PRESS INFORMATION from

The Dairy Group

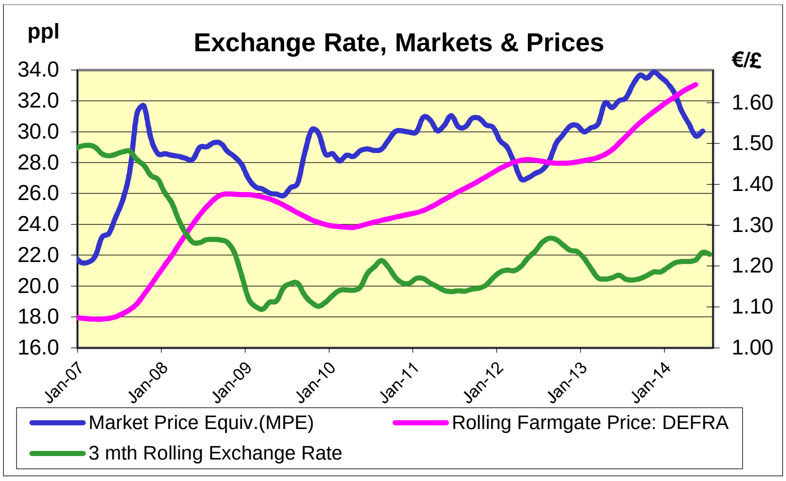
29 June 2014

The Market Price Equivalent (MPE) Update June 2014

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

Exchange Rates Set To Become a Feature of Milk Pricing

"The much discussed normalizing of UK interest rates to between 2% and 5% which the Bank of England expect over the next 10 years is diverging away from the Eurozone, which has seen their rates cut again from 0.25% to just 0.15% with some rates going below 0%. There is even the prospect of the ECB using quantitative easing as a further stimulus of the Eurozone economy" says Nick Holt-Martyn of The Dairy Group. He goes on to say "while this may seem a long way away from the farm gate, currency exchange rates are likely to be a significant issue which directly impacts on the competitiveness of EU commodities on the UK market.



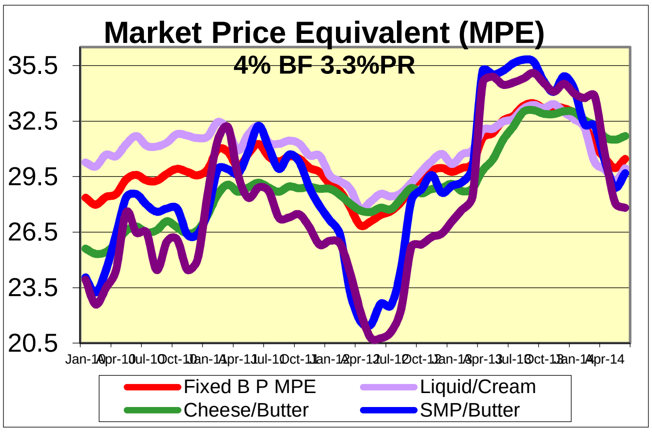
Source: The Dairy Group

The graph above shows the relatively stable position over the last 5 years with the £ worth €1.10 to €1.20. However prior to that period Sterling had been around €1.50 and as high as €1.71 when the Euro first started. The graph shows that the UK farm gate price while driven by market returns in the short term cannot remain unaffected if market returns are themselves subject to exchange rate volatility. The effect on exported commodities like powders from Westbury will be immediate, whereas the impact of more competitively priced imports will be more subliminal as they undermine the value of UK product.

With Arla now a major player in the UK dairy market the exchange rate relationship between Sterling and Kroner has become an ongoing factor in UK pricing. The currency smoothing mechanism which averages the exchange rate over 2 years will insulate Arla members against sudden currency movements and will slow the effect of strengthening Sterling, but limit the impact if or when Sterling weakens. Over the last 12 months the exchange rate has been as low as Kr 8.50 in July 2013, whereas now the exchange rate is 9.4% higher at Kr 9.30. At a time of market stability as the northern hemisphere spring peak passes and the southern hemisphere season is yet to start it will be a disappointing if UK prices are undermined by exchange rates.

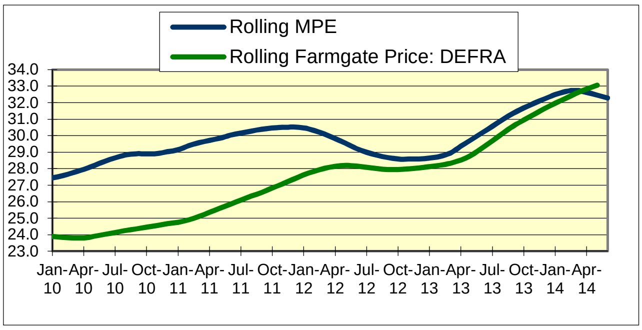
The latest GDT auction shows stability with small gains before the southern spring peak but weakness at other times. It has to be remembered that GDT prices are always below the

UK domestic and EU market returns. Until the level of new season southern hemisphere production is known markets are expected to remain stable. Arla's latest price reduction is indicative of how market returns have changed in the last 6 months with commodities (butter and powders) most affected. As usual cheese is the embodiment of stability but may come under pressure if there is a shift away from powders. The biggest risk factor at the moment is an upward move in interest rates by the Bank of England and hopefully that remains 12 months away.



Market Prices

The Market Price Equivalent (MPE) has risen slightly, up by 0.5 ppl to 30.47 ppl with gains across the board except mature cheddar. The range across the sectors has widened to 3.9 ppl, with butter & powders below cheese and WMP affected by exchange rates. The latest GDT auction was stable at +0.9% with a mixture of gains and losses with mid-term more positive, but still weaker further ahead. The MPE is now down 2.07 ppl on the year and down 2.73 ppl since December 2013. New Zealand production finished the year at +7.4% year on year due to good autumn weather while the EU finished the milk year at +2.5%. Market returns are back to their traditional relativities, although over the past 3 years there is little difference between them.



Farm Gate Prices

The graph shows the rolling MPE falling as the market returns continue to ease back from the 2013 peak. The rolling farm gate price is expected to peak around 33 ppl in June. The recent warm dry weather has encouraged production on its normal seasonal pattern with recent rain unlikely to change the trend. Despite the price falls the economics remain good compared to recent years and feed costs are expected to improve for next winter. UK production is running 4% ahead of the 5 year average and our forecast for 2014-15 is 14.1 billion litres, up 6% on 2013/14. June is forecast around 1230 million litres, +4.2% on 2013 and July around 1190 million litres, +3.8%. By the autumn/winter production is expected to to be +/- 2% on 2013.

- Ends -

<u>For further information please contact:</u>

- **Nick Holt-Martyn,** The Dairy Group (01823 444488/e-mail: nick.holt-martyn@thedairygroup.co.uk)
- **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.