U.S. Dairy
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Perspective: Export Expertise

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The Complex Potential of China

With its increasingly urbanized 1.3 billion-plus population, expanding middle class and rising-but-still-relatively-low per capita dairy consumption, China arguably has more dairy consumption upside than any other nation in the world.

From 2002-2007, annual Chinese per capita dairy consumption nearly doubled to 63 lbs. milk equivalent, a steep incline that translates into a need for nearly 40 billion lbs. more milk annually in just five years. That fact is solid.

Less certain is when the nation—hit by recession and last September's melamine contamination crisis—will return to the growth form that played such a crucial role in driving U.S. and world dairy exports to record highs in recent years.

We've seen some positive signs in recent weeks. Repeated reports out of China indicate dairy consumption is finally nearing pre-melamine scandal levels. It grew 10 percent in the first quarter of 2009 (vs. the fourth quarter of 2008) and by mid-year, consumers were eating and drinking more than 93 percent of the dairy products they were consuming before last September's revelations, according to a Beijing industry analyst.

First-quarter consumption in two categories—fresh milk and yogurt—actually showed gains over the first quarter of 2008, rising 14 percent and 15 percent, respectively. Consumer confidence is returning, and there is no reason to think consumption will not get back on the growth track as economic recovery ensues—and there too we have seen some positive signs in China.

The country, according to organizations like the International Monetary Fund (IMF), appears poised to be one of the first major nations (along with South Korea) to pull out of recession.

In its July World Economic Outlook, IMF raised its 2009 and 2010 projections for Chinese economic growth by a full percentage point to 7.5 percent and 8.5 percent, respectively. That's still shy of the 10-11

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percent the country had been averaging lately but far better than estimates of 5-6 percent made earlier in the year.

The domestic dairy industry is gearing up again to boost output in anticipation of a rebound. After a six-month period marked by canceled projects and struggling sales, investment and sentiment have turned around, and a number of large-scale projects have taken flight as the industry plans for growth it knows is coming.

The United States did a pretty good job taking part in that growth all the way through the melamine scandal last year. U.S. combined volume of butter, cheese, lactose, milk powder and whey proteins rose 91 percent to more than 115,000 metric tons from 2002 to 2008.

Through the first five months of 2009, U.S. suppliers continued doing an outstanding job specifically in whey proteins and lactose. U.S. whey shipments through May were up 56 percent to 38,713 metric tons. At this pace, by year-end, whey proteins alone would exceed total U.S. shipments of all major product categories to China in 2008. Lactose exports through May grew 71 percent to 19,872 metric tons.

Of course, it's not all good news. Some suggest China's economic recovery is far from certain, driven by government spending and exaggerated by overly optimistic "official" statistics. A prolonged turnaround in China requires the U.S. economy to mount its own long-term recovery and start consuming again, they say.

Whether purported GDP gains this year and next hold true and immediately blossom into renewed dairy growth remains to be seen.

And even if consumption starts spiraling up again, last year's melamine scandal will still make its presence felt. Because China's consumers flocked to foreign brands that they felt were safer and better quality than domestic, local producers and processors suffered. China has reportedly stockpiled about 150,000 metric tons of whole milk powder (WMP) that will need to be worked down and could displace other exports.

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Competition in nonfat dry milk has also been tough. The United States has been virtually shut out of the market this year, as U.S. export volume slipped 86 percent to only 1,451 metric tons through May. Oceania shippers, in a bid to generate cash flow and avoid building their own massive inventories, weren't very motivated to sell product from U.S. sources, while also driving down commodity prices to noncompetitive levels.

In addition, in July, China enacted new regulations that could potentially pose export problems. The regulations aim to monitor milk powder and whey imports to ensure that foreign suppliers are not "dumping" product on the Chinese market. So far, those regulations are merely an additional import requirement, but it doesn't take too much imagination to foresee them possibly leading to access barriers.

The unknowns regarding China complicate U.S. dairy export business. But the potential as well as past U.S. performance remain, and the bottom line is that any recovery in the Chinese industry—and it appears one may be coming—bodes well for the global dairy industry as a whole. **CMN**