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China - Peoples Republic of

Dairy and Products Annual

Imports To Decrease For First Time In Years

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Report Highlights:
Post forecasts that China's fluid milk consumption will increase in 2018, due to income growth and increased consumer preference for healthy foods. Domestic fluid milk production, forecast at 36.5 million tons, will also increase in 2018 due to productivity gains resulting from improved cattle genetics. This domestic production increase will constrain imports, ending a multi-year trend of import growth. Post forecasts 2018 fluid milk imports at 520,000 tons. WMP and SMP will also see production growth and constrained imports. Despite a recently signed MOU between China’s Certification and Accreditation Administration and the U.S. Food and Drug Administration regarding dairy registration, dairy imports from the United States are still encountering registration issues.

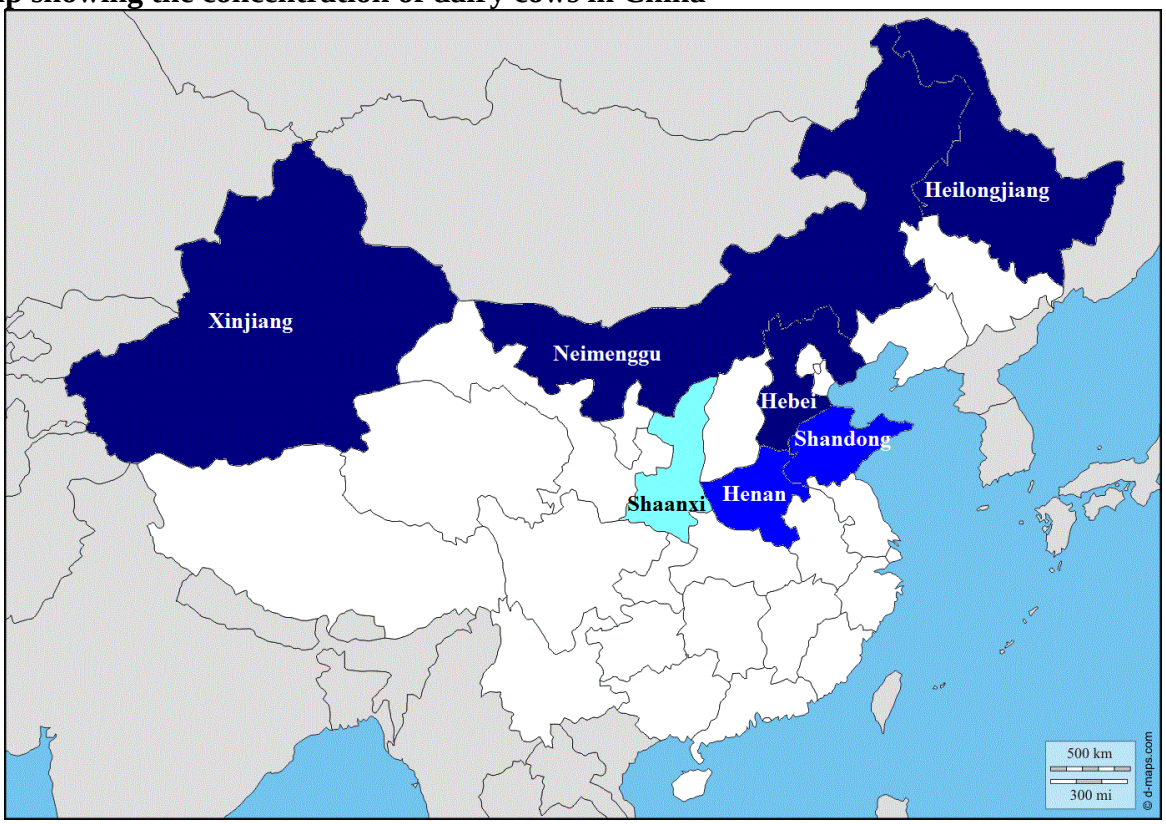
FLUID MILK

Increased milk production in 2018 due to productivity increases from stable herd size and improved cattle genetics

Post forecasts 2018 milk production will increase to 36.5 million tons, about 2.8 percent higher than 2017.

The Chinese dairy cattle herd is forecast to remain the same in 2018. However, China will continue to see increased production as a result of long-term investments in dairy cattle genetics and from the consolidation and modernization of dairy facilities.

Map showing the concentration of dairy cows in China



Source: China's Ministry of Agriculture, 2015 (the most recently publicly available data)

Legend:

Dark Blue = 10 to 20% (Hebei, Neimenggu, Heilongjiang, Xinjiang)
Blue = 5 to 10% (Shandong, Henan)
Light Blue = 3 to 5% (Shaanxi)

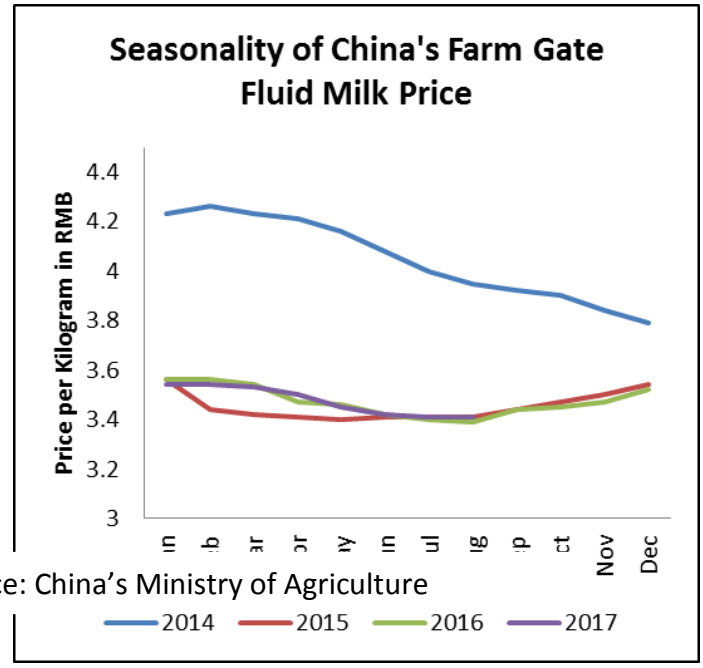
From 2008 until 2015, China imported significant numbers of dairy cattle from overseas to improve the overall genetic quality of its dairy herd. After peaking in 2015, Post anticipates that Chinese dairy cattle imports will continue to slow in 2018. However, the previously imported cattle are now entering their

prime milk production, resulting in a slight increase in production. In addition, the consolidation and modernization of dairy facilities has also contributed to production gains.

At the same time, China's continued implementation of strict environmental laws has discouraged Chinese dairy farms from further expansion. In fact, several of the large dairy companies have been increasing their overseas production bases.

China's fluid milk price is closely tied to the international Whole Milk Powder price

China's domestic milk price is closely tied to the international milk price, especially the international WMP price. Milk production in China is counter-cyclical to consumption, meaning that the peak production season from December to March is the low consumption season. As a result, many dairy facilities convert their milk to WMP during this time. During the peak consumption season from July to September, milk production is at its lowest, leading many dairy producing companies to rely on WMP instead of fluid milk.



Source: China's Ministry of Agriculture

China's underdeveloped cold chain is another reason that China's relies heavily on WMP during the summer season. Because the major production regions are in the north and the majority of consumers are in the south, dairy consuming facilities will often rely on WMP during the summer months to avoid cold chain complications and transportation costs.

Towards the end of 2017, the international milk price was slowly recovering and Post anticipates China's domestic milk price will continue to improve in 2018. This anticipated increase in the milk price will be welcome relief to dairy production facilities, many of which continue to operate at a loss. The milk price in FY 2017 averaged roughly 3.4 RMB per kilogram. Meanwhile, the average milk production cost in China was 3.5 RMB per kilogram.

In addition, production costs are anticipated to decrease because the cost of corn silage, a primary feed ingredient, continues to decrease heading into 2018. To alleviate the corn oversupply situation in China, the Chinese government is encouraging corn silage operations to increase production. The corn silage production is estimated to reach 150 million tons in 2017 and the increased supply will help keep feed costs down and improve the profitability for dairy farms.

Consumption will grow by 2.5 percent

Post forecasts 2018 consumption will reach 38 million tons, about 2.5 percent higher than 2017. Overall, Chinese consumers' per capita milk consumption remains low by international standards at about 34.1 kg—less than one third of the world average. Chinese consumers' milk consumption patterns

are similar to its neighbors Japan and South Korea, mainly focusing on fluid milk, yogurt, and milk powder products rather than butter and cheese. The fluid milk and yogurt products category occupies about a 65 percent market share, while milk powder accounts for about 30 percent.

Fresh milk consumption is reaching saturation levels in first-tier cities like Beijing and Shanghai. New consumption growth is being led by third and fourth tier cities. Due in part to government and industry education campaigns, consumers perceive fresh milk to have a higher nutritional value versus shelf stable milk, leading to an increase in fresh consumption.

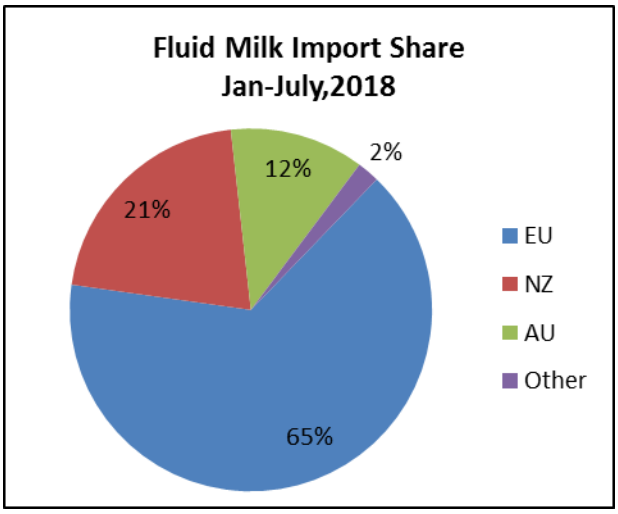
Yogurt consumption maintains its double digit growth in China. Yogurt's consumption growth was 40 percent year-on-year according to the latest market survey. The same survey concluded that roughly 40 percent of Chinese consumers claimed they will have a chilled yogurt or yogurt product at least once a day. In addition, 17 percent of consumers polled noted that they will drink fresh or shelf stable lactobacillus drink at least once a day. The majority of Chinese consumers believe that yogurt is more nutritious than milk, and helps with weight loss. All large dairy manufacturers in China have launched their own shelf stable yogurt products as shelf stable yogurt is not constrained by cold chain logistics and thus easier to distribute.

Imports of fluid milk will be slightly lower in 2018 compared to 2017

Post forecasts 2018 imports at 520,000 tons and adjusts the 2017 estimate down to 575,000 tons, about 9 percent lower than 2016. This is the first time in the past several years that milk imports are expected to decrease.

The traditional imported milk products are shelf stable UHT milk. However, as Chinese consumers develop a preference for fresh milk, or milk with a shelf life of 60 days or less, UHT imports face strong headwinds. Combined with an increasing international milk price and increased domestic fresh milk production, imports are forecast to fall in 2018.

While Germany has traditionally been the largest single country importer, New Zealand's fluid milk imports have been strengthened by the free trade agreement with China. Under this agreement, in 2017, fluid milk tariffs have dropped to zero and New Zealand became the largest single country importer. But as long as the Russian market remains closed due to the import ban, EU countries, led by Germany, will continue to occupy a major share of the Chinese market.



Source: China Customs

Import Policy

Facilities interested in exporting dairy to China must be in compliance with Decree 145, administered by the Certification and Accreditation Administration (CNCA). Since the implementation of Decree 145 in 2014, many U.S. companies have noted delays in getting their dairy plants and products registered. In July of 2017, CNCA and U.S. FDA signed a Memorandum of Understanding regarding dairy registrations. However, the issues addressed by the MOU have yet to be fully resolved and U.S. dairy facilities are still encountering registration issues that prevent trade. For further background information please see the following GAIN report on the *Registration of Overseas Food Manufacturing Facilities* and visit the U.S. FDA website for registration guidance at:

http://www.fda.gov/food/guidanceregulation/guidancedocumentsregulatoryinformation/importsexports/ucm378777.htm

WHOLE MILK POWER

Production will rise slightly by 1.4 percent in 2018

Post forecasts WMP production will increase by 1.4 percent to 1.42 million tons in 2018. With the continued improvements in production efficiency, Post forecasts milk production will continue to increase in 2018. As explained above, due to the counter-cyclical production consumption cycle of Chinese dairy, domestic production of WMP will also increase.

Consumption will increase by 1 percent in 2018

Post forecasts 2018 consumption will increase by 1 percent to reach 1.968 million tons. The primary uses for WMP are infant formula, UHT and yogurt, bakeries, and milk beverage products.

Although CFDA's Decree 26, requiring facility registration for manufacturers of special foods (including infant formula), was expected to negatively impact infant formula production, it appears that Chinese

facilities are registering and will continue to be large consumers of WMP and Skim Milk Powder (SMP).

WMP usage in fluid milk, yogurt, and yogurt related products are on the rise. Yogurt products, both chilled and shelf stable, have experienced dramatic gains in recent years. Each Chinese dairy manufacturer is working to develop their own branded yogurt products to compete in this increasingly competitive market.

Lastly, as the popularity of milk beverage products decreases, so too will the demand for WMP. Milk beverages are now considered by Chinese consumers to be low-end milk products. Health conscious middle class consumers now eschew these products for fresh milk or healthier non-dairy milk substitutes, such as soy, almond, or peanut milk.

Approximate Whole Milk Powder Usage in China	
Infant formula	25% market share
Fluid milk(UHT milk, yogurt etc)	30% market share
Milk beverage	20% market share
Bakery products	25% market share

Source: Industry Publications

Imports will continue to grow in 2018

Post forecasts imports will grow to 500,000 tons in 2018. Although domestic WMP production is expected to increase in 2018, the preference for imported products over domestic products will still lead to increased WMP imports in 2018. Imported WMP products continue to be viewed by Chinese consumers as being safer and more trustworthy. They also enjoy a longer shelf life of two years—generally double that of similar Chinese products.

In recent years, Chinese dairy manufacturers have been encouraged by the government to invest overseas in dairy production facilities and much of the WMP they manufacture is shipped to China. Currently, New Zealand dominates the import market with a 94 percent share.
Exports from the United States increased in 2017, but still account for a negligible portion of the overall market.

Exports

China exports negligible amounts of WMP. Post forecasts exports will remain at 2,000 tons in 2018, mainly for the Hong Kong, North Korea and Myanmar markets.

NONFAT DRY MILK (SKIM MILK POWDER)

Production will be higher in 2018 to reach to 40,000 tons.

Post forecasts 2018 production of SMP at 40,000 tons. In China, SMP and WMP are used relatively interchangeably. In 2017, low SMP prices in Europe lead to increased SMP imports into China, depressing domestic production. But for 2018, Post anticipates the EU SMP price will recover, leading to decreased imports and increased production in China.

SMP is mainly used in milk beverage and infant formula products. Although milk beverage products sales are decreasing, demand for lactobacillus drinks, which are viewed as a healthier beverage, is growing quickly. In particular, lactobacillus drinks produced under a dairy company's own brand are especially popular as consumers perceive these products as more trustworthy.

Policy:

On June 6, 2016, China Food and Drug Administration (CFDA) announced the Administrative measures for the Registration of Recipes for Formula Powder Products for Infants and Young Children (CFDA Decree 26), which was scheduled to enter into force on October 1, 2016. Further extensions have been given and the current implementation deadline is January 1, 2018. Decree 26 requires all manufacturers, domestic and overseas, to register their infant formula recipes with CFDA and meet additional labeling requirements. The measures were notified to the WTO as TBT 1165 in January of 2016. For details, please refer to GAIN report: *CFDA Publishes Measures for the Registration of Infant formula Recipes (CFDA Decree No.26).*

Consumption:

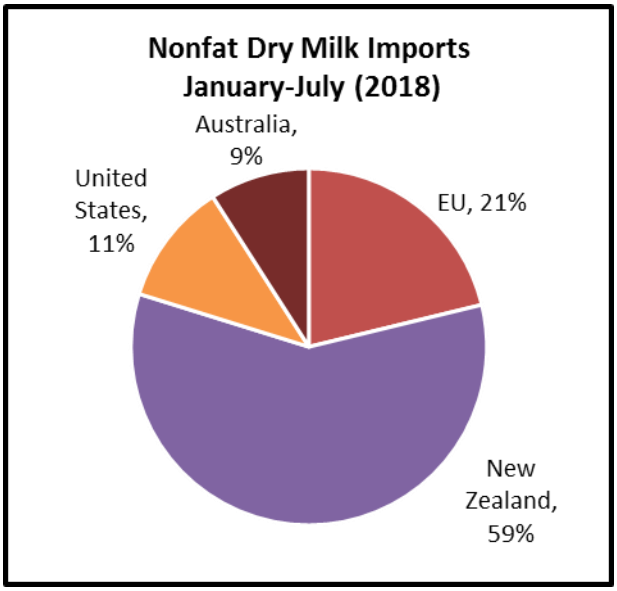
Post forecasts 2018 SMP consumption will be 240,000 tons, a 7.7 percent decrease compared to 2017. In addition, Post adjusted its 2017 consumption estimate to 260,000 tons. The higher consumption in 2017 was driven by the low price of SMP caused by cheap imports from New Zealand and the EU. Industry reports that Chinese dairy manufacturers used relatively more SMP to substitute for WMP as SMP prices were low enough to compensate for the quality difference. However, as the SMP price recovers in 2018, imports and usage will likely decrease back to previous levels.

Domestic infant formula production was expected to be constrained by the new CFDA formula registration requirements, but it appears that infant formula manufacturers are registering their products and there will be little, if any, interruption.

Trade

Post forecasts 2018 imports at 240,000 tons and adjusted 2017 imports to 260,000 tons. China has limited SMP production and consistently imports SMP to meet demand in the food processing and infant formula sectors.

The United States is a major supplier of SMP to China. However, the United States has lost market share to its competitors New Zealand, Australia and Germany.



Source: China Customs

Fluid Milk PS&D table

Dairy, Milk, Fluid	2016		2017		2018	
Market Begin Year	Jan 2016		Jan 2017		Jan 2018	
China	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Cows In Milk	8000	8000	7500	7500	0	7500
Cows Milk Production	36020	36020	35500	35500	0	36500
Other Milk Production	1600	1600	1500	1500	0	1500
Total Production	37620	37620	37000	37000	0	38000
Other Imports	634	634	575	575	0	520
Total Imports	634	650	575	575	0	520
Total Supply	38254	38270	37575	37575	0	38520
Other Exports	23	23	22	22	0	20
Total Exports	23	20	22	22	0	20
Fluid Use Dom. Consum.	14600	14600	14700	14700	0	14800
Factory Use Consum.	23631	23650	22853	22853	0	23700
Feed Use Dom. Consum.	0	0	0	0	0	0
Total Dom. Consumption	38231	38250	37553	37553	0	38500
Total Distribution	38254	38270	37575	37575	0	38520
(1000 HEAD) ,(1000 MT)						

Whole Milk Powder PS&D table

Dairy, Dry Whole Milk Powder	2016		2017		2018	
Market Begin Year	Jan 2016		Jan 2017		Jan 2018	
China	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Beginning Stocks	350	350	150	150	0	50
Production	1375	1375	1400	1400	0	1420
Other Imports	420	420	400	450	0	500
Total Imports	420	420	400	450	0	500
Total Supply	2145	2145	1950	2000	0	1970
Other Exports	3	3	2	2	0	2
Total Exports	3	3	2	2	0	2
Human Dom. Consumption	1992	1992	1898	1948	0	1968
Other Use, Losses	0	0	0	0	0	0
Total Dom. Consumption	1992	1992	1898	1948	0	1968
Total Use	1995	1995	1900	1950	0	1970
Ending Stocks	150	150	50	50	0	0
Total Distribution	2145	2145	1950	2000	0	1970
(1000 MT)						

Nonfat Dry Milk (Skim Milk Powder) PS&D table

Dairy, Milk, Nonfat Dry	2016		2017		2018	
Market Begin Year	Jan 2016		Jan 2017		Jan 2018	
China	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Beginning Stocks	0	0	0	0	0	0
Production	40	40	40	35	0	40
Other Imports	184	184	225	225	0	200
Total Imports	184	184	225	225	0	200
Total Supply	224	224	265	260	0	240
Other Exports	1	1	0	0	0	0
Total Exports	1	1	0	0	0	0
Human Dom. Consumption	223	223	265	260	0	240
Other Use, Losses	0	0	0	0	0	0
Total Dom. Consumption	223	223	265	260	0	240
Total Use	224	224	265	260	0	240
Ending Stocks	0	0	0	0	0	0
Total Distribution	224	224	265	260	0	240
(1000 MT)						