PRESS INFORMATION from
The Dairy Group

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The Market Price Equivalent (MPE) Update March 2013

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

Quota Abolition Set to Heighten Market Volatility!

"The recent 20% leap in prices on Fonterra's auction are a welcome reminder of the sensitivity of markets to supply constraints," says Nick Holt-Martyn of The Dairy Group. He goes on to say "the late season drought in New Zealand and Australia, together with a delayed spring in the northern hemisphere has been sufficient to trigger a commodity price hike. Yet New Zealand production has only just dipped below a year ago and is running at more than +5% for the year, which is on the same trend as the last 5 years. Taking the combined production of the EU, US, New Zealand and Australia as a measure of Global supply shows production up 290,000 tonnes between November 2012 and January 2013, but dipping in January 2013 by 166,000 tonnes. The trend has continued through February and March driving market sentiment into supply concerns, with declines in the EU and Australia overtaken by New Zealand. So a decline of around 500,000 t in the 3 months to March 2013 has been sufficient to push the Global Dairy Platform price up by 20%.

With the EU entering the last 2 years before quota abolition the sensitivity of markets to supply changes should be a concern, with the leading 8 EU dairy nations representing 83% of EU milk deliveries, some 6.75 times bigger than New Zealand.

Thousand tonnes	Feb '12-Jan '13	+1%	+3%
Germany	29,697	297	891
France	24,386	244	732
UK	13,530	135	406
Netherlands	11,669	117	350
Italy	9,943	99	298
Poland	9,834	98	295
Spain	5,986	60	180
Ireland	5,370	54	161
Total	110,415	1104	3312
New Zealand	20,611	206	618

Source: The Dairy Group

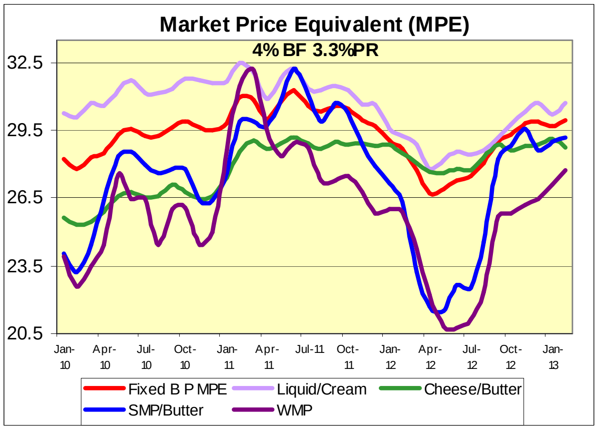
If on quota abolition these 8 EU countries see an increase of just 1%, then it would be the equivalent of an average New Zealand increase in growth, which is averaging 1,234 thousand tonnes per annum over the last 4 years. At +3% it will be like 3 years of New Zealand growth all at once.

The fears of EU production growth are not without foundation. It is not just Irish politician's rhetoric, with reports of Chinese inward investment in Irish milk processing. At the same time Arla has announced investment in an infant milk formula plant in Denmark. While across Friesland there is evidence of expansion in dairy farms in advance of quota abolition and no doubt similar thinking is in play in Germany, France and Poland. Even the UK saw growth of almost 4% between 2009/10 and 2010/11, so with the right market and weather conditions there is the potential for globally significant growth in EU production. In the absence of milk quotas PLCs are likely to insert stringent volume control into contracts. However, by contrast, most Co-ops are not in business to tell their members how much milk to produce ~ only to get the best return from the market for the milk they receive.

What does this mean for milk price? In the US, where supply and demand are more regulated by market returns and the economics of production than weather, it is generally believed that a 1% change in supply triggers a 10% change in raw milk price. This feedback mechanism tends to regulate the level of production swing unless there are global price changes from external factors, such as the market tone in the EU and New Zealand. The example of changes in New Zealand markets seems to follow this rule with supply dipping in the last 3 months by 2.5% of New Zealand annual production, triggering a 20% change in market returns, except of course this is only 0.13% of the global player's milk pool. This is significant in the context of the exportable surplus of those players, with just a 1% decline in 3 months triggering a 20% price rise. This sharp tightening of supply means that the auction is likely to see further rises until the northern hemisphere spring flush comes on stream. The UK peak is likely to be 4 to 6 weeks later than 2012 due to the continuing cold weather in contrast to the early spring last year.

Of course this is not 2015, so the current commodity boom will have passed by then and markets will have moved on somewhere else, but rapid supply growth mostly in the exportable surplus, in the absence of growth in market demand, will see an inevitable fall in price. The greater the lift in production, the more significant the price adjustment. The effect on EU dairy economics are plain to see and the intervention of the European Parliament to insert market management into CAP reform is welcome. The methodology of a levy on production expanders paid to the production contractors seems simple in principle, but unworkable without RPA records on individual producers supply. One for the Commission to work on no doubt.

For now its time to enjoy the new wave of milk price increases that will come along over the next 6 months as a commodity spike lifts market returns."

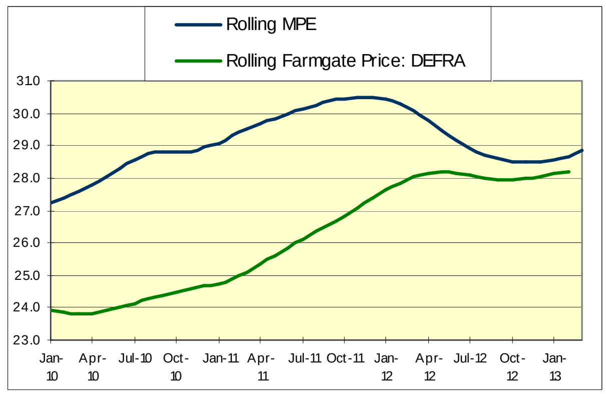


Market Prices

The Market Price Equivalent (MPE) increased again to 31.15 ppl due to rises in commodities which were up by 0.75 ppl. Powders are up sharply on the back of rises in the Fonterra auction. Exchange rates have stabilised at their new low level. The latest Fonterra auction was up 14.8% with WMP up 21.2%, SMP values rose 7.7% and butter was up 11.5%. The MPE is now up 2.4 ppl on the year and up 1.2 ppl since September 2012. New Zealand supply is now affected by drought knocking it below 2012 levels for the rest of the season; however production is still likely to end the year +5%. The US is stable in February 2013 and the EU is running at -0.3%. Weak supply is now affecting global markets, with market prices responding. The UK is still running well below last year and the late cold spring is likely to delay the spring peak by 4 to 6 weeks compared to 2012.

Farm Gate Prices

The graph shows the rolling MPE starting to rise on the back of improved commodity returns with the MPE at 30.4 ppl while milk prices have levelled at 28.0 ppl. The rise in commodities looks set to push the MPE higher this spring, increasing the gap and pressure on milk prices to respond. Weak profitability and now a cold late spring will tend to keep confidence low until milk production starts to recover. With the UK production running at **4.5% below** last year and finishing the milk year down 3% there is little prospect for a recovery very soon. The summer weather is key to 2013 and at best looks like a return to average conditions from mid april.



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- 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.