PRESS INFORMATION from
The Dairy Group

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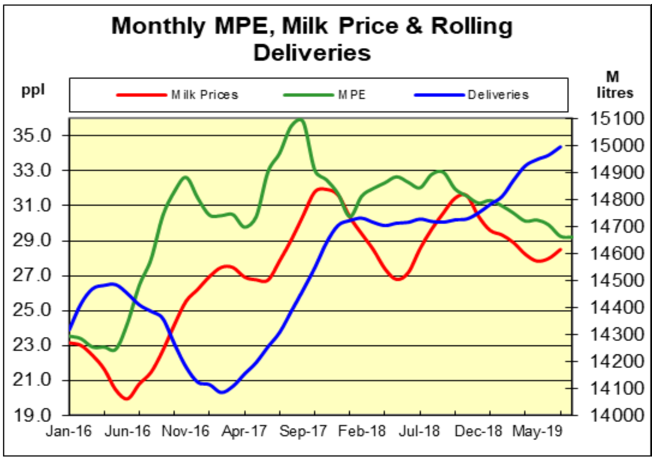
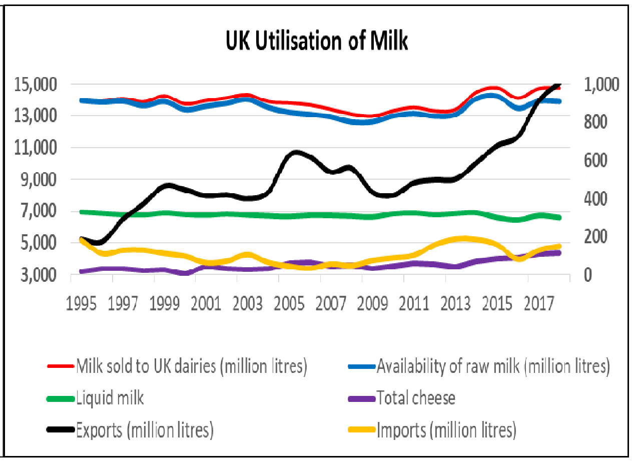
The Market Price Equivalent (MPE) Update August 2019

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

Market returns at their lowest for 3 years

"The MPE has fallen to its lowest level for 3 years." says Nick Holt-Martyn of The Dairy Group. He goes on to say "Milk prices have been remarkably stable although the range between milk processors has ebbed and flowed through this period. The milk price gap between the two largest processors Arla and Muller (non-aligned) is 3.3ppl and Arla is now 12.8% higher. While their product portfolios and import/export models are different the UK market is breaking up into distinct sectors. Aligned, cheese, non-aligned and commodity sectors are all driven by their market returns, but are still related by the overall tone in the market.





Source: The Dairy Group, AHDB and Defra

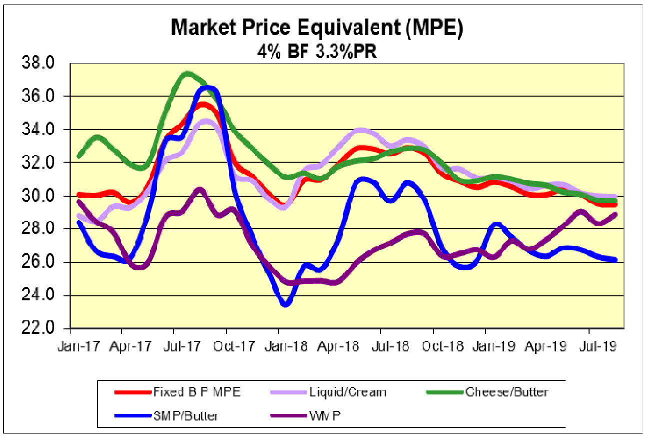
The graph on the left above shows the relationship between MPE, milk prices and milk supply since January 2016. The relationship between supply and market returns is a fairly clear inverse relationship as we have come to see since deregulation in 1994. The recent sharp rise in supply since the end of the 2018 drought, which is easing off in August, would have been expected to weaken market returns as we have seen. The movement in milk prices which have been relatively stable, operating seasonably between 27ppl and 32ppl, have yet to respond overall. Indeed the seasonal milk price trough in May 2019 was higher than 2017 or 2018 despite markets reflecting the rising supply. Individual prices are showing some degree of change with those on non-aligned contracts and more commodity based contracts falling compared to the stability of Arla and Saputo.

The graph on the right above shows the utilisation of UK supply since 1995. Imports and exports are shown on the right hand scale with other parameters on the left. The stand out feature is the rise in exports with the relative stability in the main sectors of utilisation. Liquid utilisation has stayed around 6.6 billion litres for over 10 years, Cheese utilisation has risen 25% to 4.4 billion litres, Exports +93% to 1 billion litres of milk exported , surpassing milk used for SMP, WMP and condensed milk -18% to 1 billion litres. Cream and butter utilisation is up 25% and Yogurts by 50%.

So despite liquid being the dominant user of UK milk, it has seen no growth in 10 years despite very low prices and precious little margin for processors. In the last 10 years retailer prices have fallen by 33% as the large processors have fought for market share by conceding margin to their customers which they have passed on to consumers. Liquid milk has never been cheaper and yet growth in volume has remained elusive. By comparison cheddar has retained its price and enjoyed significant growth. Muller appear to be suffering from a lack of diversity in their product portfolio with aligned contracts being protected while the non-aligned suppliers are fully exposed. Arla are benefitting from their mixed portfolio and trans-EU business model. How this will fare after Brexit remains to be seen, but for the moment they are delivering a stable and competitive price to their members. In the non-aligned sector liquid milk has been demoted to a basic commodity.

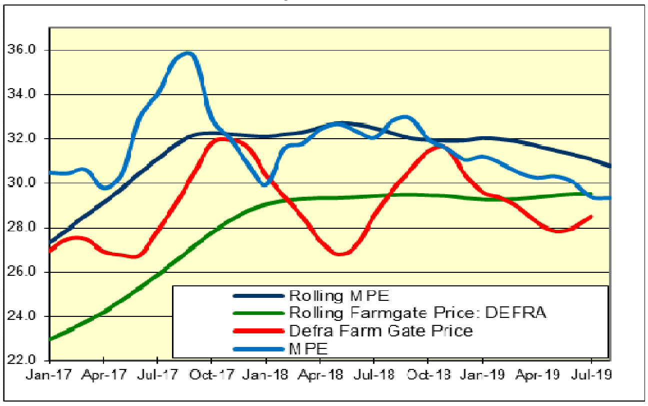
Global supply is very benign (-0.1%) with the EU recovery from the 2018 drought faltering despite a strong performance from Eire, UK, Poland and Belgium, countered by supply weakness from France, Germany and Netherlands. The UK MPE has benefitted from a 34% rise in SMP returns countering a decline of 37% and 40% in Cream and Butter respectively. Liquid has remained stable while Cheddar prices have fallen by 6%. So a mixed picture on supply and the same on market returns, but any market developments are likely to be over shadowed by the eventual Brexit outcome.

Production costs have risen by 5.7% to 33.5 ppl resulting in a fall in profit after family labour of 1ppl to -1.3ppl. The cost of production has risen by 13.2% in the last 2 years with feed costs up 26%. The only defence against the potential turmoil outlined above is to bear down on production costs and only those with the lowest production costs will endure the future challenges.



Market Prices

The Market Price Equivalent (MPE) continues to drift lower to 29.4 ppl (-0.2%, -0.05ppl). MPE is down -1.1ppl (-3.6%) in the last 6 months and down 3.5ppl (-10.5%) year on year. SMP climbed 2.2% to £1850, Butter was down -4% and Cream fell -0.7% as high butterfat supply (+4% YoY) continues. The weakness remains on the butterfat side of the market with proteins stable. The range across the sectors stabilised at 3.9 ppl from Liquid /Cream returns to SMP/Butter. The GDT price equivalent has climbed to 28.1 ppl, +0.4% in the last month, still +7.3% in the last 6 months. The UK SMP price has narrowed to £186/t below the GDT auction, but is £299/t above Intervention. Global supply growth has slowed to -0.1% with weakness in EU supply to -0.3% in June, but is expected to recover in late summer/autumn.



Farm Gate Prices

The July 2019 farm gate price has risen by 0.5 ppl to 28.5 ppl, down -1.1ppl (-3.7%) in the last 6 months, down 0.05ppl (-0.2%) in the last year. The rolling Farm Gate price rises to 29.45ppl 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 to June. The graph suggests that the UK average milk price will remain above the 2018 level 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 which will cause difficulties for smaller processors in the cream and butter sectors.

Production in June was confirmed at 1285 M litres (+16 M litres) and July was 1261 M litres (+31 M litres). UK weather has remained warm with sufficient rain to ensure a recovery in grazing, but despite this supply has eased back. August production is running at +0.6% at 1203 M litres (+7 M litres) and September is forecast at 1160 M litres (+6 M litres) subject to grass supply. UK 2019/20 supply is now forecast at 15000 M litres, +0.9%, +128 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. Brexit confusion continues with alternatives to the backstop yet to materialise. Sterling remains in the firing line dipping down mid-month before recovering to £/€1.10 and £/$1.22 at end of August. Milk prices for September have started falling in the non-aligned liquid sector with Arla and the cheese makers still providing all the support to the market. Weather has less of an impact but remains benign. The cost of production results show +5.7% rise to 33.5ppl in 2018/19 and a decline in profit after family labour to -1.3ppl. Returning to the long term level of around 30ppl seems unlikely. Brexit uncertainty over agricultural markets will continue and new migrant rules means labour supply is a key issue on many dairy farms."

<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**