PRESS INFORMATION from

The Dairy Group

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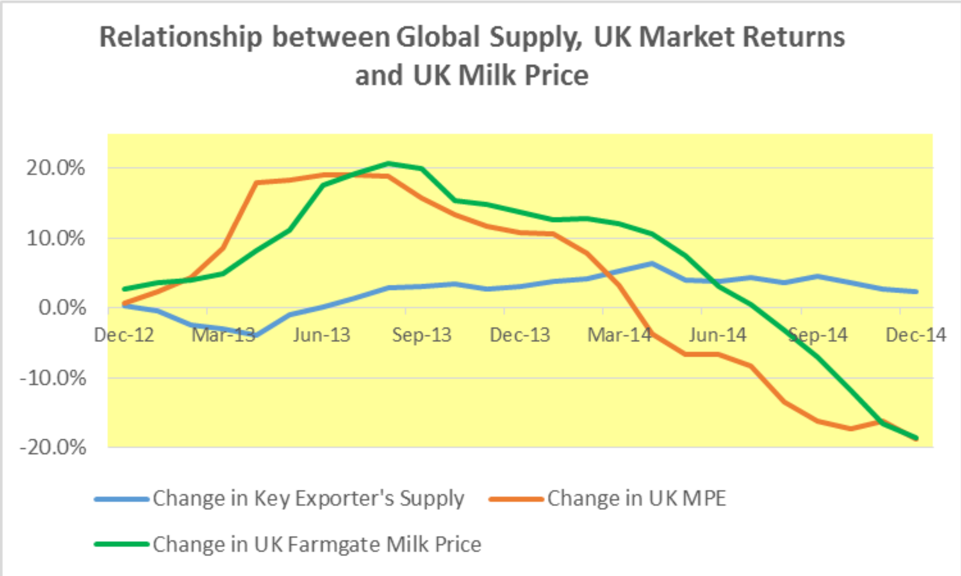
The Market Price Equivalent (MPE) Update January 2015

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

When will the milk price increase?

With updated supply figures allowing analysis of 2014's supply growth we can at least explain why markets have fallen and see what the effect has been on farm gate price." says Nick Holt-Martyn of The Dairy Group. He goes on to say "It also tells us what conditions need to be in place for the reverse process to begin to occur and only then can we start to speculate over what kind of time frame this is likely to happen.



Source: The Dairy Group

The graph above shows the monthly year on year change of 3 key indicators. It shows 2013 started with supply from the key exporters (EU, NZ and US) declining due to continued adverse weather and economics in most production regions at the same time. Markets responded to falling supply with price increases which eventually fed into the UK farm gate price. From mid 2013 supply, markets and farm gate prices were all rising at the same time which led to various politicians to declare in a state of hubris that a new world order was in place and to "go for growth"!

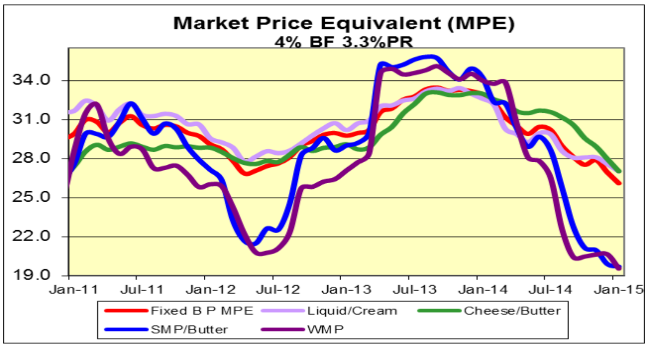
Alas no, the fundamental nature of markets and the people that operate in them from the primary producers to the commodity brokers and traders are the same as they ever were. Helped by good weather and strong economics supply kept growing faster, accelerating until spring 2014 with record levels of production every month, with the market price falling and farm gate prices following on behind.

Supply is yet to follow into negative territory, growth is slowing down all the while but has not yet found a reverse gear to hasten any recovery in market returns. In the US there is a belief that a 1% change in supply triggers a 10% change in price, in the opposite direction! The EU, New Zealand and the US have seen supply growth of about 5% in the last two years and commodity returns have halved since their peak in August 2013. Global markets are growing at a long term rate of about 4 billion litres per annum, but when supply grows by 12.2 billion litres in 2 years volatility becomes extreme. A supply correction needs to take place for a rapid recovery, or supply stability for a slower gentle recovery as demand slowly soaks up the excess supply.

At the turn of the year the US is still seeing +3.1% supply growth, the EU has eased a bit to +2.3% and NZ was +3.1% in November, which on the face of it is not very encouraging. However, quota is biting in the EU and drought is becoming established in NZ such that both Ireland and NZ are falling behind January 2014 production levels, but the US is still ploughing on despite the collapse in their prices more recently.

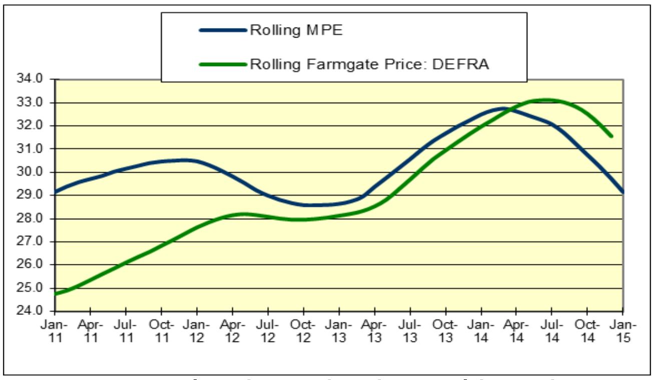
2015 is certainly starting off the right way with production growth slowing down. Lower production is the right course for the dairy industry, but it is not in an individual farmer's interests to deliberately cut production, which will only make it more difficult to cover fixed costs. The outlook for 2015 is for supply growth from the EU, NZ and the US to be as low as just 3.5 billion litres, which is low enough for markets to recover a bit of the lost ground. Quota abolition is still an unknown quantity and has the potential to stymy any constraint in supply growth that might otherwise become apparent. The EU Commission is forecasting +1.6% production growth, but it could easily be more if the New Zealand drought lifts markets and the spring weather encourages milk production on top of the execution of investment plans in countries held back by quota.

While supply is still growing a recovery of more than 10 to 15% in milk price is unlikely, but none the less, the rot will have been stopped and the new dairy cycle can begin again. Please, no talk of a new world order this time, let's just work hard to ensure our cost of production allows the UK to be competitive enough to secure our domestic markets against our nearest competitors!



Market Prices

The Market Price Equivalent (MPE) has slipped 0.8 ppl to 26.1 ppl due to falls in Cream, Butter, WMP and mild Cheddar, with only SMP bucking the trend by stabilising. The range across the sectors narrows to 7.4 ppl between Cheese/Butter and WMP. SMP which has stabilised at £1425/t and Butter at £2225/t are below the latest GDT auction, which was up another 1.4% in Sterling equivalent, with some modest rises in most commodities and contract periods. The GDT price equivalent (GDTPE) is up to 18.4 ppl after 3 successive rises. The MPE is down 6.8 ppl on the year and down 4.1 ppl since July 2014. Production globally is still rising but the rate of increase is slowing and is expected to almost stop as the EU nears the quota year end. New Zealand production is now running 6% behind in January, but still on course to achieve +8% in 2014; the US is now running +3.1% in December while the EU is at +2.3% in November. So the slowdown has started and with New Zealand on the brink of drought markets are now showing some small signs of improvement, but significant gains are unlikely until the EU spring flush has passed.



Farm Gate Prices

The graph shows the rolling MPE falling back as market returns drop away, on course for 2012 levels in the spring. The rolling farm gate price is tracking MPE as expected, with a significant fall likely as monthly prices replace the higher values of 12 months ago. The weather remains relatively normal in the northern hemisphere, but dry weather is impacting on New Zealand production, although Australia has seen rain. The El Nino risk has passed although values remain on the El Nino side of the graph, but expected to become more neutral giving rise to a more average seasonal outlook. Oil prices have fallen again helping the cost of production and now Sterling is rising against the Euro making UK dairy product less competitive providing a new risk to UK farm gate prices. UK production is running 2% ahead of last year with January forecast at 1200 million litres and February 1110 million litres, so the UK is still on track to finish the last ever quota year at 14.45 billion litres, 750 million litres below quota butterfat adjusted. The expectation for February and March is for production to be up 1% on 2014, with the new milk year less certain due to the weather and the number of dairy farmers leaving the industry.

- Ends -

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

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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.