# PRESS INFORMATION from
# *The* Dairy Group

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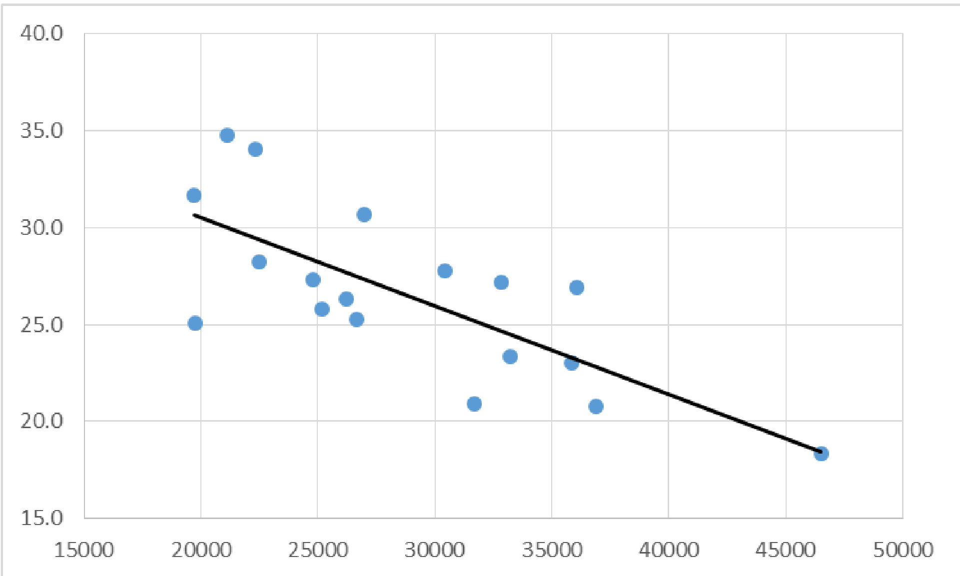
## The Market Price Equivalent (MPE) Update September 2015

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

### Will The Lessons Be Learnt This Time?

“The encouraging signs of 3 consecutive rises on the GDT and the fall in New Zealand milk output in August of 0.74% is tempered by rises in EU production of 2 to 3%, with Ireland at +12% and the US +0.8%. Even so markets have firmed and stability is the order of the day now that the GDT and UK (EU) commodity prices are aligned and the bottom of the market appears to have been reached.” says Nick Holt-Martyn of The Dairy Group. He goes on to say “Although recovery may be some months away (judging by the positive milk production signs in both the US and more importantly the EU), following any major crisis it is imperative to learn the lessons to minimise volatility in the future. It is not sufficient to say that markets will always be volatile if there are steps that can be taken to minimise the impact of supply volatility in the future.

The GDT has achieved such a global significance in price setting around the world that Fonterra needs to change its use from a sales platform of last resort with volatile tonnage to a core sales platform with a consistent offer to customers. The past practice of offering product to the market in a production led seasonal profile is grossly flawed as it ignores the demand profile of the customer. The evidence from the EU and US is that there is precious little seasonality to demand. Through the course of its existence there was little correlation between GDT price and tonnage sold, but in the last year this has changed such that for 2015 the correlation is now strong as shown below.

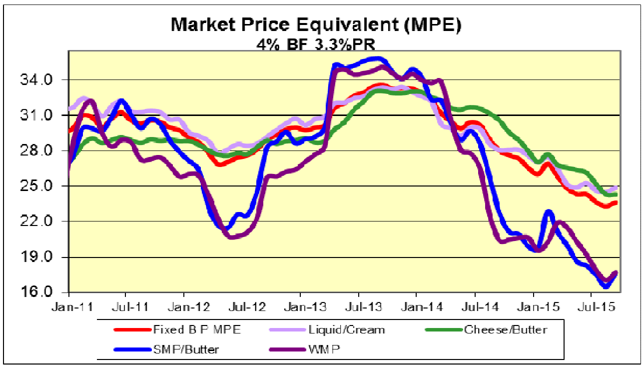



**Source: The Dairy Group**

It is noted that going forward Fonterra’s forecast tonnage is flat at its current level so stability should prevail. The latest El Nino news suggests a low rainfall spring for both New Zealand and Australia which has led to downward revision of their production forecast for the next 6 months. Rather than cut the GDT tonnage Fonterra should direct buyers to the GDT so that increased competition for supply increases prices.  Changing the tonnage offered would only add to the volatility.

The lessons for the UK market are to pay less attention to vagaries of the GDT and to end the link between the wholesale price of liquid milk and commodities.  Liquid and cheese take up 77% of supply which falls to 70% when mild cheddar is excluded.  Whilst these prices will need to reflect global markets they should not be driven by them given that the UK average cost of production remains above 30 ppl.  Linking to commodity indices undermines the unique value of a fresh perishable product.  The latest cut (1.5 ppl) by Dairy Crest Davidstow on the back of lower Dairy Crest 1st half year profits will come as a shock to many suppliers.  Comparisons regarding competitor pricing look thin when Arla (as have Campina Melkunie in Netherlands) have started paying higher prices due to market improvements.

Markets appear to have bottomed out so we are now looking out for “the green shoots of recovery”. A weaker spring flush in the southern hemisphere will help, but runs the risk of being undermined by continued strong EU post-quota production.  Many countries, the UK included, are yet to see any reversal of the supply growth needed to lift markets off the floor.  This is the new dairy world reality that despite production easing in one part of the world the rest carry on regardless.  This makes the likelihood of markets returning above 30 ppl less likely in the future, so increasing the need for UK producers to tackle their cost of production.  The challenge for dairy farmers will be to put in place the necessary system changes when their cashflows are negative to set themselves up for a challenging 2016.

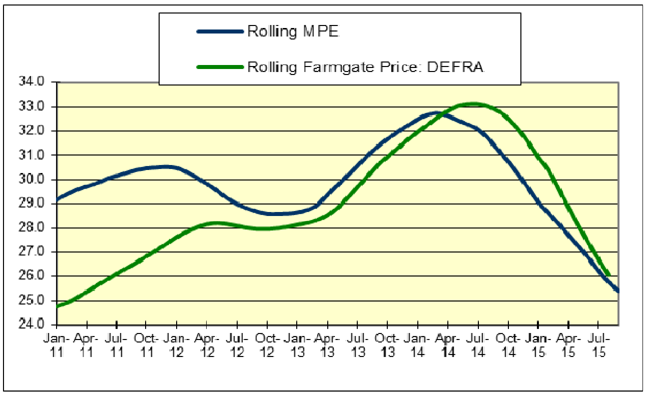



### *Market Prices*

The Market Price Equivalent (MPE) has lifted by 0.33 ppl to 23.6 ppl due to rises in commodity products. The range across the sectors narrows to 7.2 ppl due to rises in powder returns. SMP has now risen to £1250/t, £2/t above Intervention and £47/t below the last GDT auction, which rose another 16.6% in Sterling equivalent. The GDT price equivalent (GDTPE) is up to 17.5 ppl, on 3 successive increases. The latest 3 GDT auctions have seen stable tonnage offered but 27% down on 2014. The MPE is down 4.4 ppl on the year and down 2.2 ppl since March 2015. US production is running at +0.8% and New Zealand was -0.8% in August while the EU was at +3.6% in June.

### *Farm Gate Prices*

The graph shows the familiar pattern of rolling milk prices following market returns although there is a hint of the curves flattening out. September weather has been variable across the country and production has held up at +2%. Sterling has weakened to €1.35 raising the SMP Intervention price above market returns. UK production in July has been corrected up to +2.4% at 1254 million litres, August has been reported +1.8% at 1199 million litres and September 1150-1170 million litres. There is confusion regarding the expectation for the milk year, but our forecast is growth of 0 to 2% as low prices take affect this autumn and winter. The latest 2015/16 milk price forecast is around 23.5 ppl by next spring, unless there is a significant upturn soon.

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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.