PRESS INFORMATION from

The Dairy Group

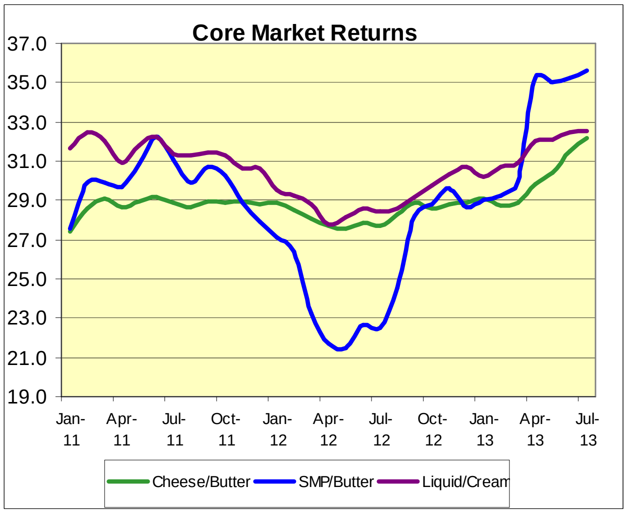
12th August 2013

The Market Price Equivalent (MPE)

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

Weather factors should see the UK farm gate price reach 35ppl

"The sudden weather change from drought to "normal British summer" in the last 2 weeks highlights the susceptibility of milk production to extreme weather. Apply that to a global scale and it is easy to see that weather drives supply, supply drives markets and markets determine prices" says Nick Holt-Martyn of The Dairy Group. He goes on to say "2013 has been marked by drought in New Zealand and Australia which has reduced production by 1.5 billion this year; a cold late spring in the EU cut another 1.2 billion litres by the end of April and flat production in the US left markets more than 3 billion litres shorter than 2012. When production declines it is commodities that are affected mostly as supplies are directed towards higher value domestic products. The effect is to tighten the market which sends commodity prices higher, eventually significantly above core products which then provide a pull on their prices. As the graph below shows this has been the feature of the last 12 months, reversing the 2011-12 position and all due to the weather.



Source: The Dairy Group

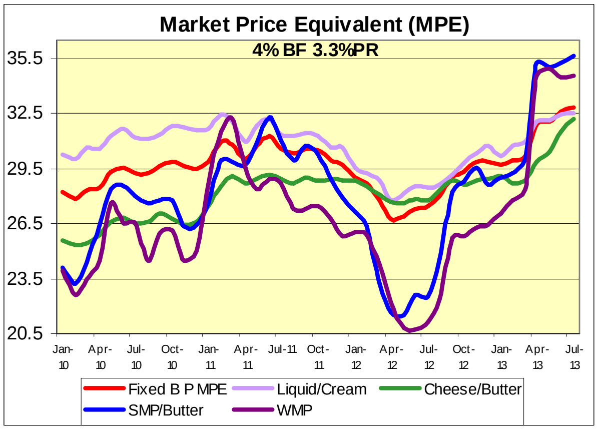
With commodities up to 10% above core product market returns and production still weather affected there is likely to be more upward movement in prices over the next 3 months. 2 weeks ago the Irish were planning for serious forage shortages (down 23%), with drought following the cold late spring hampering silage production, by importing hay and high fibre concentrates. If their winter forage stock remains inadequate then production may be affected through the winter and spring, although just like the UK they have recovered current production to the falling 2012 levels.

With the UK lying mid-table in the EU farm gate price league and most of our near competitors already over 35 ppl, more upward price movement for the UK should be expected. This is backed up by a rising cheese market which is supported by rising retail returns for both own-label and branded mature cheddar and butter/powder returns at 35 ppl. Current base contracts are in the range 30-32 ppl but 35 ppl by the end of the year looks possible. The liquid sector will take its lead from cheese to remain competitive.

With milk prices up and a softening of feed prices, so where next for production? Well, as said above, it all depends on the weather, not so much in the UK or EU now rain has arrived and boosted grass production, but in New Zealand and Australia. The rain came just in time for most of the EU, although there is now a heat wave in Eastern Europe so production will probably move ahead of the low levels of late 2012 and early 2013 by the start of this winter. Weaker feed costs will encourage supplementary feeding and coupled with better forage will lift yields and margins. On balance 2013 is likely to be an average summer in both the EU and US as well providing better crop yields and quality than 2012.

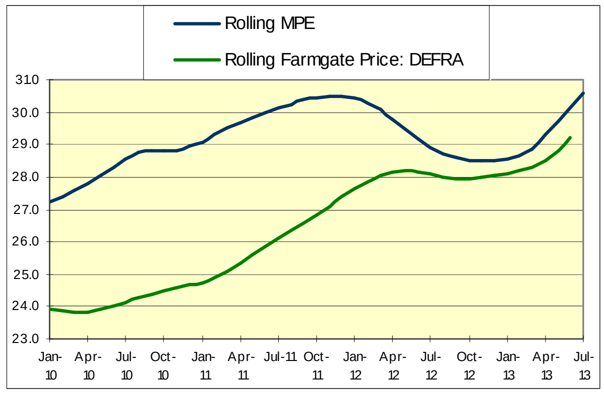
The weather forecast in New Zealand is much the same with a warm damp spring forecast providing plenty of grazing and production recovering up to 2012 levels. Pacific patterns are neutral with a trend towards the wetter side of average, so this pattern is expected to extend through to the southern hemisphere autumn.

Gently rising global GDP, despite China's growth stabilizing, should mean steady demand which will be met by improved production in the major dairy areas. So the conditions that have led to price increases are not likely to persist far into 2014. The rate of softening will depend on the rate of recovery in production which is highly weather dependent. As we can't forecast next months' weather with any certainty, the outlook for next year is uncertain to say the least."



Market Prices

The Market Price Equivalent (MPE) is still increasing, up 0.17 to 32.79 ppl due to further rises in mature cheddar and butter, although powders are more stable. The range across the sectors has narrowed again, but liquid and cheese are playing catch up. The latest Fonterra auction was up 0.7% due to SMP and autumn WMP, but falls in butter values. The MPE is now up 5.33 ppl on the year and up 3.07 ppl since January 2013. New Zealand new season is underway with positive weather forecast while the UK has caught up 2012 and is now running at 2011 levels.



Farm Gate Prices

The graph shows the rolling MPE continuing to rise sharply due to cheese and butter prices. The farm gate price is back over 30 ppl due to seasonality and is on track to be 33 ppl by October with headline prices over 35 ppl. Despite the brief drought the weather has delivered an average summer with good quality forage. There should be positive effects on production and there are firm expectations of lower feed prices for the winter. UK production has moved ahead of 2012 in July and is likely to follow a 2010 or 2011 profile. The 2013-14 production forecast is up to 13.2 billion litres, up 350 million litres on the rolling figure and around 225 million litres up on 2012-13.

- Ends -

For further information please contact:

- **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.