

PRESS INFORMATION from *The Dairy Group*

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The Market Price Equivalent (MPE) Update February 2016

By Nick Holt-Martyn, The Dairy Group

Are There Any Winners In The Dairy Market?

“With UK rolling milk supply likely to peak in February at 14.8 billion litres and rolling prices edging down towards 24 ppl it is timely to look again at the utilisation of UK milk and how the wholesale and retail markets have responded in the last 9 months. The farm gate value of milk has dropped by £580 million despite 2.8% growth in volume in the last 9 months so farmers have lost out for sure. In fact the farm gate value is £180 million less now than when production began to rise in June 2013. AHDB Dairy reported in October 2015 that processor margins in mild cheddar were negative and there was insufficient data to report on liquid or mature cheddar. The recent low cheese sector pricing, the loss of one cheese maker and the rapid introduction of A & B pricing would seem to confirm this view” says Nick Holt-Martyn of The Dairy Group. He goes on to say “if not the farmers or processors what of the retailers or consumers? The retailer woes have made the mainstream media in recent weeks with most seeing declines in sales over Christmas and renewed emphasis on undercutting each other to maintain footfall. Our latest survey of online retail pricing shows some variation, but generally deflation in the dairy sector, particularly when compared to 2014.

Retail	Size	May-14	May-15	Feb-16	Change
Liquid milk	4 Pint	117	103	98	-5%
Fresh Double Cream	600 ml	165	168	156	-7%
Butter	250g	163	163	120	-26%
English Mild Cheddar	p/kg	638	608	668	10%
English Mat Cheddar	p/kg	1031	842	724	-14%
Weighted Average Price Change					-6.6%

Source: The Dairy Group

The table above shows the pricing of the key dairy foods over the last 3 years and the change in the last 9 months. Mild cheddar is the surprise with an increase of 10%, but it has to be said there is immense variation in cheddar pricing from store to store, processor to store and the level of differentiation in both mild and mature cheddar. Consumers are probably overwhelmed and buy the familiar brand/package each time. In liquid, only Asda was out of step with the main retailers, with 89p/4 pints compared to the universal £1.00. The categories are weighted to give the average figure of 6.6% decline in retail values.

Wholesale	Change in Wholesale Prices May '15 - Feb '16
Liquid milk	-3%
Fresh Double Cream	-7%
Butter	-9%
English Mild Cheddar	-21%
English Mat Cheddar	-9%
	-6.3%

Source: AHDB Dairy/DIN

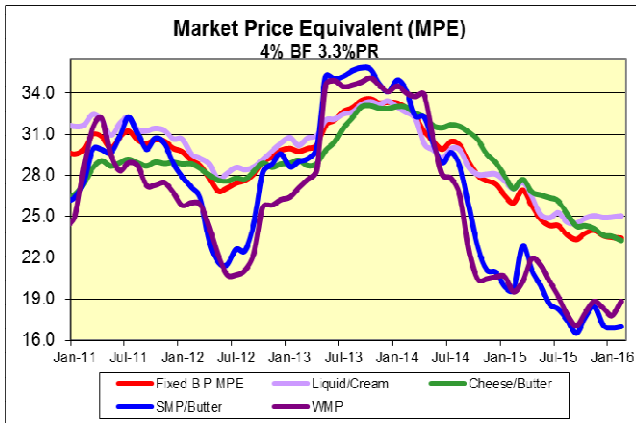
When we compare that to the wholesale prices as reported by AHDB and DIN with see a similar picture with the weighted average down 6.3%. This compares to the Defra rolling farm gate milk price which is down 16% over the same period.

The weighted average takes in to account that liquid and cheese still represent 77% of milk utilisation, which means that the weakness in fresh milk and cheese weighs heavily on dairy returns as a whole. In milk processing raw milk represents between 40 and 60% of the costs, so declining wholesale incomes with have a disproportionate effect on raw milk values despite the deflating energy costs and relatively stable packaging/distribution costs. There is no authoritative estimate of the retail value of the dairy supply chain but our estimate would be around £8.3 billion, down from £8.9 billion in May 2015, a decline of £600 million. At its peak it was worth around £10 billion. On this calculation it is clear that farmers have carried the can for the decline in retail income almost entirely, retailers and processors have been able to largely protect themselves and the clear winner is the consumer!

Defra's milk utilisation figures for 2015 show that while production grew by 383 million litres, exports grew by 114 million litres and imports fell by 156 million litres to leave a net available milk figure of just 113 million litres, +0.8%. Not the rampant growth we were expecting after all. The utilisation also shows that powders and condensed milk used 110 million litres less milk (-5.9%) than 2014 as did liquid and butter production, 14 million litres and 15 M litres respectively. The rising utilisation came from Other (+104), Waste (+64), Yogurts (+42), Cream (+24) and Cheese (+18) accounting for 253 million litres, but significant growth in the 'Other' category. From the utilisation figures there is no evidence of a large increase in cheese stocks. Overall this doesn't look like a market depressing growth in one particular sector, but a more normal variation, so the main driver of lower market returns is import competition forcing UK prices lower.

All in all a confusing picture which shows only consumers have gained from dairy food deflation, this is linked to the decline in wholesale markets globally which have provided a competitive impact on the UK market forcing domestic returns lower. Clearly there is no evidence of the excess from supply growth due to balancing of import reduction and increased exports of raw milk. This might suggest that if the UK supply does indeed drop back this spring then prices might at least stabilise, supported by a decline in sterling resulting from the uncertainty of the EU Referendum. As for a meaningful market recovery, there is no likelihood until the EU supply stops growing, hopefully later this year.

Although the UK production growth may be halted the countries most held back by quotas last year; Ireland, Netherlands, Spain and Belgium are still forging ahead such that in December 2015 the EU was still +4%. This positive month on month production growth is unlikely to change until the quota affects diminish around May/June 2016, or unless producers take immediate action, or the spring is particularly late. The main exporting countries have finished 2015 with supply 2.2% higher than December 2014, the EU more than compensating for declines elsewhere - particularly Australia and New Zealand. The prospects for 2016 show no sign of improvement yet.



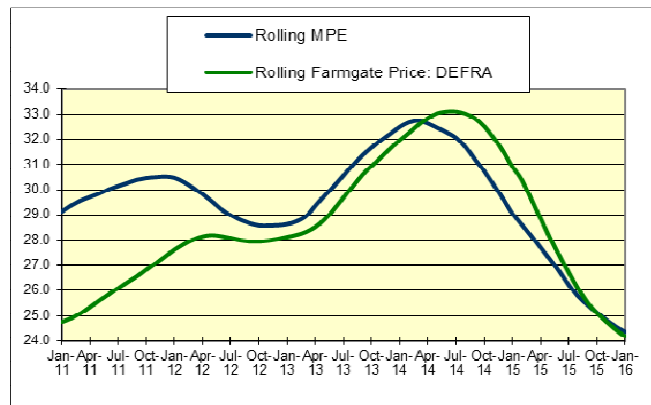
Market Prices

The Market Price Equivalent (MPE) has slipped 0.27 ppl to 23.16 ppl due to weakening cheese, butter and cream countered by SMP and the fall in sterling. The range across the sectors is stable at 8.0 ppl from Liquid returns to SMP/Butter. SMP has firmed to £1200/t, but £114/t below a rising Intervention price and £92/t below the latest GDT auction, which rose 4% in Sterling equivalent. The GDT price equivalent (GDTPE) is up to 16.1 ppl. The

last GDT auction saw tonnage fall further, indicating Fonterra are reducing the GDT influence on their own returns. The MPE is down 3.8 ppl on the year and down 0.2 ppl since August 2015. United States production is running at +0.3% and New Zealand was -2.1% in December, while the European Union is forecast at +4.6% in December.

Farm Gate Prices

2016 starts off with an average milk price of 23.1ppl and a weighted average of 24.2ppl, down 3.3 ppl on the year. As before the curves are flattening out, but are still falling and expected to fall below 24 ppl by March 2016. Winter has turned cold and the forecast is distinctly average for March holding back the rush to grass and perhaps helping supplies drop behind 2015. Sterling has weakened further to €1.29, raising the SMP Intervention price above the falling market returns and weakened against the dollar at \$1.38 since the EU Referendum campaign got underway. UK production in January was +2.7% at 1226 million litres, February is forecast at 1103 million litres (28 days) just +2 million litres on the year and 1142 million litres including the extra day. The forecast for the year slips to +2.1% taking the UK to 14.7 billion litres. The milk price forecast for February & March 2016 is to weaken below 23 ppl due to weakness in the cheese market causing concern, to leave the year end rolling figure around 23.5 ppl.



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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.