PRESS INFORMATION from

The Dairy Group

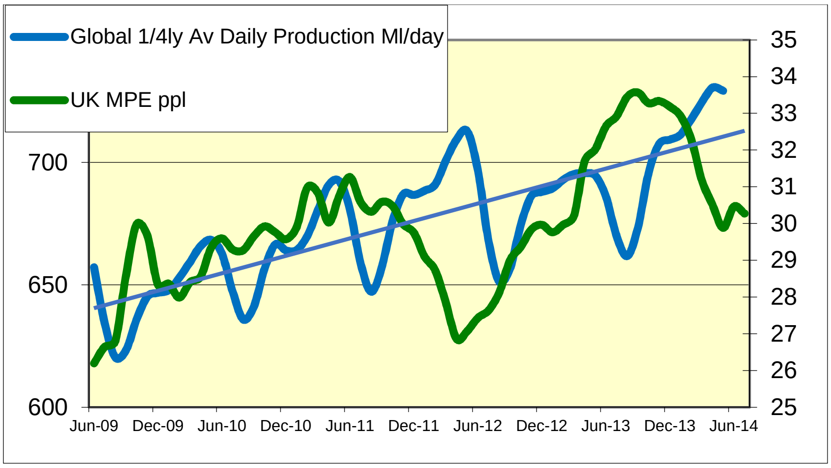
31st July 2014

The Market Price Equivalent (MPE) Update July 2014

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

Milk price under pressure from rising production

"The recent 8.9% collapse of the GDT auction and the comments by Goldman Sachs of a 5 year milk supply glut have fuelled the doom and gloom regarding milk pricing in the future, however a more balanced view needs to be taken" says Nick Holt-Martyn of The Dairy Group. He goes on to say "while it is true to highlight supply as the key factor determining market tone and the dependence on Chinese consumption, 5 years without a market changing climatic intervention seems unlikely, even with the supply growth potential of quota removal. The decline in EU prices may well be sufficient to limit post quota supply growth to modest levels in 2015 after the strong recovery in 2014.



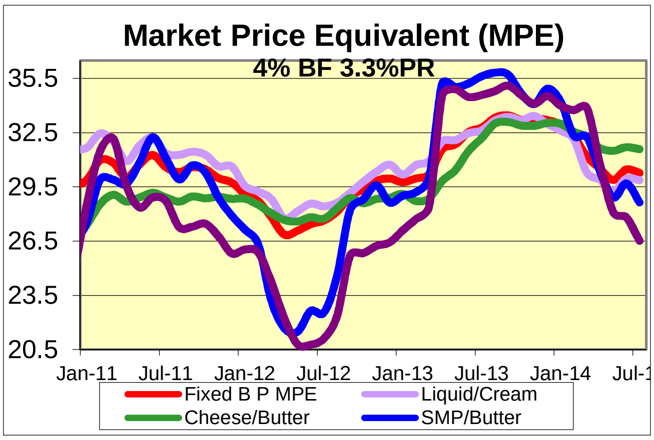
Source: The Dairy Group

The graph above shows the updated milk supply position of the 3 major exporters which indicates that the northern hemisphere peak has passed with supply at an all time high, so little wonder markets have weakened in the last 3 months. Conditions in the southern hemisphere are indicating a good start to the new season, although recent months have been below 2012 levels. The similarity with 2012 is clear ~ strong supply and weak markets will coincide until supply eases back nearer the longer term trend line which represents underlying demand growth.

The EU market had stabilized until the recent GDT fall, so the European price is expected to follow suit in the coming months. Current GDT prices equate to a MPE around 14% below the July UK level, but actual market returns are higher due to the weight of product sold on a non-auction basis. Lower milk prices this winter should have less effect in dampening supply than expected due to the lower feed prices, so markets look set to remain weak into 2015. Then with quotas ending in March 2015 there is likely to be further supply pressure in the absence of adverse weather.

The latest cuts by Arla and Dairy Crest are indicative of the reducing market returns, Arla have a significant exposure to commodity products, while Dairy Crest, although less exposed to commodities due to the stability of the cheese sector, will be tracking market price movements. The increased spread of returns between cheese and powders now suggests there will be a movement of raw milk into higher value products which ultimately weakens market returns overall. Arla has declared such a policy, which is laudable over the medium term, but can exacerbate weak returns when milk is in over supply.

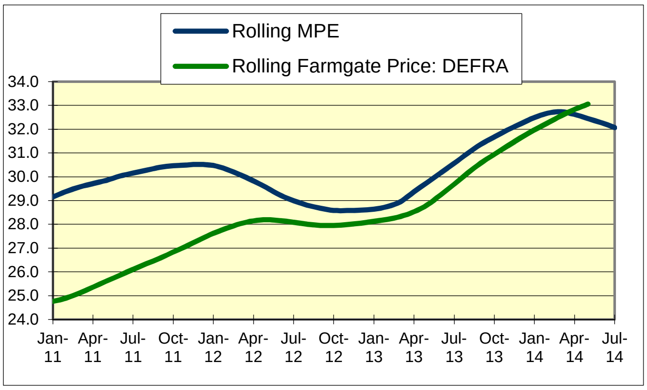
Although supply growth is likely to moderate there is nothing currently on the horizon to suggest an easing of supply giving consumption and demand time to catch up. Weaker prices for the next 12 months are likely, but there will be factors further ahead, possibly prices themselves, but more likely weather that will change the tone of the market. 5 years ahead is too far to look for nothing to change, but the message to farmers is to focus on the internals (cost of production and unit productivity) and let the externals take care of themselves.



Market Prices

The Market Price Equivalent (MPE) has fallen slightly, by 0.2 ppl to 30.27 ppl with falls across the board except cheese and liquid. The range across the sectors has widened to 5.1 ppl below cheese with WMP dropping sharply. The latest GDT auction fell 8.9% across all contracts and commodities. The MPE is now down 2.5 ppl on the year and down 2.6 ppl since January 2014. New Zealand production has dropped below 2012 levels ahead of their new season while the EU is up 3.8% and the US +0.9%. Market returns are similar to 2011 when global milk supply was last in significant surplus, but hopefully powder returns can stay in touch with core products unlike 2012.

Farm Gate Prices



The graph shows the rolling MPE falling as the market returns continue to ease back from the 2013 peak, with the rolling MPE down 0.67 ppl from peak. The rolling farm gate price is close to its peak at around 33 ppl in June. The recent hot weather will reduce milk output and there is a risk of drought for the rest of the summer. The economics remain good with feed costs dropping rapidly with cereals very low this winter. UK production is running 7% ahead of the 5 year average and the forecast for 2014-15 is up 6% to 14.4 billion litres. July is forecast +7.2% up on 2013 to 1225 million litres and August +5.5% to 1180 million litres. By the autumn/winter production is likely to be around 4% up on 2013 helped by cheaper feed and good forage stocks.

- Ends -

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

- **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.