PRESS INFORMATION from
The Dairy Group

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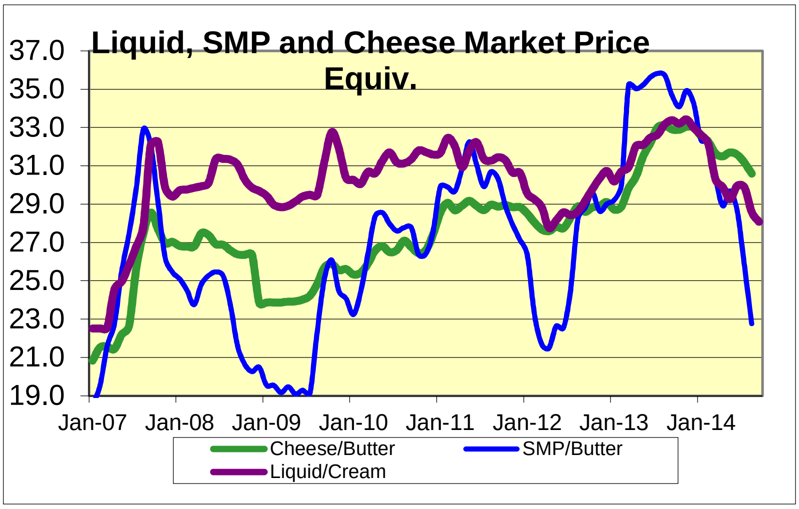
The Market Price Equivalent (MPE) Update September 2014

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

Commodity Markets Plunge

“The Russian dairy import ban is starting to bite on commodity markets in the UK with powders falling below £2,000/t for the first time since summer 2012” says Nick Holt-Martyn of The Dairy Group. He goes on to say “powders are just £50/t above the bottom reached in 2012 and perilously close to the Intervention Level. The Russian ban has added a new dimension to the global oversupply of milk which restricts the ability of processors (particularly in Europe) to move raw milk into cheese when powder supplies are plentiful. The opposite is happening with excess cheese milk switching into powder for ease of storage when powder markets are already at rock bottom. The prognosis is not good until supplies correct in response to low market returns.

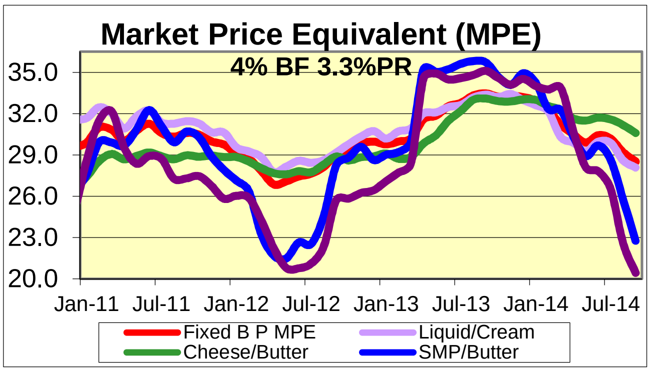


Source: The Dairy Group

The graph above shows an alarming 3 year cycle of crashing commodity markets which undermines the stability of the UK’s core products of liquid and cheese. For those saying this wasn’t foreseen, it was, over 12 months ago we flagged up the risk of excessive growth in supply on global markets. As for the opportunities of global markets, it has to be based on added value product not commodities. The world may well demand more dairy product, but only at a price it is prepared to pay and that price is usually as low as possible and that demand is inelastic. Dairy consumption is not expected to change radically with lower prices, so yet again supply is the culprit, with 12 months of unfettered growth in the major export nations and the restrictions to trade (which is what Russia’s ban amounts to) have burst the dairy bubble as so many times before.

There are differences this time which are that liquid is now a loss leader in supermarkets and mostly from protected aligned supply pools; Arla is now a UK farmer’s Co-op and exposed to the Russian import ban; and there is the Defra June 2014 Census evidence of a 2.6% increase in dairy cattle numbers. This means that UK supply is likely to remain strong with real year on year gains, liquid milk will not be setting prices, but following a lead from the usually more stable cheese sector and Arla, while not fully exposed to commodity markets, will be a weaker player due to the Russian factor. Those on formula pricing are likely to see a real test as the cost of production and commodity markets trigger lower prices.

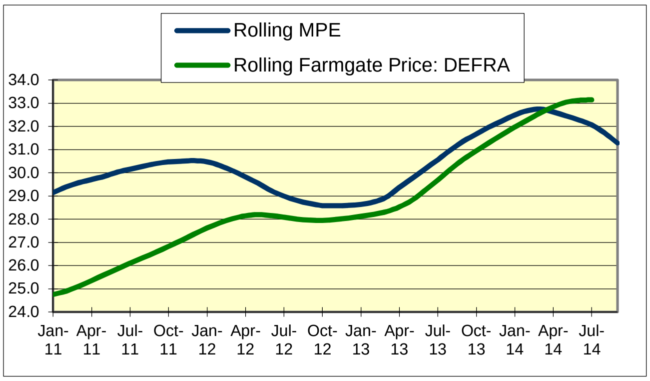
The good news is hard to find except by default the EU will get a soft landing for quota abolition, with prices so low in 2015 that expansion will be limited to the committed. Global supply has stopped rising as the EU slips back into the autumn trough months accommodating the peak in the southern hemisphere. The next pressure point is likely to be in February/March as the EU begins the climb to the spring flush. Feed costs are lower but not sufficient to counter the falls in milk price. The pressure on cashflows will increase as the winter progresses. The challenge for UK dairying is surprisingly familiar; try to contract to the more stable milk buyers in the liquid and cheese sectors and lower your cost of production to ensure viability at the bottom of the market cycle.



Market Prices

The Market Price Equivalent (MPE) has dropped again by 0.67 ppl to 28.52 ppl with falls across the board including cheese. The range across the sectors has widened to 10.16 ppl below cheese with powders dropping sharply. The pattern is very similar to 2012. The latest GDT auction was stable overall, but the forward contract declined slightly. The MPE is now down 4.95 ppl on the year and down 2.66 ppl since March 2014. The New Zealand production season has started up 5.4%, but is level with 2012. The EU is up 1.8 billion litres (+4.8%) in April to July and the US is up 2.5% in August. The GDT MPE averaged 18.1 ppl equivalent in September and seems to have little room to fall further.

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 1.4 ppl from peak. The rolling farm gate price was at its peak of 33.15 ppl in July and is expected to drop below 30 ppl in spring 2015. Production shows signs of growth again with September forecast to be 1156 million litres (+8.7%) and October 1170 million litres (+7.5%). The milk price will be putting the milk production economics under pressure for those most exposed to price cuts, while for others margins will remain good for now. UK production is now running almost 11% ahead of the 5 year average and our forecast for 2014-15 is up 7% to 14.65 billion litres. There is no evidence yet of falling milk prices affecting UK milk output.

- Ends -

For further information please contact:

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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.