PRESS INFORMATION from

The Dairy Group

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The Market Price Equivalent (MPE) Update February 2014

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Can China dairy product consumption keep up with rising production?

"A key feature of dairy markets in the last year is the growth in dairy product imports into China following so quickly on the back of declines in production in both New Zealand and the EU" says Nick Holt-Martyn of The Dairy Group. He goes on to say "the recovery in production in the last 6 months in both these main dairy product exporters is expected to continue and markets will be dependent on Chinese consumption to maintain the current price levels.

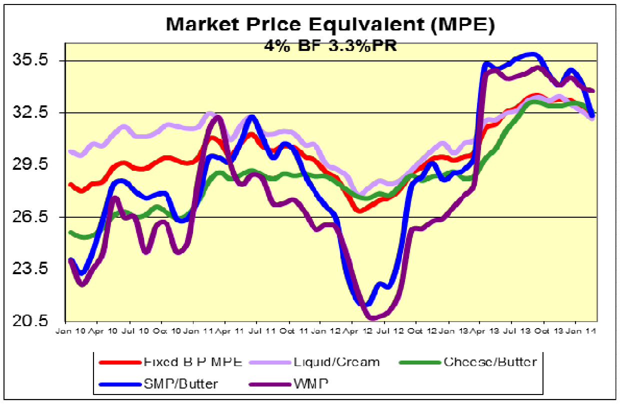
Milk Equiv. billion litres	2012	2013	Change	
China Imports	5.4	7.8	**2.3**	**+43%**
EU Exports	13.8	12.7	**-1.1**	**-8%**
US Exports	6.5	8.4	**1.9**	**+28%**
NZ Exports	19.0	19.1	**0.1**	**+1%**
Total exports	**39.3**	**40.2**	**0.9**	**+2%**

Source: DG Agri & The Dairy Group

The table above shows the relative milk equivalents of Chinese imports and the main dairy exports in 2012 and 2013. There are several points that stand out; Chinese imports are still less than 20% of the main exporters external sales, the imbalance between Chinese growth and supply growth in 2013 was +1.4 billion litres equivalent, slightly more than the contraction in EU exports and the high growth in US exports. When you consider the recovery underway in the EU and New Zealand production and the likely effect on the amount of product for export in 2014 the fragility of dairy markets to rising supply is clear. China alone can't be expected to raise its consumption just because the EU and New Zealand have a favourable milk production season, so there would appear to be significant market risks later in 2014.

The USDA Foreign Agricultural Service published its latest forecasts in December 2013 for supply and demand which shows a recovery in milk production in 2014 by 4.2 billion litres with New Zealand adding 5% and the EU 1%. China's own production is forecast to improve by 10%. On the demand side rising incomes in Asia (+4.2%) and China (+7.7%) in particular are maintaining growth in dairy demand which is holding markets stable at high levels. Chinese demand for milk powder is expected to grow by 16 to 20% which the USDA estimate is in line with both increases in production and exports from the key exporters. For 2014 at least supply and demand look set to remain stable which really means markets operating within a relatively narrow band of +/- 10% with any large movements not until the EU peak has passed and the shape of the New Zealand new season becomes apparent. With production growth expected in Australia, Argentina and India as well then supply and demand is finely balanced.

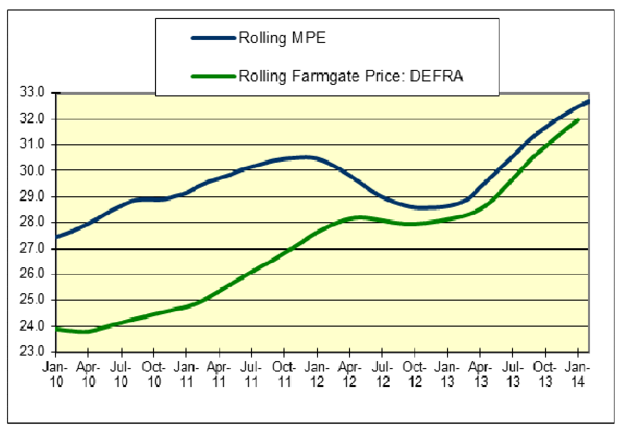
The earliest weather forecast for spring is looking decidedly average through to the end of March. Although southern Europe is enjoying better conditions there is little sign of settled weather in northern Europe, which means that the key EU milk producing countries will start the final quota year close to normal quota driven production levels. The UK should be able to maintain the current advance on last year, but this increase is likely to slacken as we pass peak production in early May and lose the weaker months of early 2013. So the expectation for UK markets is that supply will remain positive, but that EU markets are likely to exert a stabilizing influence and holding the current farm gate prices through to 2nd half of the year.



Market Prices

The Market Price Equivalent (MPE) has softened further to 32.29 ppl with further falls in cream and butter compounded by falls in SMP and mild cheddar. The range across the sectors has narrowed to just 1.6 ppl as rising supply satiates stable demand. The latest GDT auction was down -1.2%, due to butter -3.8% with SMP -0.1% and WMP -0.3%. The contract prices are mixed through to August 2014 with New Zealand product trading at a 10% premium over US, EU and Indian product. The MPE is up 2.3 ppl on the year and down 1.0 ppl since August 2013. New Zealand production finished 2013 down just 1.8% on 2012 and is still running +4% in December, and despite dry conditions is still forecast at +4%; the US is running +1.0% in January, while the EU is +0.4% and Australia -2%. Globally production is rising, but markets await the northern hemisphere spring flush for a clear supply signal for 2014.

Farm Gate Prices



The graph shows the rolling MPE starting to level off as the market returns ease back from the 2013 peak. The farm gate price is following a similar path albeit a couple of months in arrears and still heading up to a peak of around 33 ppl. The mild wet weather continues and is forecast to carry on in to March with only a subtle improvement, delaying turnout for many. The economics remain good with margins showing a strong recovery. UK production is running ahead of the 5 year average for the rest of the quota year and 2013-14 production is forecast at 13.7 billion litres, which is up 5.7% and 744 million litres above 2012-13.

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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.