PRESS INFORMATION from
The Dairy Group

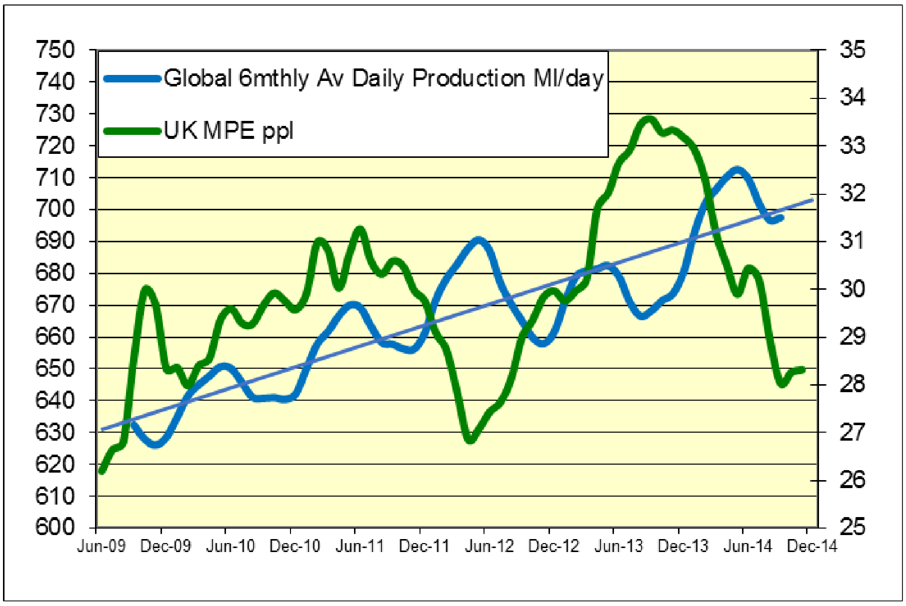
30th November 2014

The Market Price Equivalent (MPE) Update November 2014

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

Supply Growth Swamps a Weak Market

“Despite the sharp reduction in market returns supply growth shows little signs of easing in the major exporting dairy producing nations.” says Nick Holt-Martyn of The Dairy Group. He goes on to say “Weakness in the market is all about supply growth with the major exporting nations all showing 4 to 5% year on year growth this autumn. While it is true that current Chinese purchases of dairy product have dropped below 2013 levels, the purchases in January to September 2014 exceed 2013 by between 25 to 94% in the key commodities. Some reduction was inevitable, but it has come at a time when global supply continued its upward growth.



Source: The Dairy Group

The graph above shows how average daily supply has dipped through the northern hemisphere trough months as is normal, but only at a level close to the 5 year trend line. This is higher than ever before, 4 to 5% above 2013 and still higher than the previous supply peak in May 2012. Supply growth has now been at this level since April 2014 and looks set to continue in to 2015 despite the rapid falls in market returns.

There is no sign of a drought in New Zealand to curb their 5% growth and 2014 looks set to finish +9%, well above their long term average growth of +5% per annum. Australia is seeing some drought, but looks set to return to growth this year. The US looks set to finish the year +3% while the EU is running at +4%.

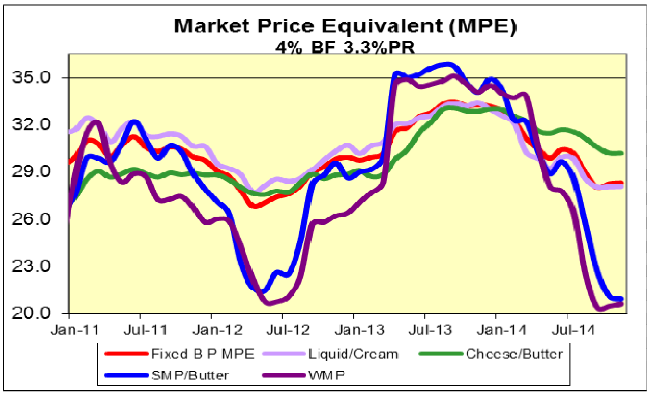
The EU production growth in 2014 equates to 30% of New Zealand total production. This is an indicator or what a post quota world will look like; in the past EU growth was controlled to around 1 to 1.5% per annum as quota was relaxed, whilst growth in the last 2 years has been double at over 3%.

My recent trip to Holland reveals quota management this autumn has been achieved by selling fresh calved cows and accepting a certain level of super-levy, spread over this and next year. Many herds are operating with cow numbers 10 to 20% below capacity. Robot herds with only 50 milking cows per box is common, which they expect to increase towards the optimum (60) as quotas finish. The only constraint would be the environmental limits for manure spreading or the cost of exporting surplus manures, but this was likely to prevent many new units or stop increases in current herds. If this pattern is echoed around the major over quota EU milk producers (Germany, Ireland, Denmark and Poland) then EU supply growth in 2015 is likely to continue at current levels despite lower milk prices. The Dutch view on prices was that would stay above 30€c/litre (24 ppl), a fall of 15% from their current level and that would be difficult but manageable.

The stability in global markets is being achieved with returns at very low levels, particularly for powder which has seen significant growth in 2014 in both the EU and New Zealand. With AMPE returning 21 ppl and the MCVE commodity cheese index under 25 ppl there is not much downside left. There is also little prospect of recovery until production levels have been stabilized for several months to allow the normal growth in global demand to reduce accumulated stocks. Previously this has taken 3 to 6 months and often aided by a drought or other climatic problem in one of the major production regions.

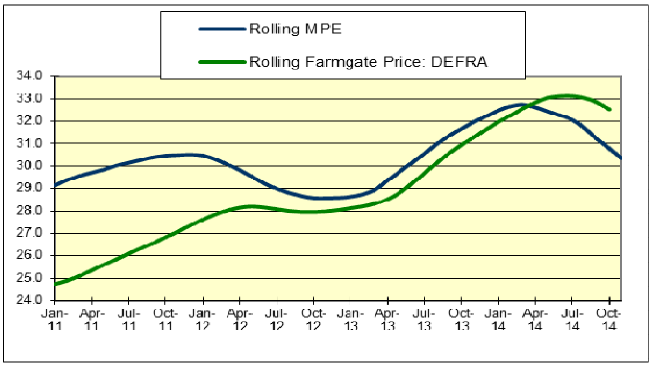
Returns from liquid, branded products and mature cheese will be higher and provide the UK an element of detachment from global commodity markets provided consumer returns are passed back to farmers. The UK price prospects for 2015 are expected to be 5ppl above the commodity level, but will be affected by further movements in commodity values. Given the likely EU supply position as outlined above there is little sign of an improvement into 2016 without a global weather event to constrain supply.

The challenge for farmers will be to reverse production cost inflation of recent years, which will be helped by lower feed and oil prices, but fixed cost inflation will be more stubborn. Seasonal calving and intensive grazing will undoubtedly come to the fore although changing calving patterns takes several years by which time market returns may be at a different level. The post quota world may well provide great opportunity to expand over time, but the risks of sustained low market returns go hand in hand with un-fettered production. The only solution is to be on top of your cost of production at all times to ensure a viable business even at low market returns.



Market Prices

The Market Price Equivalent (MPE) has stabilised at 28.3 ppl, mainly due to the increased proportion of liquid milk in the trough period as returns are still trending down. The range across the sectors remains at 9.6 ppl between Cheese/Butter and WMP, mainly due to very weak trade in mature cheddar and no prices being reported. The latest GDT auction was down -3.1% due to falls in powders which dominate the tonnage sold. The GDT price equivalent (GDTPE) is down to just 17.1 ppl, down 2% on the month and down 27% in the last 6 months. The MPE is down 4.97 ppl on the year and down 1.58 ppl since May 2014. New Zealand production is running +5.2% in September with continued damp conditions, which is line with trend growth over the last 6 years. The US is increasing as feed prices have fallen and is now running +3.8% in October while the EU is at +4.6% in September. No change for the major exporters with supply still growing at 4 to 5% which can only weaken markets into 2015.



Farm Gate Prices

The graph shows the rolling MPE reducing as market returns drop away, still above 2012 levels but with further to go. The rolling farm gate price has dropped below 30 ppl in October 2014 for the first time since October 2012. The weather continues to be benign globally and despite recent US snow there is no impact on supply just yet. UK production is running 5% ahead of last year with November forecast at 1120 million litres and December 1194 million litres, to keep the UK on track to finish the last ever quota year at 14.5 billion litres, 700 million litres below quota subject to butterfat adjustment. There is no evidence that lower milk prices are affecting milk production, although the year on year gain is expected to ease back to around 3% at the quota year end.

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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.