Bailey

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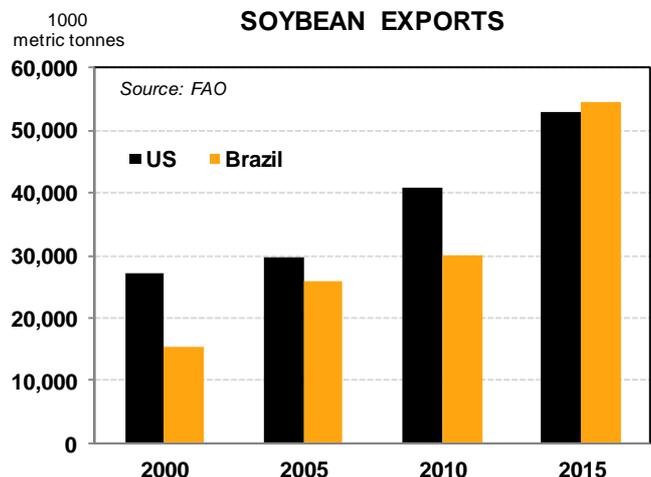
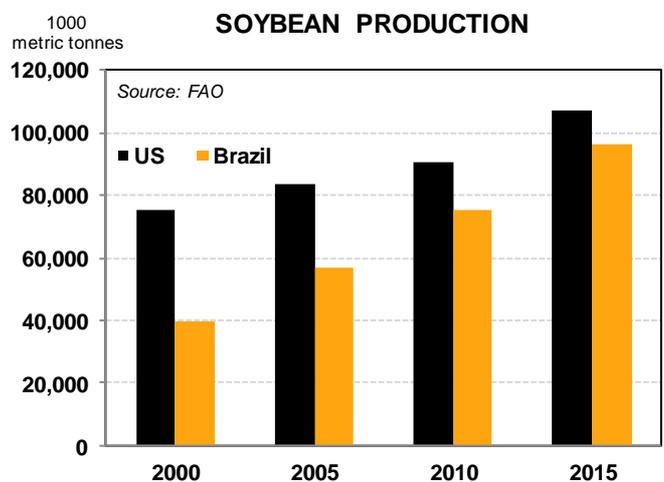
South American dairy: Is the threat real?

- South American dairy production will likely grow over time.
- However, South American consumer demand is likely to absorb most of the production increase.
- As a result, South American dairy exports are unlikely to pose a serious threat to NZ dairy’s export fortunes.

Over the past 15 years, the position of the United States as the leading producer and exporter of soybeans and soybean products has slowly eroded as other countries – particularly in South America – have aggressively increased production and exports. Given this experience, and the scale of South American agricultural resources, one does wonder which agricultural sector might be next. In this column we pose just that question and ask “does South America pose a real competitive threat to New Zealand?”

Threat 1: Reordering of trade relationships

While very unlikely, the potential exists for a significant reordering of trade relationships. This reordering can happen when countries establish trade barriers in response to trade-disruptive actions by other countries. Such a reordering (for example increased New Zealand dairy exports to Mexico replacing imports of US origin) would clearly take time for adjustment. However, despite President Trump’s negative comments about both NAFTA and Mexico, US dairy exports to Mexico continue to remain strong. Since November 2016, Mexico has expanded its lead as the top US customer. In October 2017, the value of US dairy exports to Mexico was up 5% yoy. Mexico represented nearly 30% of total US dairy exports over the first 10 months of 2017. In contrast to dairy and in anticipation of a bad outcome for NAFTA, Mexico is taking action to secure new suppliers other than those in the US, as discussed below.



For example, to diversify its agriculture supplier base in anticipation of a breakdown in NAFTA talks, Mexico is currently negotiating a trade agreement involving cars and agricultural products with Argentina. Under the potential agreement, Mexico, which currently exports 80% of the cars it produces to the US, would shift exporting those cars to Argentina. In turn, Argentina would export corn and soybeans to Mexico, replacing US origin corn and soybeans.

Threat 2: New export competitor

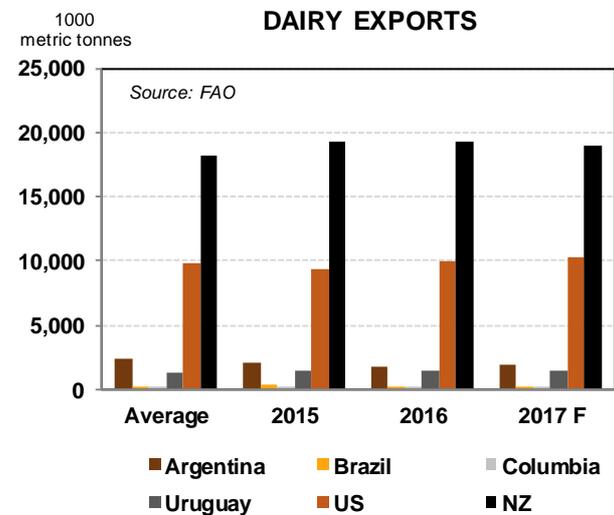
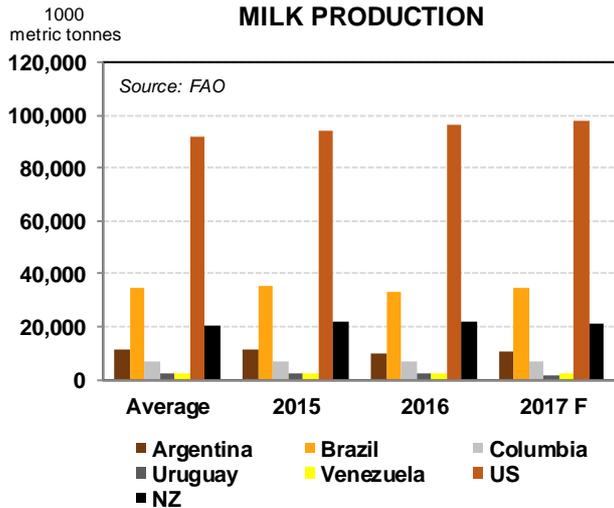
A second potential threat to New Zealand dairy exporters is the emergence of new dairy-exporting countries. A reordering of trade relations does not create new demand, it only changes the composition of countries that meet the existing demand. On the other hand, an increase in world dairy products available for export could be more unsettling to current trade relations. While Argentina has corn and soybeans to export to Mexico, what if Mexico looked to Argentina or another South American country, instead of the US and New Zealand, for dairy imports to meet its domestic demand?

To answer that question, let's first look at a real example – the growth of the Brazilian soybean industry. As Brazilian soybean production has increased over the past few years, so have its soybean exports. Brazilian soybean exports more than tripled between 2000 and 2015. At the same time, US soybean production and export growth were more modest and Brazil moved into traditional US markets. The growth in the importance of Brazil to the world's soybean markets was a combination of the country bringing new land into production and the aggressive use of new and emerging technology. For the US, there is very limited potential to bring new land into production and new technologies are usually quickly brought into the farming system. While US soybean production will slowly grow, it will difficult to increase sufficiently to match the growth in Brazilian production.

In light of the impact of a robust and aggressive Brazilian soybean sector on US competition, one wonders what a similar focus by Brazil and other South American countries might mean for New Zealand dairy exports. First up, a look at South American production trends shows that Brazil and Colombia have demonstrated an increase in production between 2000 and 2015. While weather could be a factor in the production declines seen for Argentina, Uruguay and Venezuela, none of those three countries have (or are) forecast to return to 2012-2014 production levels for either 2016 or 2017. Brazil's milk output for 2017 is forecast to be only very slightly above the 2012-14 average. Colombia's output showed the greatest growth, with 2017 output forecast to be nearly 10% above the 2012-14 average. Dairy production in Argentina, Chile and Uruguay declined.

Brazil has potential...

From a purely historical perspective, Brazil appears to be the country to watch for increased dairy production. Brazilian dairy output is currently about 60% above New Zealand levels. It is believed Brazil has the potential to further increase output by bringing new land into production, as was demonstrated for soybeans. In addition, improvements in herd genetics, greater use of emerging technologies and improvements in their infrastructure all



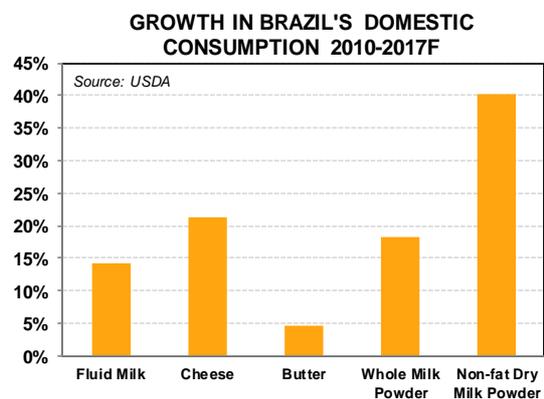
point toward the possibility of significant increases in Brazilian milk output. A similar outcome for Colombia, albeit on a smaller scale, brings another increasingly significant South American country into the dairy mix.

In addition to improved herd genetics and adaption of contemporary technologies, there are several other broad changes that could increase production. There could be a consolidation of farms which could lead to increased efficiencies and economies of scale. For example, Brazil has nearly 1.2 million dairy farms. As seen in many different countries, consolidation of smaller farms into larger farms results in increased productivity. Further, South America has considerably less water stress than other regions, enhancing growth potential. The area uses hybrid production systems, blending together farm level grain feeding with pastoral feeding. This ability to mix pasture and grains to feed livestock helps to cushion dairy farms from the vagaries of feed or rainfall availability experienced by farms with more focused feeding choices.

...but growing domestic markets are likely to take priority over exports

While the countries discussed have the potential to increase production, the reality is that domestic consumption is growing in those countries, providing a more accessible market and reducing the volume of dairy products available for export. For example, Venezuela has minimal exports, given robust domestic demand. Because of production challenges in that country, it is not expected that Venezuela will become an exporter anytime soon. With a smaller population and a reasonably well-developed production sector, Uruguay should remain a consistent dairy exporter. It has increased exports almost 15% during the time frame discussed and is the second leading exporter, after Argentina. But volumes exported are expected to remain small when compared to New Zealand exports.

The challenge for the South American dairy industry is to meet the consistently growing domestic demand for dairy products. For example, the population of Brazil increased more than 6% between 2012 and 2016. In contrast, US population grew 4%. This means, for South America, increased domestic consumption could take most, or all, of an increase in milk production, leaving limited quantities available for new or additional exports, although production could, and probably will, grow. Traditionally, as the population in a country becomes more affluent and matures, consumer demand changes from lower-value products to higher-value goods. As this happens, lower-value bulk dairy products could move into world markets as domestic demand is met through higher-value imported products.



As a result, we expect the dairy threat from South America to remain modest

In summary, while South America has the resources to increase dairy production significantly and become a more important participant in world markets, challenges exist. Recent unstable economic conditions have had very negative impacts on Venezuela and Argentina. Further, the political climate of other countries, such as Brazil, raise the risk of investing in those countries, further dampening significant growth in dairy production in the near and medium term.

About the author

William C Bailey was Chair of Agribusiness at Massey University for 13 years. He has written weekly world dairy market columns for ASB Bank for almost 15 years. He currently is President of Topker Consulting, specializing in agricultural market research and supply chain issues relevant to agriculture. He retired as Dean, College of Business and Technology, at Western Illinois University, in Macomb, Illinois, in July, 2017. Bill spent 5 years in the US Marine Corps and received his PhD in Agricultural Economics from the University of Missouri. Before shifting to New Zealand, Bill was Chief Economist for the US Senate Committee on Agriculture, Nutrition and Forestry, served as Deputy Undersecretary of Agriculture and was Vice President and Director of Research for World Perspectives in Washington, DC. His beer of choice is Tui.



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