PRESS INFORMATION from

The Dairy Group

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The Market Price Equivalent (MPE) Update June 2015

***By Nick Holt-Martyn,* The Dairy Group**

Where has all the milk money gone?

"In May the UK produced 1362 Million litres (+2.2%) but the Defra average milk price dropped by 25.4% to a miserly 24.1 ppl, indicating that UK farmers received 8.2 ppl less in 2015 than 2014. That equates to a total of £111 million reduction from farmers' milk cheques, equivalent to £11,336 per producer!" says Nick Holt-Martyn of The Dairy Group. He goes on to say "Is this benefitting consumers or is it lost in the dairy supply chain between producers and consumers?

There are 2 pieces of evidence to consider. First, the ONS (Office for National Statistics) reported in May the following price indices; RPI +0.2%, Fresh Milk -5.1%, Butter 0.1% and Cheese -3.4%. So these falls would seem much more modest than at the farm gate. Indeed butter shows no reduction at all, but fresh milk and cheese are down on the year.

The second piece of evidence is from The DairyCo Retail price data that gives the following:

	May 2015	May 2014		
Liquid milk	103	117	p/4 pint	-12%
Fresh Double Cream	168	165	p/600ml	2%
Butter	163	163	p/250g	0%
English Mild Cheddar	608	638	p/kg	-5%
Branded Cheddar	842	1031	p/kg	-18%
			Weighted	**-12.3%**

Source: DairyCo & The Dairy Group

The weighted average takes in to account that liquid and cheese still represent 77% of milk utilisation, which means that the weakness in fresh milk and cheese weighs heavily on dairy returns as a whole. In milk processing, raw milk represents between 40 and 60% of the costs, so declining incomes will have a disproportionate effect on raw milk values given the difficulties of recovering costs from energy, packaging/distribution or labour. So it is disappointing to discover that a decline of 12.3% in the retail milk price does broadly equate to a reduction in the farm gate milk price of 25%.

Consumers really are benefitting from a decline in dairy prices as borne out by the ONS. It is highly unlikely that the milk processors are benefitting from low milk prices any more than the retailers and hence the announcement of job losses in New Zealand, Holland and in the UK. So the conclusion is that the dairy industry is collectively damaged by low prices, which makes the hubris and complacency of the EU Commission and National Governments so disappointing.

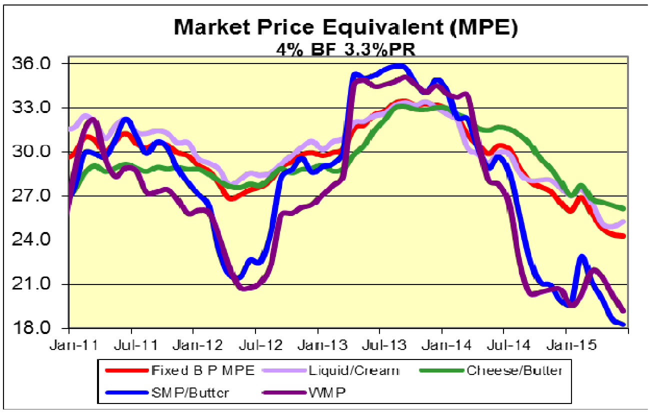
Until supply stabilises there can be little recovery in market returns without an unlikely significant shift in demand. Milk pricing for the rest of 2015 awaits the new season reports for the EU and in New Zealand for any signs of reduced supply, combined with a response in the EU showing supply easing off through late summer and autumn. 2016 pricing will depend on what state 2015 finishes or else it will be much the same!

We all know the problems, they are all too evident, but unfortunately the solutions are not. There will need to be an end to supply growth before markets can hope to recover and even then it will need to be coupled with improved demand. Hopefully, despite dairy products inelasticity, low prices might stimulate some increase in demand on the back of an improving world economy.

Fonterra needs to fix the tonnages in place on the GDT. It is unrealistic and only encourages volatility if the effects of supply patterns are magnified and projected on the GDT tonnage. The surplus in 2014 and the recent New Zealand drought were used to implement massive changes in the supply to the GDT which, while not responsible for volatility, did nothing to dampen volatility which occurs with great regularity. The weather does not respond to market forces, it is immune to supply/demand dynamics, so the GDT should be insulated from a “local difficulty” when the rest of the world is awash with the white stuff!

One thing Arla, Dairy Crest and Wiseman can learn from Fonterra is to use the dairy futures/options markets to offer farmers the opportunity to fix part of their price into the future. This will help to smooth out the volatile returns so that individual months/seasons don’t damage the supply base. These markets are not really accessible for most farmers so it falls to the processors to take the lead on behalf of their suppliers and themselves.

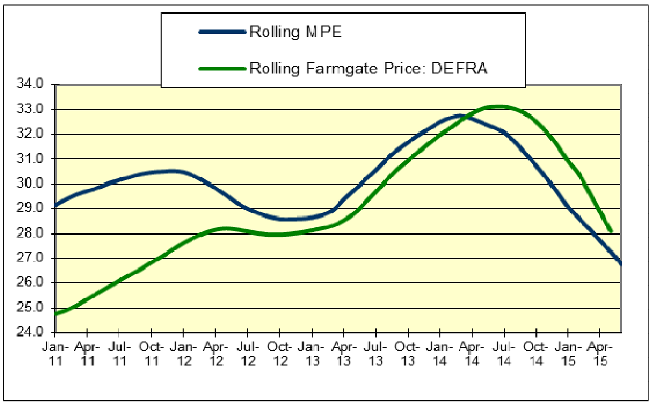
The latest supply figures are eagerly anticipated to see how the EU as a whole has responded to the end of milk quotas. Global supply stabilised as the quota regime came to an end with high super levy penalties for the usual European suspects. Ireland increased milk production in April 2015 by 15% compared with the previous year. It is expected that Holland, Germany and the UK amongst others have had a good productive spring as well. The markets are certainly indicating that supply is still strong and prices are likely to remain weak for some time. Not a lot will change now until the New Zealand August production is known later in the year, which may be the first glimmer that supply has stabilised and some stability can return. The 2015 market looks to remain weak and the prospects for 2016 are more hope over substance!



Market Prices

The Market Price Equivalent (MPE) has slipped back again by 0.1 ppl to 24.3 ppl due to falls in milk powders being countered by a rise in cream. The range across the sectors widens to 7.8 ppl due to stable cheese, but weaker powders. SMP has now fallen to £1275/t, 1% above the latest GDT auction, which fell another 2.6% in Sterling equivalent. The GDT price equivalent (GDTPE) is down to just 16.1 ppl, a new record low since the start of twice monthly sales in September 2010. Recent GDT auctions have seen a stabilisation in product offered although still 24% less than the corresponding auction last year. The proportion of WMP offered has fallen to a relative low of 51%. The MPE is down 6.2 ppl on the year and down 2.3 ppl since December 2014. US production is now running +1.6% in May while the EU is at -1.2% in March due to quota management; while New Zealand recovered from the drought to increase supply in April by +8.5%.

Farm Gate Prices



The graph shows the familiar pattern of rolling MPE falling back as market returns drop away, being closely tracked by the rolling farm gate price. June's mix of sun and rain will have helped maintain good milk production at +2.75%. Sterling has risen again, over €1.40, but oil prices have been more stable through June. UK production in April was amended to 1280 M litres (same as 2014), May was up 2.2% at 1362 million litres, June is forecast at 1275 million litres and July is forecast at 1233 million litres. The expectation for the new milk year remains flat (+1.0%) overall but is being helped by the good weather to date. The latest cut in the Arla price means the 2015/16 milk price is forecast to average 25 ppl by next spring, maintaining significant pressure on dairy profit margins.

- Ends -

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- **Visit www.thedairygroup.co.uk**
- The MPE is calculated from the weighted actual wholesale prices for liquid milk, cheese, butter and powders after the normal processing costs. The MPE accounts for 90% of the UK market utilisation of milk. The MPE is calculated from wholesale market values, whereas IMPE (Intervention Milk Price Equivalent) accounts for just 11% of UK milk production and is effectively determined by the Council of Ministers and the prevailing exchange rate. The MPE provides a far superior indicator of the wholesale value of milk and therefore the likely market returns available to the dairy farmer.