PRESS INFORMATION from
The Dairy Group

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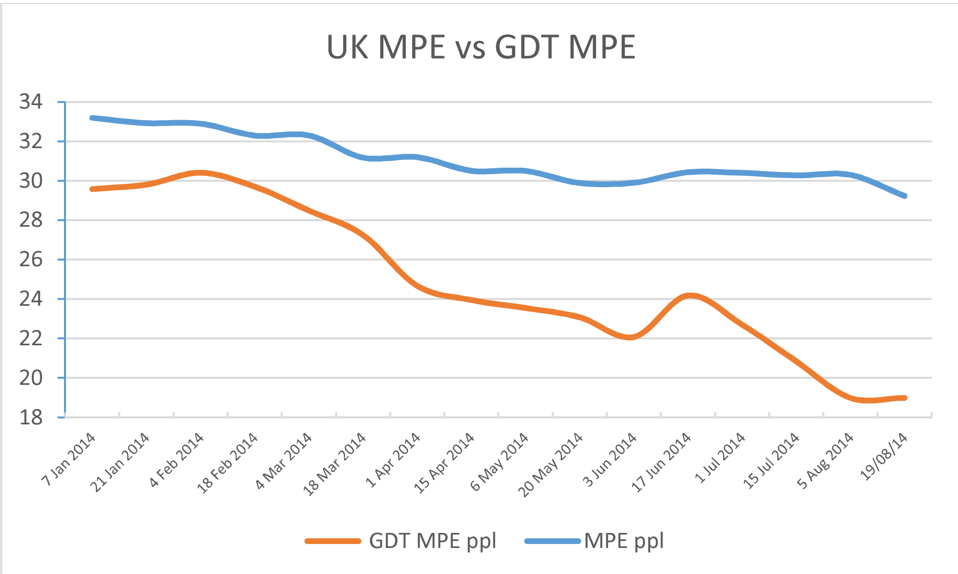
The Market Price Equivalent (MPE) Update August 2014

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

Russian ban sends shock wave through global markets

"The worsening conflict in Ukraine which sees more evidence of direct Russian involvement has prompted a dairy trade ban of at least 12 months which is only beginning to impact on milk producers in most of the world's export nations. With the EU the largest exporter of cheese to Russia, a 100,000 t trade has been stopped overnight which includes some UK processors being directly affected" says Nick Holt-Martyn of The Dairy Group. He goes on to say "if the collapse of powder markets globally wasn't enough, the usual safe haven of the stable cheese market is now rocked by the trade ban with the inevitable knock on consequences to the UK. Soothing words about the "limited impact" on UK markets are not borne out by the evidence from milk utilisations, historic trade relationships and the performance of the Global Dairy Trade (GDT) platform in recent months. Although the UK is not a major producer of commodities, 46% of the 1.1 billion litre rise in milk output in the year to June 2014 has been used for milk powders and UK product from Westbury has been sold on the GDT in recent months.



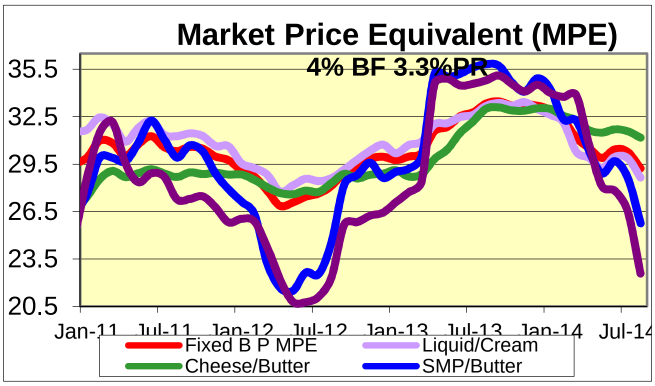
Source: The Dairy Group

The graph above shows a comparison between the weighted returns from the GDT when compared to the UK. The UK weighting has been dominated by liquid and cheese which accounts for 79% of UK supply over the 12 months to June 2014, whereas the GDT has been dominated by WMP and SMP at 82%. So it is true to say that although the GDT informs discussions in the UK and EU regarding the direction of travel of markets it is merely an indicator and not a replacement for direct UK or EU market data.

Normally events like the Russian ban balance out through the market, so that the EU's loss is somebody else's gain and dairy product will change direction, but eventually the ripples die down and markets recover. However, in this case with the EU such a major supplier and Russia banning the US, Canada and Australia as well, it is not clear from where Russia can replace 100,000t of product without significant investment and all the time and risk that entails. The Ukrainian problem shows no signs of a quick resolution and the impact of sanctions is likely to weigh on the market for some time. The EU's quick response has been to introduce storage aid for butter and SMP and to look to extend this to cheese as well. This subsidises the storage of commodities for up to 210 days without the product changing ownership. This is to buy time so the processors have a chance to find new markets, but again replacing that demand elsewhere is a tall order.

The latest cuts by Arla and Dairy Crest are indicative of the reducing market returns with Arla particularly exposed to commodity markets, while Dairy Crest less exposed to commodities, but watching their cheese returns closely in the coming months. While the MPE has dropped below 30 ppl for the first time since March 2013 cheese remains the one bright spot at still over 31 ppl. The problem Arla members have is that they receive a pan-European price that at certain times may not reflect the UK market's very domestic production. They probably gained when commodities were at their peak in 2013 having suffered previously in the changeover period from Milk Link. With markets dropping rapidly again Arla members find themselves the wrong side of the commodity markets which their price will inevitably reflect.

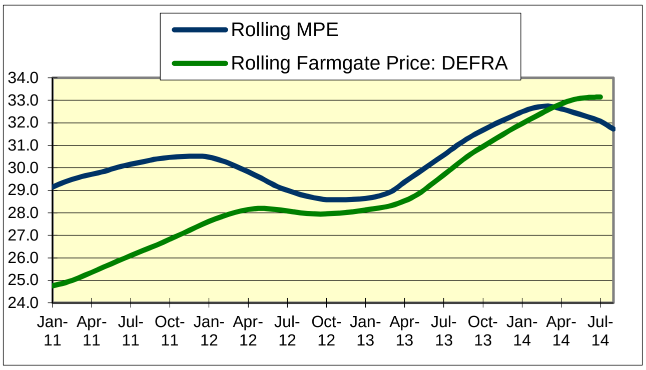
On the supply side the EU is running at +5% April to June 2014, the US +3.9% in July and New Zealand +3.8% up on June 2012. Cheaper feed prices and strong US cheese and butter prices are fuelling production increases while lower prices have yet to impact on supply in either the EU or New Zealand. Until the supply side comes back into balance with demand markets are likely to remain weak. The prognosis for dairy farm profitability for the next 12 months looks difficult with farmers having to bear down on costs and make better use of forage and cereals.



Market Prices

The Market Price Equivalent (MPE) has dropped sharply, by 1.05 ppl to 29.23 ppl with falls across the board except cheese. The range across the sectors has widened to 8.6 ppl with powders dropping sharply. The pattern is very similar to 2012. The latest GDT auction was stable overall, but SMP fell 12% while WMP rose 3.4% to leave markets balanced. The MPE is now down 4.1 ppl on the year and down 3.1 ppl since February 2014. The New Zealand production season has started in damp conditions and is up 3.9% on 2012 levels, while the EU is up 1.8 billion litres (+5%) in April to June 2014 and the US is up 0.7 billion litres (+0.9%). With the GDT already below 20 ppl (market price equivalent) the commodity markets have already reached very low levels.

Farm Gate Prices



The graph shows the rolling MPE falling as the market returns continue to drop back from the March 2014 peak, with the rolling MPE down 1.02 ppl from peak. The rolling farm gate price was at its peak at 33.15 ppl in July 2014. Production shows little sign of abating with August forecast to be 1190 million litres (+6.5%) and September 1125 million litres (+6.0%). UK production is running 9% ahead of the 5 year average and our forecast for 2014-15 at 14.45 billion litres is up 6% on the previous year. By the winter production is likely to be 5% up on 2013 helped by cheaper feed and good forage supplies, but tempered by falling milk prices.

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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.