PRESS INFORMATION from

The Dairy Group

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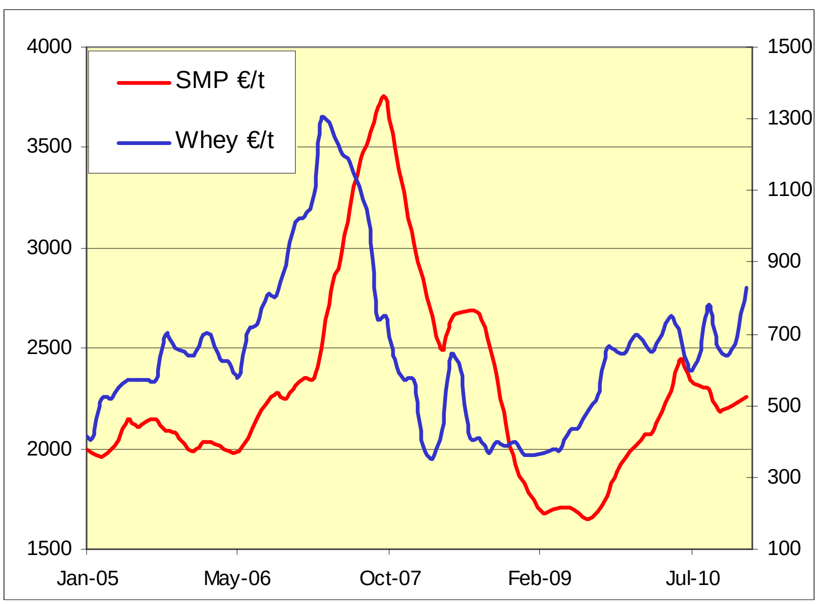
The Market Price Equivalent (MPE) December 2010

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

Milk price increase still not covering higher production costs

"Farm gate price is on the increase from two drivers ~ higher commodity values and increased production costs." says Nick Holt-Martyn, Director of The Dairy Group. He goes on to say "So far we have seen price increases from the farmer co-ops and many cheese makers of around 1ppl, but most non aligned liquid contracts have not seen any increase. We forecast a production cost increase in the year to March 2010 of 1.7ppl with the average cost of production increasing to 30ppl. Meanwhile the commodity markets continue to firm on the back of adverse weather in the southern hemisphere, so those linked to commodities are seeing the benefit.

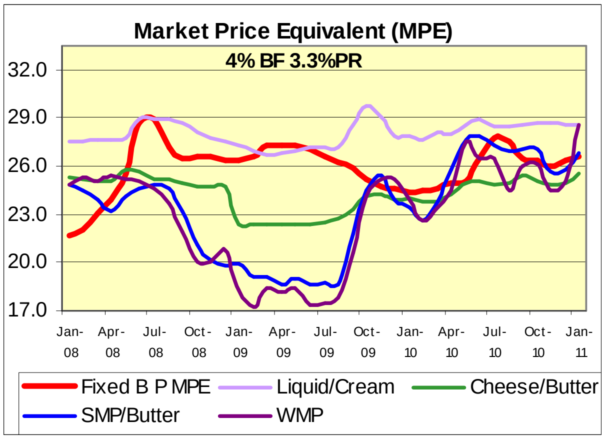
As the graph shows the commodity market is not yet at the level of 2007, but there are signs that the market is on the up. Whey prices are a good indicator of where things are going and so far the trend is up, but volatile. The next move could be down, but with the weak production in New Zealand and Australia, as indicated in the Fonterra auction, this doesn't look likely.



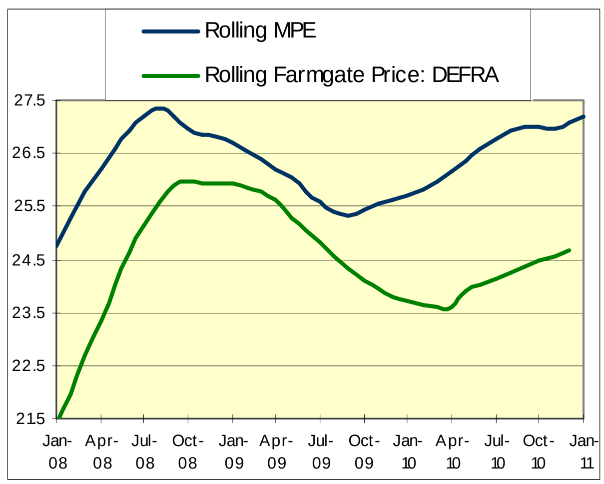
The strength in the commodity markets is now showing higher market returns than the cheese sector which is the normal prelude to sharply rising prices. With higher returns from commodities milk is switched away from cheese towards the higher returns of butter and powders. To date cheese production has been rising, but that is likely to change in 2011 as markets heat up, so even the cheese sector will be affected when stocks diminish later in the year.

In every previous cycle, as seen in 2007, the period of higher prices is characterised by an over correction in supply that leads to a collapse in prices subsequently. The spike in market prices is often triggered by adverse weather in the southern hemisphere which has a habit of recovering in the following season. It is too early to say which way this cycle will develop, but a flatter longer up swing is more likely to deliver a sustained price than a dramatic rise. This time production cost inflation will act against production rises helping to deliver the sustained increase in prices."

Market Prices



UK commodity markets are following the influence of world commodity prices by rising sharply above cheese returns. The manufacturing sector is now drawing milk away from the cheese sector which will strengthen cheese returns in the future. The Northern Ireland auction price rose to 29.16 ppl which suggests milk is beginning to be switched to the higher returns from commodities. The Market Price Equivalent (MPE) rises to 27.62 ppl, up 0.33 ppl on November, up 0.39 ppl since July 2010 and up 1.25 ppl on last year. The combination of weaker supply, GDP driven demand and general commodity inflation is leaving markets set firmly for the early part of the year. This is not a repeat of 2007 yet and there are signs it will be a more gradual and sustained price increase this time around.



Farm-gate Prices

Milk price rises are gathering pace with those closer linked to commodity markets responding first. The aligned liquid suppliers are gaining on the back of production cost inflation, with the cheese sector seeing increases of around 1ppl, but the remaining liquid suppliers have been slower to respond. The gap between market returns is still not closing so further rises are likely. So far the price increase has been around 1ppl, which is still some way short of meeting the production cost increase over the past year.

- Ends -

<u>For further information please contact:</u>

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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.