PRESS INFORMATION from

The Dairy Group

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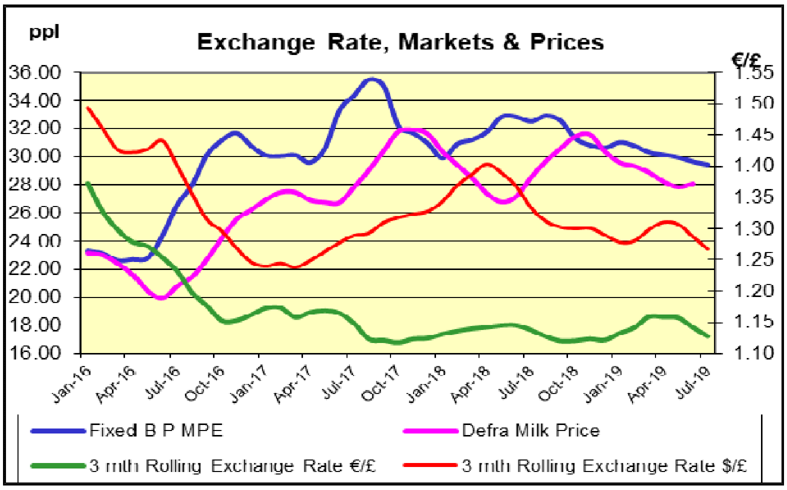
The Market Price Equivalent (MPE) Update July 2019

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

No deal brinkmanship threatens UK dairy farmers

"Unless by some miracle there is a resolution to the Irish border issue the UK will leave the EU on 31st October without a deal in place" says Nick Holt-Martyn of The Dairy Group. He goes on to say "we will get to see first-hand what a managed or facilitated no deal really looks like. Project complacency has replaced project fear and the UK will be treated by the EU as a third country under WTO rules without a customs agreement for 40% of its trade in place. Currently this trade is carried on as part of the single market/customs union without tariffs, quotas or inspections. Without a deal there will be full 3rd country tariffs from 1st November. Sterling is already on the slide. A deal would allow the status quo to continue in a transition period preventing the cliff edge of 1st November.



Source: The Dairy Group

The graph above shows the decline in Sterling since January 2016. While there is a positive effect on milk prices one must not forget the mirror effect on costs and the overall inflationary effect of a devaluation. The £ has already fallen as the Government has stepped up its 'No Deal' planning and rhetoric. Exchange rate forecasters are suggesting Sterling is edging down to almost parity with the Dollar and sub parity with the Euro. This is brinkmanship (or poker) with the well-being of the economy and agriculture in particular at stake. Taking 40% of your exports out of a free trade area and out of the protection of the single market until a trade deal is reached cannot be good. Until then tariffs on imports and exports will be applied until replaced by a trade agreement.

The basic principle of GATT rules is that other than by a trade agreement all third countries are treated equally so the same tariff rules will apply to all 3rd countries until such agreements are in place. Defra's asymmetric tariffs as outlined in March (it is not known if these are still in play), are not compliant with GATT rules unless the tariffs applied to the EU are replicated to all WTO members (e.g. USA, Australia, New Zealand). As they currently stand (see below) the effect on dairy imports is minimal, but exports will be halted overnight together with a rise in low tariff imports.

2018	Production kt	Imports kt	Exports kt	Supply kt	UK self sufficiency %	Net UK self-sufficiency %	Import Tariffs %	Export Tariffs %
Raw Milk	15168	**132**	**938**	13965	109%	102%		**63%**
Liquid	6799			6799	100%	100%	**0**	**63%**
Cream	280	**32**	**24**	288	97%	89%	**0**	**37%**
Butter	151	**84**	**62**	173	87%	**51%**	**32%**	**41%**
Cheese	468	**517**	**190**	794	59%	**39%**	**7.5%**	**40%**
Condensed Milk	120	**51**	**7**	164	73%	69%	**0**	
Milk Powders	90	**56**	**126**	20	453%	-179%	**0**	**79%**
Yogurt	350	**151**	**27**	474	74%	68%	**0**	**17-20%**

Source: The Dairy Group, NFU and Defra

The biggest problem remains Ireland with an export tariff of 63% (around 18 ppl) on the 900 M litres exported south from Northern Ireland, so this milk will add to the UK milk pool, (+6%) and with limited processing capacity in Northern Ireland would head towards GB. This increased supply would weaken GB prices due to oversupply of raw milk.

The reason weaker (devaluing) sterling has helped milk prices in the past is due to the single market and the free flow of goods within it. With tariff borders that won't necessarily be so because markets will not able to balance across internal EU member's borders other than at the net tariff price. So Cream leaving the UK will have a +37% tariff, but cream coming in will be tariff free! The net result would be lower internal UK prices and the higher supply would not be exportable against the tariff wall.

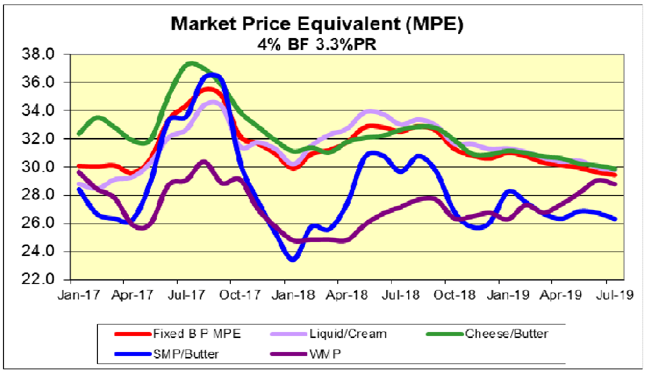
Butter is only affected by the knock on effects of supply and tariffs in other commodities due to the near parity of tariffs. Irish cheddar is the biggest import which faces a 7.5% tariff encouraging an increase in UK cheese prices and supply, but countered by the increased supply of raw milk. With the imbalance and the cost of transport likely to weigh on milk prices rather be passed back to consumers.

On lamb and beef there is opposite problems. Lamb will suffer from loss of exports and collapse in prices while beef will benefit from reduced imports notably from Ireland. However, imports from other 3rd countries (USA, S America, Australia) would be expected to take their place. AHDB/Andersons Centre have produced an excellent if scary "Red Meat Impact Study" which suggests that overnight red meat trade would cease. Sheep producers would see a 24% price reduction while Beef would see a 4% reduction coupled with rising costs of a weaker currency wiping out Lowland Livestock's opportunity to make a profit. The beef decline would knock on to cull cows and calf prices from the dairy herd.

All these external factors are almost impossible to counter by milk producers or even processors unless they up sticks and relocate to an EU27 country. They have to look within their businesses to find mitigating actions that will minimise the damage while trade solutions are found. For the individual farmer it will be a case of get bigger or get closer to your retail customer or best still a combination of both. For most producers it is more basic and a continuation of what they have been doing for some time. Maximise the income from the milk contract (volume, hygienic quality, milk solids, welfare and management payments). Increase the quantity and quality of forage to maximise milk from forage or stocking rate depending on system. Buy inputs cost effectively using local grain & straights. Put in the infrastructure to allow maximum lorry sizes for efficient logistics for handling feed and for feeding as well as selling milk. Breed efficient, hard wearing cows and effective cows that better suit the requirements of your contract, farm and system, minimising replacements, veterinary input and breeding costs.

When all this is said and done what we know and have always known is that the Top 25% will be OK, the middle 50% will get by, but the Bottom 25% are the businesses most likely to fail. We saw that with the price crash of 2015/16 with businesses still falling by the wayside now 3-4 years later, but then we knew it would recover when the supply side was in better balance. The difference about Brexit is that we cannot be certain that the sunny uplands beloved by politicians can be delivered in a sufficient time frame. The European dairy market will have to find a new equilibrium with import/export dynamics changed possibly for good. Markets lost will be almost as hard to recover as new markets won.

The era of free trade has been suspended by the USA if not gone for good under the Trump administration, protectionism is very hard to reign in once it takes hold. The UK seeks to become an independent champion of free trade by walking away from the world's biggest freed trade area. Historians will decide if it was reckless in the extreme or an economic masterstroke, because at the end of day 'it's always about the economy stupid.'

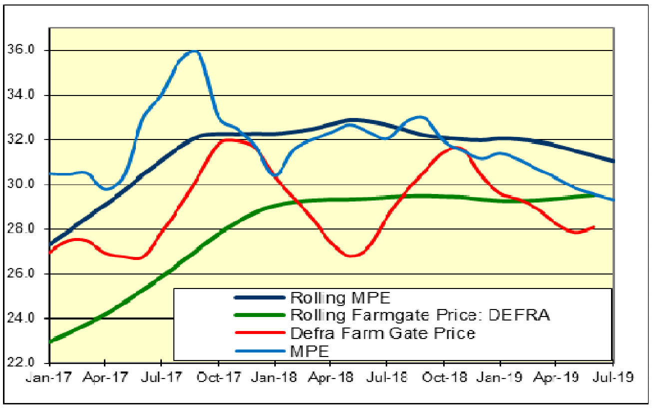


Market Prices

The Market Price Equivalent (MPE) continues to drift lower to 29.4 ppl (-0.7%, -0.2ppl). MPE is down -1.6ppl (-5.1%) in the last 6 months and down 3.1ppl (-9.5%) year on year. SMP slipped 0.6% to £1810, Butter was down -2.9% and Cream fell -2.8% as high butterfat supply continues. The weakness remains on the butterfat side of the market with proteins stable. The range across the sectors stabilised at 3.5 ppl from Liquid/Cream returns to SMP/Butter. The GDT price equivalent has climbed to 28 ppl, +3.5% in the last month, still +13.5% in the last 6 months. The UK SMP price has widened to £209/t below the GDT auction, but is £286/t above Intervention. Global supply growth has picked up in 2019, but is drifting along around 0.4% with the New Zealand drought affected year coming to an end and a recovery in EU supply to +1.4% in April. Recent high temperatures are likely to have suppressed EU production in June and July.

Farm Gate Prices

The June 2019 farm gate price has risen by 0.25 ppl to 28.1 ppl, down -2.3ppl (-7.6%) in the last 6 months, but up 0.9ppl (+3.3%) in the last year. The rolling Farm Gate price rises to 29.5ppl and continues to remain above 29ppl suggesting the milk price norms of 26-32ppl and a rolling average of 29-30ppl. The graph shows the relationship between the farm gate price and market returns over the last 2 years and the strong seasonal element in April-June. The graph suggests milk will remain above 2018 levels despite market returns continuing to drift lower each month. This is due to higher milk quality and the stability of Arla's pricing a key indicator for many basket prices.



The production in May was confirmed at 1395 M litres (+23 M litres) and June was 1285 (+16 M litres). UK dry conditions became very hot in July, but has ended in a fairly beneficial mix of weather helping grass supply recover in the drier areas for August. July production is running at +3.1% at 1270 M litres (+40 M litres) and August is forecast at 1230 M litres (+45 M litres) subject to grass supply. UK 2019/20 supply is now forecast at 15016 M litres, +1%, +144 M litres.

The UK farm gate price has followed its normal seasonal pattern and risen to 28.1ppl in June and is expected to rise with better milk quality and seasonality payments towards 29ppl in August/September.

Boris Johnson has hit the ground running both promoting the chance of a Brexit deal while preparing full steam ahead for a no deal brexit. Sterling is in the firing line down to £/€1.09 and £/$1.21 at end of July. Currency deflation will increase inflation as the £ buys less $ related inputs such as oil and proteins. On the flip side milk prices will be supported while the UK remains in the EU.

Milk prices continue to be stable although reports of low margins in liquid milk is no surprise with Arla and the cheese makers providing all the support to the market. Drought fears diminished again with July's closing rain but may return again as hot weather is forecast for mid-August. The current cost of production remains high at around 32ppl and is increasingly unlikely to return to the long term level of around 30ppl."

- 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 United Kingdom market utilisation of milk. AMPE (Actual Milk Price Equivalent) also only accounts for 14% of United Kingdom milk production. The MPE provides a far superior indicator of the wholesale value of milk and therefore the likely market returns available to the dairy farmer.