PRESS INFORMATION from

The Dairy Group

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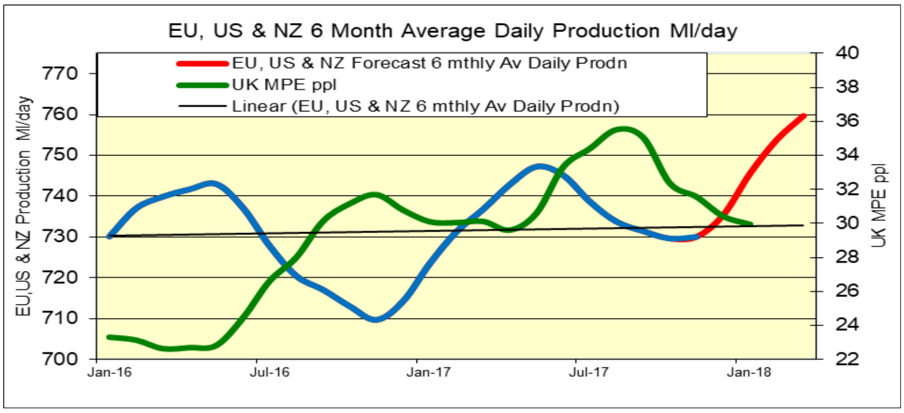
The Market Price Equivalent (MPE) Update December 2017

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

Rising production fuels the start of another roller coaster year

"With market returns down 16% since August 2017 it is no surprise that we are seeing the farm gate price fall this year as the usual time lag unfolds. Muller have added a second 1 ppl price cut which serves as an indicator of where prices are going in liquid and commodities. The cheese makers will probably move more slowly due to the UK centric nature of their product, but the direction of travel will be the same." says Nick Holt-Martyn of The Dairy Group. He goes on to say "butter, cream and cheese are down to the level of last springs' market trough, liquid is above and rose in December, while SMP and WMP are a car crash!



Source: The Dairy Group

The key to market temperament is supply's relationship with the normal steady growth trend. The chart shows that the supply followed its normal seasonal pattern, but dipped sharply in late 2016 which lead markets to firm in 2016/17. Supply tracked a normal pattern through to a normal summer peak and markets showed limited volatility early/mid 2017. Then the EU "suffered" its butter bubble which drove markets up by 17% encouraging strong production through late 2017. This has severely limited the normal autumnal trough causing markets to fall back to normal levels. Currently the forecast is for supply to rise further through 2018 to give a strong summer peak leading to weaker market returns throughout the year. Weaker market returns will have a corresponding effect on farm gate prices. The only way this can be prevented is for supply growth to stop, giving time for markets to catch up.

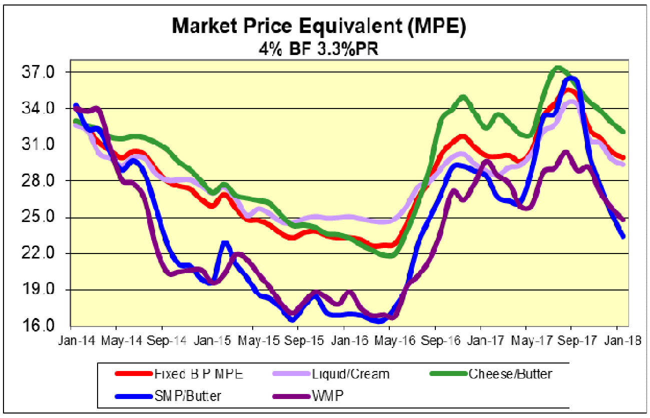
The lessons of the last 20 years are clear; there can be growth in dairy but only at a modest 1 to 2% per annum. At higher growth rates the milk price suffers and at lower growth rates the milk price surges. Volatile supply leads to the boom and bust market volatility of the last 10 years. Droughts, floods and prolonged adverse weather can curtail supply triggering the volatility, but it takes many years for the supply/market reaction to settle down. Currently global supply is still in the backwash of quota abolition and the expansionist nonsense that went with it. Production discipline amongst EU farmers still appears to be lacking, with supply growth fuelling the volatile dairy markets.

In the past, when intervention and milk quotas were in place the EU by default took the responsibility for managing the global dairy market. Excess supply growth was rightly blamed on New Zealand which has been able to expand its dairy industry by 35% in the last 10 years on the back of low cost of production. The EU has grown by half that amount through the gradual quota relaxation following Agenda 2000 and Mid Term Review CAP reforms. Quota abolition is a ‘game changer’ in that EU suppliers can now also respond to market signals and increase supply when markets are firm. The problem globally is that the EU is seven times bigger than New Zealand and any above trend growth is a significant volume of milk. 3.5% growth in the EU is like adding a whole Denmark or 25% of New Zealand in a single year.

This is where the real Brexit risk for the dairy industry stems from. Irrespective of the future trading arrangements politicians will talk up the opportunities that exist outside the EU without any reference to markets, milk prices or cost of production. If the trading arrangements deliver a farm gate price above 28ppl then UK dairy is well versed to increasing milk production when markets are good. The trading arrangements will provide the interface with EU and Global dairy markets which will still determine the UK farm gate price.

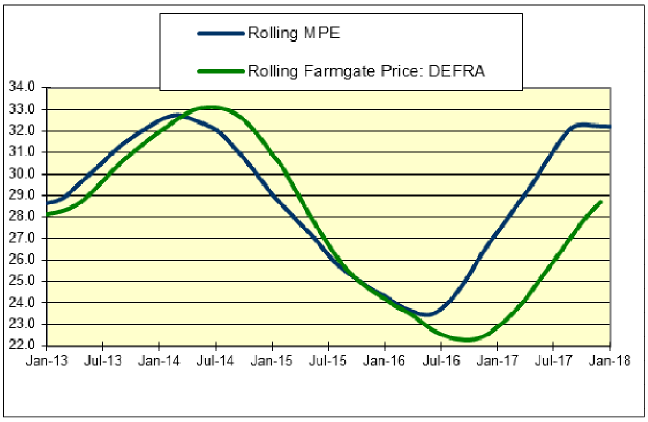
The opportunities are the same as always with dairy companies needing to sell existing added value products or develop new ones and be competitive under the new trading arrangements. This will allow a higher farm gate price which in turn drives a higher supply requirement. The UK already has around 10% of its supply used for highly volatile milk powder which is the supply available for added value development.

The supply will grow organically through demand and markets not through well-meaning but ill-judged comment. Un-fettered encouragement by grandstanding politicians could lead to another quota abolition type disaster if supply ignores the market signals. Even the brave new world has to obey the crude rules of market mechanics.



Market Prices

The Market Price Equivalent (MPE) continues to slide, by 0.47 ppl (1.5%) to 29.95 ppl due to all sectors dropping back, other than liquid which managed a rare rise. Butter dropped another 8.5% and Cream 14% and are now at or below levels 12 months ago, down 32% & 38% in the last 6 months. SMP dropped 5.7% to £1160, 22% below Intervention. The range across the sectors widens to 8.6 ppl from Cheese returns to SMP/Butter. The GDT price equivalent (GDTPE) has risen to 24.1 ppl and rolling at 26.1 ppl. The GDTMPE rose 3.8% in the month and is down 10.6% in the last 6 months compared to the MPE which fell 1.5% in the month and is down 13% in the last 6 months. UK SMP has dropped to £157/t below the last GDT auction and is £331/t below Intervention. Global supply is growing strongly at 4% with the US at +1%, New Zealand -2.6% in December and the EU +6% in November. New Zealand has experienced drought hitting December production, but EU production remains the main global supply driver. With farm gate prices dropping sharply UK supply growth has slowed and EU production growth may ease by the spring.



Farm Gate Prices

The December 2017 farm gate price at 31.7 ppl, is down 0.2ppl from the November peak and is flattening out following the MPE curve and is likely to move down in January 2018. The rolling milk price curve will continue to improve into the winter tracking the MPE curve which is starting to ease. Weather continues to be seasonal with spring still looking far away.

Sterling has risen through December on the back of better Brexit news climbing to $1.41 to the Dollar and to €1.14 to the Euro. The production for November was 1171 million litres (+8.6% on 2016) and 1212 million litres in December, up 58 million litres (+5%). The forecast for January is 1221 million litres (+0.4%) and 1136 million litres (+1.6%) for February. Milk price cuts are coming through thick and fast with few suppliers escaping completely. Production is still rising rapidly in the EU and market returns have fallen, so the prognosis for farm gate prices in 2018 are poor. Unless EU production is curtailed before the spring, prices will continue to fall. The farm gate price fall will echo the fall in market returns of 16% and with EU supply at +6% and global at +4% a sharper fall can't be ruled out.

- 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 United Kingdom market utilisation of milk. AMPE (Actual Milk Price Equivalent) also only accounts for 14% of United Kingdom milk production. The MPE provides a far superior indicator of the wholesale value of milk and therefore the likely market returns available to the dairy farmer.