U.S. Dairy Export Council
Ingredients | Products | Global Markets

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USDEC Export Profile

BUSINESS AS USUAL

High prices haven't convinced food and beverage processors to swap dairy for substitute ingredients—not yet.

In early March, one couldn't help but feel a bit of 2007 déjà vu as international commodity prices went on an impressive upward spiral. Then, amid uncertainty surrounding the Japanese earthquake, conflicts in the Middle East and the Northern Hemisphere spring flush, the markets reversed.

But don't get too comfortable. The experts say another reversal may be just around the corner.

That's life in today's volatile dairy sector. And it begs the question: How are buyers responding to the pricing roller-coaster, particularly the upswings?

"Toward the end of the first quarter of 2011, we were beginning to see push back," says Jim Hrusovszky, vice president, business relations and development, United Dairymen of Arizona. "Prices were getting high for many people's income around the world."

The price softening that began in March "will cause many to sit back and wait to order until they feel the prices have hit the bottom," he adds.

But market fundamentals will reassert themselves, Rabobank said in its last *Dairy Quarterly*, noting that demand is very strong.

"There is no doubt that Oceania and Asia are now operating in a higher milk price and dairy commodity environment. The important thing is that Asia is driving this," says Jon Hauser, editor/publisher of global dairy information website Xcheque.com.

"China (and the rest of Asia) is building a modern dairy market on the back of grain and Western lot fed dairy systems (plus imports)," says Hauser. Chinese raw milk prices over the past year "tell us that a $20 per cwt milk price and the associated commodity price is not going to be a barrier

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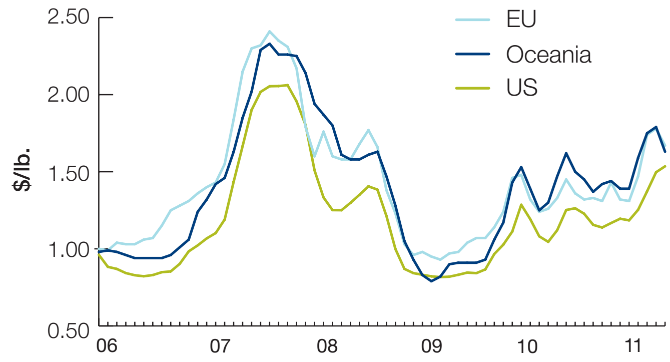
SMP Prices



Don't expect a market crash à la 2007-2008, analysts say. Economic recovery continues, demand remains strong and prices have not reached the lofty heights of three years ago.

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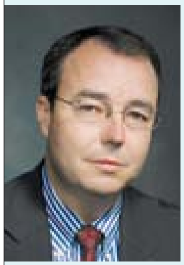
RUNNING WITH THE REGULATORY BATON



By Matt McKnight, vice president, market access and regulatory affairs, U.S. Dairy Export Council

When USDEC formed in 1995, one of the major challenges to raising U.S. dairy exports was complying with unfamiliar and often complex foreign rules and regulations.

Diane Lewis, who retired as USDEC vice president of market access and regulatory affairs on March 31, set up the system that has helped steer U.S. exporters through many of those regulatory ABCs from the very beginning.

Over the past year, Diane and I spent a growing amount of time working to resolve conflicts caused by shifting importer regulatory demands—sanitary and phytosanitary (SPS) measures that ultimately function as non-tariff barriers to trade. USDEC's trade policy staff is directing a long-term, multi-faceted "Regulatory Coherence" initiative (see "Countering the Shenanigans" on page 6) that aims to change the playing field to reduce the incidence of non-tariff trade barriers by integrating a harmonized approach to food safety into free trade agreements.

Much also is being done here in the United States as part of that effort to make us better equipped to handle the barrage of barriers inundating the industry. One challenge involves recognizing U.S. regulatory agencies' staff and budget limitations that restrict their abilities to take on so many new certification requests.

As I step into Diane's role looking to advance the good work she began years ago, a key responsibility is exploring what the U.S. industry can do to help take some of that work off those agencies' plates while still maintaining the integrity of the U.S. regulatory system. We are investigating a number of innovative solutions in the form of language and practices—including outside-the-box concepts like self-certification—that meet a new requirement's intent if not the exact foreign government demand.

Over the ensuing years, we hope such a proactive approach will help the U.S. industry become even more adept at navigating import regulatory requirements and that will lower the transactional risk that comes with becoming a consistent global dairy suppliers. ■ ■ ■

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while Asian economies are strong and the market has so much opportunity for growth."

That doesn't mean buyers are immune to high prices. But determining the point at which food manufacturers decide to switch to alternative ingredients is more art than science.

"Consumer and buyer resistance is just about impossible to judge," says Hauser. "We know that the actual demand for dairy products only fluctuates by a few percent and it has more to do with general fashion and the overall economy rather than the specific price of individual items."

There really is a two-level system, says Guy Bouthillier, director, business development, Main Street Ingredients.

"If you talk to consumers in industrialized countries, they realize world demand is increasing and exceeding production and having an effect on cost. It makes sense to them that the average price point is going up," he says.

Because the prospect of an ingredient swap is costly, it takes them a lot to pull the trigger on a switch. But once they do, they are not likely to come back, says Bouthillier.

Emerging countries are quicker to act.

"They get to point where they can no longer afford raw materials, so they start replacing with ingredients ranging from maltodextrin to soy protein to other proteins," says Bouthillier. But because they are smaller and so price motivated, they are also willing to switch back more easily, he adds.

If anything, at this point, substitution caused by high prices may be reducing the rate of growth, but not sending it backward.

Rabobank notes several reasons for continued optimism regarding demand, including stronger economic recovery in Western nations, no negative buying signals out of China, the entry of India as a short-term buyer, reductions in import tariffs in countries like Taiwan, and expanded buying in South Korea.

The rise and fall in the first quarter were normal market movements.

Says Hauser, "Many people bemoan the volatility of the market but it is none-the-less effective in keeping supply and demand balanced." ■ ■ ■

MARKETUpdate: India

AN ENIGMA WRAPPED IN A RIDDLE

India may be the world's largest milk producer, but questions abound about its growth potential, product quality and whether it will eventually become a major dairy importer.

On the one hand, the Indian government "Economic Survey" report projects that the nation is on a path to becoming a consistent dairy product importer by 2022, as domestic consumption outpaces milk production growth.

On the other, the nation's top dairy processor, Gujarat Cooperative Milk Marketing Federation, better known as Amul, projects that the nation can and will lift milk output by 10 percent per year by 2013, easily outpacing consumption growth and giving the nation enough milk to become a consistent dairy exporter.

The two projections on the surface could not be much more divergent. But they agree about one thing: India needs more milk.

The divergence appears because Amul believes the nation can address its dairy production shortcomings and turn potential into reality. Considering the limitations India needs to overcome, it draws more than a little skepticism.

Small farmers, owning five or fewer cows (or water buffalo, which account for a little less than half the nation's milking herd), produced between 65 and 80 percent of India's annual output of 117 million tons in 2010, most of which is sold locally and never enters the "organized" sector.

The system endures for a number of reasons, not the least of which is that it provides a living to far more rural Indians than would a larger "organized" dairy farming model. But it is rife of faults.

India's per cow yields are 85-90 percent lower than global averages due to poor genetics, low-quality feed, inadequate veterinary care and simply bad management. Because farmers in the unorganized sector lack the money to invest in their operations, the inadequacies are rarely addressed.

Even if they were able to upgrade their stock and learn more modern dairying techniques, they would still be hindered by India's poor rural infrastructure, making moving milk in a safe and timely manner a difficult task.

Poorly equipped small farms with 1-5 cows (or water buffalo) produced the bulk of India's 117 million tons last year.

Insiders say that the situation is further complicated by the position of Amul, which dominates the organized sector, has close ties to the government and a vested interest in the status quo—or at least controlling how the unorganized sector develops to ensure its dominant position remains intact.

In addition, the nation faces widespread milk adulteration problems, raising the specter of India having its own melamine-type incident.

The government is not blind to the problems. It cracked down on adulterators, arrested dozens and is considering harsh punishments for milk tampering, including life imprisonment and the death penalty.

It also earmarked nearly $4 billion for a "National Dairy Plan" to raise milk output 50 percent to 180 million tons in the next 10 years by focusing on improving cattle genetics, providing better access to quality feed, encouraging the growth of cooperatives and building a network of milk collection centers.

Analysts still have their doubts.

Rabobank, while not backing the Economic Survey's long-term outlook, noted last December that India is likely to call on world markets more frequently over the next three to four years.

However, even if the nation becomes a regular dairy importer, the United States will not see direct benefits due to a ban on U.S. dairy products because of non-scientific rules regarding animal feed. The United States will be a residual beneficiary, though, as India exits the export market and stocks from competitive suppliers like Oceania move to India.

Everything hinges on whether India can capitalize on its potential. ■■■

Q&A: South Korea

WITH YOON SANG LEE

Q: Should the South Korea-U.S. (KORUS) FTA remain stalled, can U.S. suppliers compete when the EU-South Korea FTA enters into force July 1?

YSL: Even without the KORUS FTA, the United States would remain competitive for a year or two because the EU's tariff rate quotas (TRQs) for dairy products, particularly ingredients, are less than initially anticipated. However, the EU would gain a limited advantage for cheese, where it has duty-free access for 4,560 tons.

TRQ access is critical in South Korea due to the country's relatively high tariffs. Cheese exports outside TRQs are taxed at 36 percent, for example, making it very difficult for any country to compete with the price competitiveness that a TRQ provides.

Q: What is the status of negotiations for South Korea's Australia and New Zealand FTAs?

YSL: The FTAs Korea is negotiating with Australia and New Zealand are the bigger threat to the U.S. dairy industry, since they were shipping more product in 2006 (the base year used to calculate TRQs) and have established more buyer relationships.

Last year, Korea held its fourth round of talks with New Zealand and its fifth with Australia. This year, the Australian ambassador in Seoul said his country wanted to finalize its FTA in 2011 or 2012 at the latest.

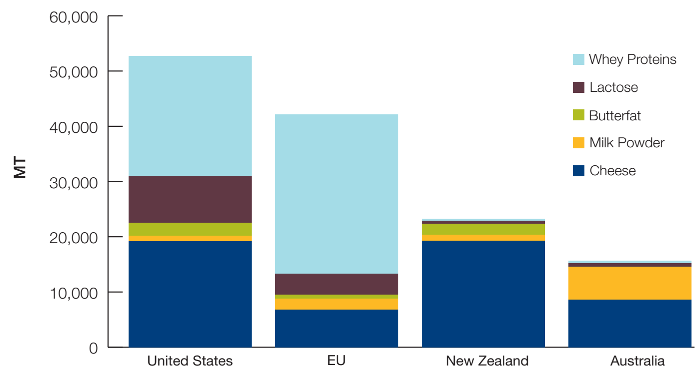
Q: How does the United States rate in product quality and customer service from a buyer's perspective?

YSL: It depends on the product (cheese or ingredients) and availability. Overall, in the past, U.S. dairy suppliers gave the impression that they were not interested in the Korean market, since they often failed to respond to inquiries in a timely manner. However, these days we have seen and heard of improvements from U.S. suppliers as export volumes have increased, and I am sure this would improve further as more USDEC members become more familiarized with the South Korean export market.

Q: How severe was the outbreak of foot and mouth disease (FMD) that hit last December?

YSL: The disease took its toll. Cows were slaughtered. Local milk output fell by 8 percent, and the milk now produced is largely spent on meeting local fluid milk and yogurt demand, leaving little for manufactured products like butter, whipping cream, condensed milk, cheese and milk powder. The situation will likely continue for at least two-to-three years, since Korea will not be able to increase its dairy herd in a shorter time frame.

2010 Selected Dairy Exports to South Korea



Source: USDA; World Trade Atlas

Based on total volume of the main dairy export products, the United States is the No. 1 supplier to South Korea—for now. U.S. export volume in the selected products rose 56 percent in 2010, compared to gains of 25 percent and 11 percent, respectively, for the EU and New Zealand, and a 5 percent decline for Australia.

Q: South Korea raised its 2011 TRQs by nearly 120,000 tons combined across eight dairy categories. Do you expect them to be fully utilized?

YSL: Yes! All will be utilized—and maybe more. The temporary zero TRQs are valid for 2011, but I would not be surprised if the industry calls on the government to allocate additional volumes when all the quotas are used up.

Because the temporary TRQs are more favorable and impactful than the FTA TRQs, it is critical for suppliers to partner with Korean dairy companies such as Seoul Milk, Maeil Dairy, Namyang Dairy and Dongwon Dairy, since they would be allocated with the bulk of the quota volumes. ■■■

Yoon Sang Lee is USDEC's South Korea office representative, based in Seoul.

TRADE POLICY

GI BATTLE HEATS UP

The EU moves full speed ahead in its effort to restrict common cheese names.

The EU continues to actively campaign for broad protections for its cheese industry through a system of "geographical indications" (GIs).

"The bloc built the scheme off a system that protected the exclusive origin of what had previously been locally produced, largely artisan products," says Shawna Morris, USDEC vice president, trade policy. "While the original concept did provide some appropriate protection, the EU focused heavily on staging a market share grab for the most well-known and commonly used names."

Over the past decade, the bloc has escalated its tactics. EU authorities:

- Attempted but failed to wall off certain names for exclusive use by EU localities in World Trade Organization negotiations.
- Limited exclusive usage rights internally for some of the most well-known cheese names, including parmesan and feta, restricting its own cheesemakers.
- Began including GI language in its free trade agreements (FTAs) that would require its FTA partners to enforce the exclusive use of many long-since generic names on all cheese sold within their borders, domestic or imported.
- Pursued other methods, such as economic agreements with intellectual property protections, where full-blown FTA talks were unfeasible.

The logical question is, "Where will it end?"

"If the EU were willing to take on major manufacturers in its own backyard, such as German and Danish parmesan makers, who is to say that 10 years from now it won't go after provolone or mozzarella globally? Or aggressively try to prevent us from even using such names in the United States once it establishes a strong precedent in many other countries?" asks Morris.

In the coming weeks and months, USDEC is preparing a proposal to upgrade U.S. weapons in this global battle to defend critical generic cheese names.

The EU argues that U.S. cheesemakers should not care about many GIs because we don't export significant volumes of varieties like feta or gorgonzola. But until a few years ago, we weren't shipping much mozzarella or cheddar overseas either.

Says Morris, "We look forward to working with concerned U.S. cheese manufacturers, international allies and other leading U.S. associations to ensure that the EU is not successful in confining the U.S. cheese industry to lower value, commodity cheeses."

COUNTERING THE SHENANIGANS

USDEC pursues "Regulatory Coherence" concept to counter the rising tide of non-tariff barriers to trade.

Non-tariff trade barriers continue to vex the U.S. dairy industry.

"The mushrooming array of specious sanitary and phytosanitary (SPS) measures robs U.S. suppliers of time and resources, creates commercial risk, upends the best product and marketing plans, and undermines the industry's and government's investments in expanding exports," says Jaime Castaneda, USDEC senior vice president, trade policy.

To address the issue, USDEC has spearheaded an SPS arm of the "Regulatory Coherence" concept.

Regulatory Coherence as it relates to SPS issues is a multi-faceted program that seeks to better equip the U.S. government to handle foreign regulatory requirements, to streamline bureaucracy and to minimize disruptions caused by non-tariff trade barriers by ensuring that trading nations adhere to transparent procedures and science-based reasoning when setting food safety and animal and plant health standards.

It is a continuous, long-term proposition that includes improving U.S. government and ag sector cooperation to increase the focus on practical solutions to export barriers and to help anticipate problems before barriers become entrenched. And it begins with using our free trade talks to aim at finding common ground among trading nations to head off problems before they begin.

"The Trans-Pacific Partnership (TPP) FTA talks provide a special opportunity to pursue many of the program's goals, including greater reliance on scientific analysis, greater stakeholder consultations, harmonized documentation requirements and specific disciplines for timely and rigorous risk assessments," says Castaneda.

The current roster of countries in the TPP offers relatively little commercial upside from prospective tariff changes (and in fact a large negative impact from the prospective inclusion of U.S.-New Zealand dairy trade).

"Yet in it, we have a chance to create a template for all future trade agreements and a 'gold standard' for other countries to follow for internal SPS practices," Castaneda says.

At the sixth round of TPP talks in March, U.S. negotiators, encouraged by USDEC and other ag sectors, tabled the first-ever legal text on regulatory coherence in U.S. history.

Says Castaneda, "How that text is greeted or whether it can be even strengthened remains to be seen, but we will continue to advocate for a better system that enables the industry to continue on the road to becoming consistent global suppliers."

Beyond the TPP effort, work on the SPS Regulatory Coherence initiative also entails exploration of how our government can improve its own process in order to better facilitate trade. A key aspect of that is how we can address the need for improved coordination between policy departments such as Foreign Agricultural Service and U.S. Trade Representative and U.S. regulatory staff such as Agricultural Marketing Service, Animal and Plant Health Inspection Service, and Food and Drug Administration—both sides of which are critical to the resolution of non-tariff trade barriers.

Fostering more proactive work to avoid negative trade impacts and to create swifter responses to resolve them when they do arise is a critical aspect, particularly where the U.S. lacks FTA ties. ■ ■ ■

The regulatory requirements for shipping dairy overseas continue to pile up. Regulatory Coherence aims to reduce the load.

INGREDIENTS MARKETING

WHEY: AN INGREDIENT FOR THE WORLD

Emerging markets join developed countries in their acceptance of whey proteins.

If you had any doubts whether overseas food manufacturers and consumers truly valued protein as much as all the analysts and prognosticators claim, Krista Faron, Mintel International's director of innovation and insights, could dispel them.

Food and beverage manufacturers rolled out a record 1,254 new products containing whey protein in 2010, a 25 percent increase over the 2009 total of 1,003, which was the previous record, according to Mintel.

In fact, global product launches containing whey have risen five years straight.

"Despite the recession, protein-based products continue to expand—even with premium prices. Protein's value-added benefits allow brands to emphasize more than low cost," Faron says.

The emphasis on value-added benefits can be clearly seen in the United States. More than half the whey protein concentrate (WPC) used by U.S. food and beverage processors and nearly all the whey protein isolate (WPI) goes toward nutritional products (supplements, bars, beverages and infant formula), according to USDEC's Project Diamond.

Project Diamond is a comprehensive, all-channel look at U.S. dairy ingredient utilization by ingredient and end use. It seeks to quantify volumes, trends and expectations for future use among food and beverage processors, and helps delineate where those ingredients are going and why processors are using them.

The United States has consistently been a leader in developing innovative products that capitalize on the benefits of whey protein. But the numbers suggest this is far from a U.S.-only wave. In 2010, the United States rolled out more new products utilizing whey protein (299) than any nation. However, three emerging markets—Brazil with 150, China with 85 and Mexico with 62—came in second through fourth.

"Consumers around the world are demanding products that deliver health and nutrition," says Faron.

The market is coming full circle, she adds, wherein U.S. companies may even borrow and adapt innovation from abroad.

One caveat is that despite the nutritional edge delivered by whey protein, U.S. users rate cost as the No. 1 factor when deciding whether to expand use levels, maintain volume or opt for a substitute protein, according to Project Diamond.

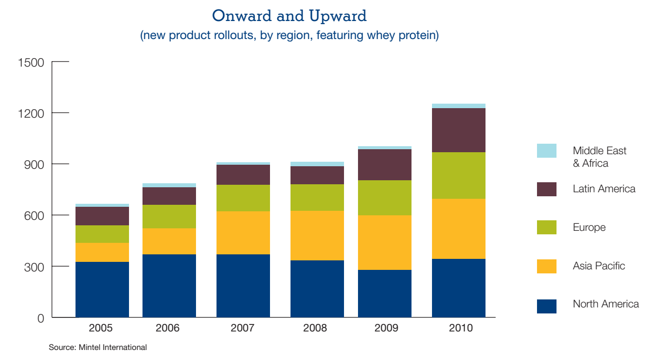
Consumers too are more interested in the general protein message rather than whey protein in particular.

"The average consumer doesn't understand the difference between 'protein' and 'whey protein' specifically," Faron says.

"The United States still has work to do to delineate whey protein advantages to consumers and food and beverage processors," says Vikki Nicholson, USDEC vice president, U.S. manufacturing and ingredients marketing, "But we are getting there." ■■■

Apure Foods' ReGen muscle recovery beverage contains 11g of dairy protein, natural cocoa and other essential nutrients.

Note: To access the Project Diamond online database that details U.S. milk powder, whey/lactose, MPC/casein and milkfat use by finished product, click here and enter your USDEC username and password. Click here to download the USDEC Project Diamond Report titled "Guide to Dairy Ingredient Usage in the Food Industry: 2009."



One of the reasons for the consistent uptick in whey protein use in processed foods and beverages, besides nutrition, is versatility. Mintel research shows a product range that covers "round-the-clock consumption"—drink mixes, ready-to-drink beverages, snack bars, cereal, candy, yogurt and frozen meals, among others.

DATASnapshot

Not only did U.S. dairy suppliers post a near-record $3.71 billion in dairy export sales in 2010 (shipping 3.04 billion pounds of total milk solids and regaining market share lost the previous year), they got off to a hot start this year. Led by SMP, cheese and butterfat, export value for January-February 2011 grew 52 percent to $674.8 million vs. the first two months of 2010. ■■■

SMP Exports Jan. – Dec. (volume, MT)

Country	2009	2010	% change
US	247,634	384,104	+55
EU-27	228,500	377,700	+65
NZ	407,993	343,275	-16
Australia	167,240	131,597	-21
SUBTOTAL	1,051,367	1,236,676	+18

Whey Products Exports Jan. – Dec. (volume, MT)

Country	2009	2010	% change
US	350,703	452,016	+29
EU-27	387,000	387,400	+0
Australia	66,120	44,381	-33
Argentina	36,720	42,260	+15
NZ	35,520	27,890	-21
SUBTOTAL	876,063	953,947	+9

Cheese Exports Jan. – Dec. (volume, MT)

Country	2009	2010	% change
EU-27	577,800	676,300	+17
NZ	290,097	264,819	-9
US	108,410	173,531	+60
Australia	161,735	159,516	-1
Argentina	48,076	45,029	-6
SUBTOTAL	1,186,118	1,319,195	+11

Butterfat Exports Jan. – Dec. (volume, MT)

Country	2009	2010	% change
NZ	448,438	392,527	-12
EU-27	144,700	150,200	+4
Australia	83,450	56,568	-32
US	28,203	56,193	+99
SUBTOTAL	704,791	655,488	-7

Lactose Exports Jan. – Dec. (volume, MT)

Country	2009	2010	% change
US	219,218	274,524	+25
EU-27	125,300	126,900	+1
NZ	30,002	18,773	-37
SUBTOTAL	374,520	420,197	+12

WMP Exports Jan. – Dec. (volume, MT)

Country	2009	2010	% change
NZ	818,081	948,431	+16
EU-27	461,600	444,100	-4
Argentina	146,824	127,383	-13
Australia	139,877	120,138	-14
US	23,075	52,983	+130
Brazil	12,923	5,078	-61
SUBTOTAL	1,602,380	1,698,113	+6

Sources: USDA, EuroStat, DairyAustralia, World Trade Atlas

U.S. dairy export data is just a click away!

For the latest export trade data, click here.

For more information about the resources provided by the U.S. ingredients program at USDEC, or to learn the latest information on dairy-related research and information, visit www.innovatewithdairy.com

To view a current list of USDEC members, click here.

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U.S. DAIRY GLOBALIZATION DASHBOARD

Goal	Stakeholder performance indicator	Current assessment (based on data through fourth quarter 2010)	
Increase global competitiveness	Is U.S. becoming more competitive globally?	U.S. building on gains made before 2009 downturn.	
	Is U.S. filling the latent demand gap?	U.S. capturing a growing share of larger market.	
	Is U.S. moving beyond surplus disposal and "supplier of last resort" status?	Some recovery, but unclear if gains would be sustained under less favorable market conditions.	
Strengthen domestic market	Is U.S. becoming more competitive domestically?	U.S. milk solids continue to displace imports in the domestic market.	
Provide value to producers	Is the global market contributing to higher returns to U.S. milk producers?	Returns from Class III products in export markets routinely exceed domestic returns.	
Improve commercial focus	Is U.S. better fulfilling increasingly demanding needs of global customers?	Buyers say they want U.S. supply option in market, but customer service improvements needed.	

Positive Neutral Negative

WHAT IT MEANS

The second edition of the Globalization Dashboard suggests progress continues.

The "Globalization Assessment Dashboard" provides an at-a-glance snapshot of U.S. progress in achieving four goals (laid out by the Innovation Center for U.S. Dairy's Globalization Operating Committee) aimed at moving the industry along the path toward "Consistent Supplier."

The Dashboard is updated on a quarterly basis. The "traffic lights" on the right compare data (from the most current period for which numbers are available) to a benchmark of average results from 2005-2007.

The latest data follows on a generally positive assessment published late last year. Overall trends support that U.S. suppliers are growing more globally competitive.

- The United States accounted for 39 percent of the growth in global dairy exports for the year ending October 2010.
- For the 12 months ending October 2010, U.S. share of the global export market reached 17.2 percent, compared to 14.1 percent for the baseline period.
- U.S. share of the world cheese export market registered nearly 9 percent for the 12 months ending October 2010, vs. 5 percent for the baseline. For the same time frames, U.S. whey protein share of global exports jumped from 32 percent to 36 percent and milkfat share increased from 3 percent to 8 percent.
- The United States is far outpacing the rest of the world in skim milk powder (SMP) as well, with shipments up 2.5 million lbs. per month from February 2009-October 2010 vs. a 100,000-lbs.-per-month decline for U.S. competitors. U.S. suppliers, however, have yet to make up all the market share they lost at the end of 2008/start of 2009. ■■■

Note: For more on the Innovation Center's globalization initiative and the creation of the Dashboard, see the last issue of Export Profile *by clicking here.*