PRESS INFORMATION from
The Dairy Group
29 January 2016

The Market Price Equivalent (MPE) Update January 2016

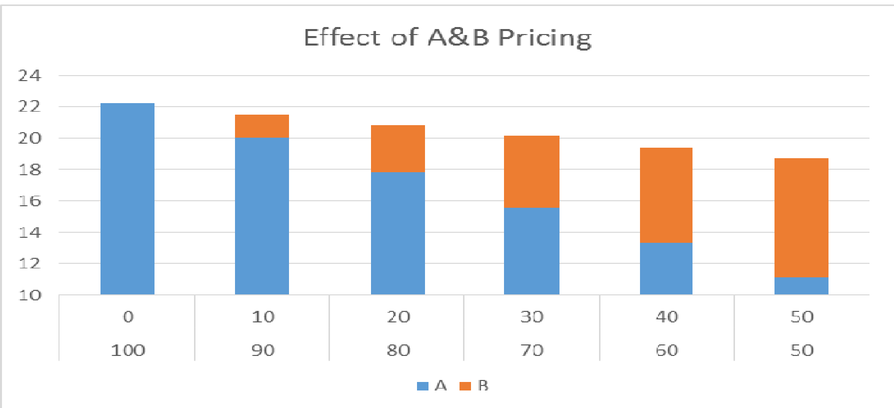
***By Nick Holt-Martyn,* The Dairy Group**

Supply Management Will Become The Norm

"Despite the welcome news that the growth in UK production might just be slowing down in January, December production was up 5% and EU figures for November 2015 show a 5.6% increase, so hence the further weakening in the dairy markets" says Nick Holt-Martyn of The Dairy Group. He goes on to say "As we all know until supply growth reduces and demand catches up, there is little prospect for better market returns or for them to be sustained. There remains no political will or even desire from the Commission for any CAP based measures to regulate supply or change Intervention Prices for fear they will encourage further increases. Indeed the Commission only a few months ago were expecting EU production in 2015 to grow by just 1% with France and Germany under supplying. The bad news is that they are both exceeding 2014 levels and have joined the rest of the key EU dairy states in expanding milk production. Despite the quota affected production from January to April 2015 the EU is likely to end up with 2015 supply +2%.

So 2016 is starting off with most EU dairy countries with supply growth as compared to the quota affected first quarter of 2015, unsustainable milk prices and no support at National or EU level. The Commission expects low prices to eventually impact on supply with producers forced to quit milk production, reduce herd size or limit feeding. The EU commission appear to be hoping for milk processors to implement supply management through differential pricing.

The 3 most notable A & B pricing schemes are First Milk, Grahams and Meadow Foods, all operate with a fixed reference volume (usually 80-90% of previous production) and the remaining volume priced at different levels. The B litres are often priced at or below Intervention Equivalents to discourage growth. Those who have recently expanded rapidly bear the brunt of lower prices and even the A price is often less than generous, but reflects the core dairy processor milk returns and the realities of the UK dairy market today.

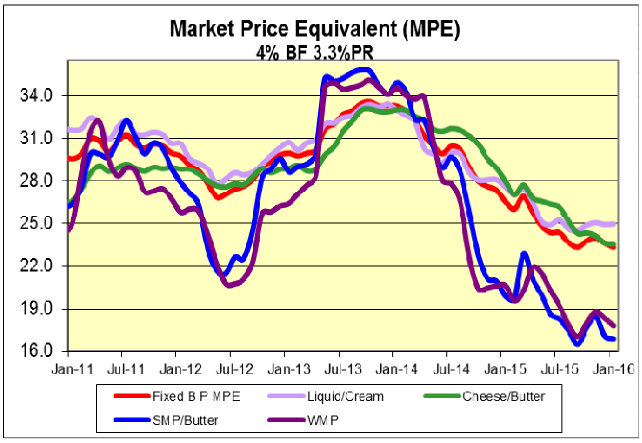


Source: The Dairy Group

The chart above shows the impact of an increasing proportion of B litres at 15 ppl diluting an A price of 22 ppl. For most producers the goal will be maximise the A volume without straying too far into B territory. All this can change of course if/when markets recover and B litres could be valued higher than A litres, but this will be a rare event. Seasonality is usually applied on top making the effective May price for a high B litre producer excruciatingly low.

So far this affects relatively few producers although some of the retailer aligned groups have this in effect with litres produced over the pool volume. With a new milk year just ahead these models may be coming to a dairy contract near you. 2 tier or even 3 tier models (retailer aligned contracts) are possible and a new quota regime by the back door is born. For private dairy companies they will become the norm, no longer open ended volume contracts, but for the larger Co-ops there may be more resistance to these models.

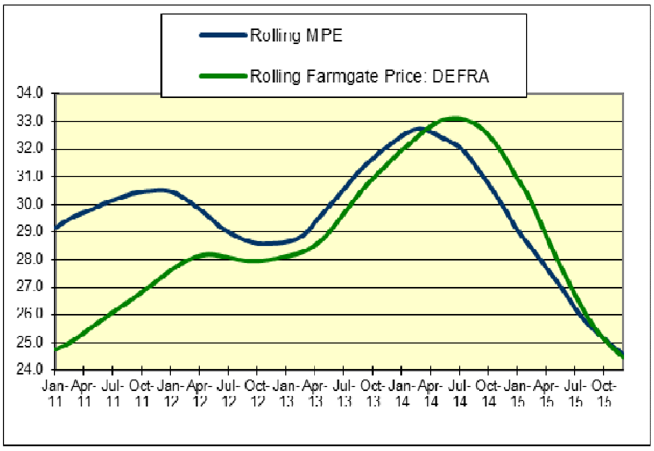
Volatility in the dairy markets comes from supply volatility, either from weather impacts or economic drivers, and both have featured in the current roller coaster. Supply management is inevitable and should be welcomed as it can help limit the volatile market returns to the margins of supply. Currently even core litres are hammered by market volatility which does no one any favours at all.



Market Prices

The Market Price Equivalent (MPE) has gained 0.1 ppl to 23.43 ppl due to improvements in butter and the fall in Sterling. The range across the sectors is stable at 8.0 ppl from liquid returns to SMP/Butter. SMP is stable at £1175/t, but £111/t below a rising Intervention price and £121/t below the latest GDT auction, which climbed back up 2.5% in Sterling equivalent. The GDT price equivalent (GDTPE) is up to 17.5 ppl. The last GDT auction has seen tonnage fall another 12% at a time when Fonterra announced record sales in December, which suggests a much reduced role for the GDT in the future. The MPE is down 4.8 ppl on the year and down 1.9 ppl since July 2015. United States production is running at +0.7% and New Zealand was -1.6% in December while the European Union was +5.6% in November.

Farm Gate Prices



The UK ends 2015 with an average milk price of 23.7ppl and a weighted average of 24.5ppl, a 14% and 22% fall respectively. The curves are flattening out, but are still falling and expected to fall below 24 ppl by March 2016. The winter remains mild, but production growth is showing signs of easing off to +2.4% in January. Sterling has weakened further to €1.31 raising the SMP Intervention price above the falling market returns and has weakened against the dollar at $1.43 since the United States raised interest rates. UK production in December was +5% at 1214 million litres, January is forecast at 1230 million litres and February at 1170 million litres. The forecast for the year is +2.7% taking the UK to 14.78 billion litres. The milk price forecast for January to March 2016 remains flat around 23 ppl with weakness in the cheese market causing concern.

- 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.