EU Dairy Markets, Situation and Outlook, September 2015

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Highlights:

- EU milk production will continue to grow at slower rates. Also World milk production has slowed and is expected to grow slower than demand.
- In the domestic market of the EU modest increases of dairy consumption can be expected.
- The demand of importing countries for dairy produced in the EU will continue to grow.
- Prices of butter are moving above intervention level and a recovery might be possible.
- Skim milk powder prices will probably stay close to intervention in the next months.
- With delay cheese prices are also down at low levels and it will take time to see them recover.
- Producer milk prices will not go up in the second half of 2015.

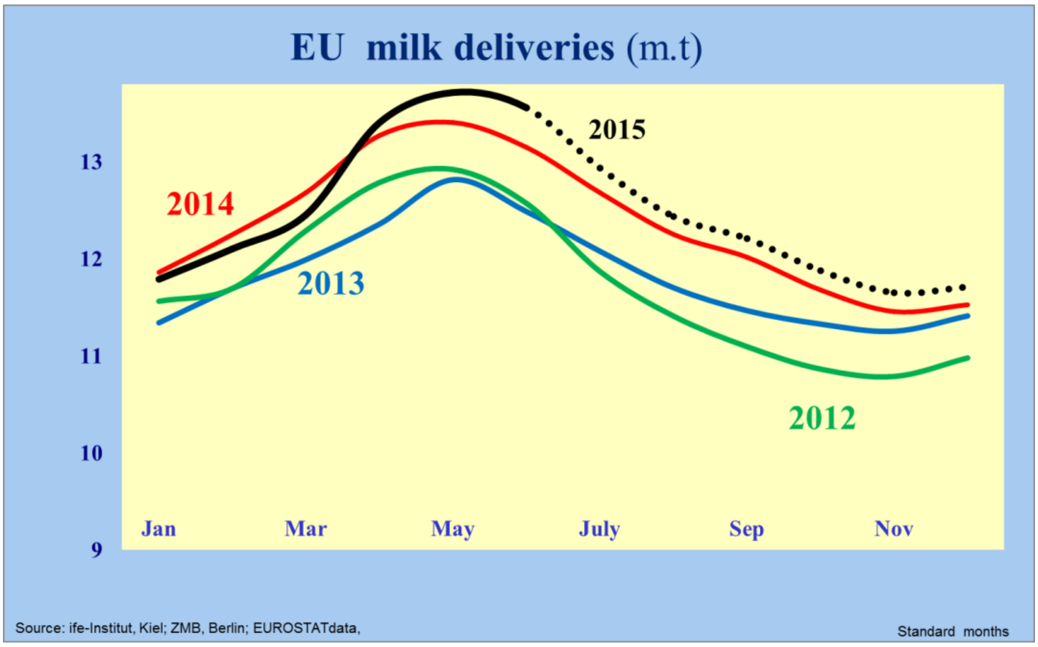
EU-milk supplies: Reduced growth compared to 2014

The situation of depressed milk prices, which are the result of expanding milk supplies and reduced demand in particular from export market destinations, is a new experience under the absence of any supply control since the end of milk quotas in the EU. The question is what might be the response of dairy farmers to the low milk prices. The now more than one year lasting downward movement of dairy product prices has not yet completely transformed itself into the farm milk prices, therefore it is hard to identify right now the expected reaction. The reasons are:

- the end of milk quotas and prior to this the efforts of curbing down milk production by more farmers than over many years before with the objective to avoid or reduce super levies

- the seasonal milk flush in spring which is still evident in milk collection statistics, which has been boosted by many farmers because of the new freedom without quotas

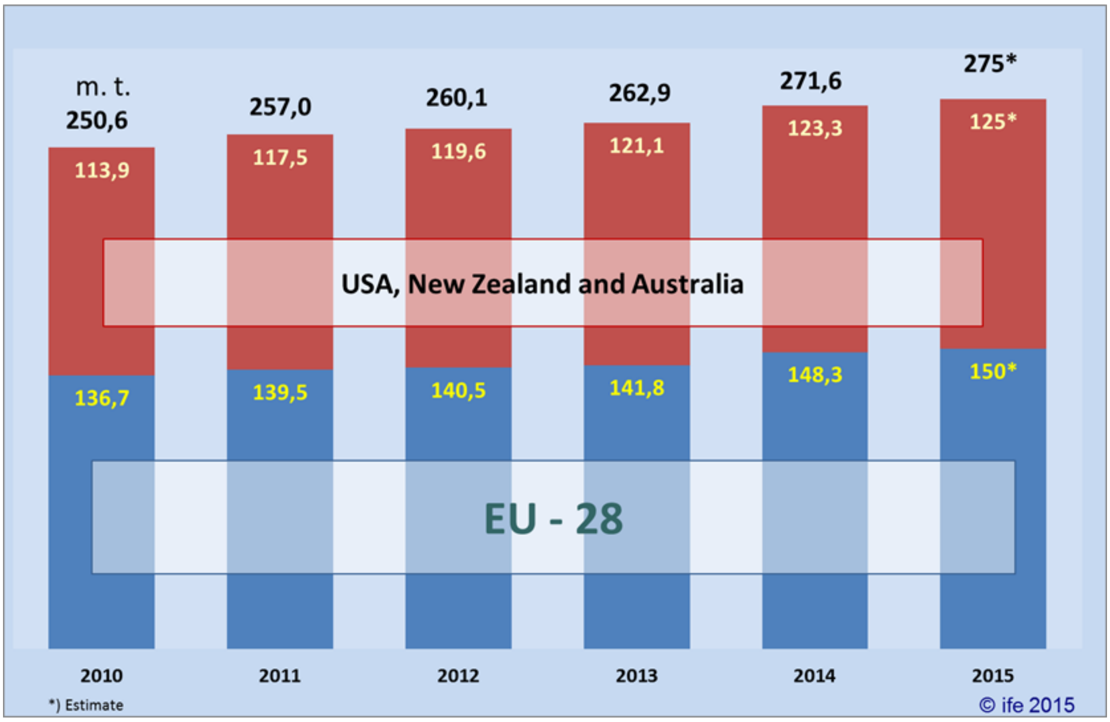
After strong efforts to curb down before the quota deadline the expansion of milk deliveries had immediately expanded in April with 1%, coming to 3% in June. In July the rate has been reduced, but it is unclear whether the extreme summer heat or the poor price prospects were the major driving force. Anyway it would be premature to see already now a clear reason for a reduced expansion in the second half of 2015 after the peak in June, but it seems to be likely that the expansion rates will be diminished. For the whole year 150million t of milk, deliveries are expected in the EU, **which is 1,7m. t more than 2014**, when the growth ended up in 6,5m. t more or 4,6%, respectively. Since 0,4 m. t more than the year before were delivered in the first half, it might be 1,3m. t more in the second half.



World: Reduced growth in all major exporting countries

Also in the other major exporting countries the growth is not only reduced in relation to last year, the rates are also expected to be more modest in the second half of 2015, which is already evident in the recent statistics on milk production in the USA. Oceania milk production is still in the early season. The expansion is expected to be weaker because of the reduced milk prices. The reported 8% growth of New Zealand milk production in June cannot be regarded as a clear indication for the time ahead since it is less than 1% of the annual production. The combined production of the three might grow by a volume of **1,7m. t**, which is similar to that of the EU.

Combined milk supplies of EU-28, USA, New Zealand and Australia



All together can dispose of milk supplies in the size of 275 million t, **1,3% more than 2014**, which is behind the average growth of production of the years before. Different evolutions are reported from other exporting countries with ongoing expansion in Belarus and Uruguay but declines in Argentina and Chile. On the part of major importers only significant increases are reported from Mexico. The situation in China is not clear yet.

Therefore it is a question of time that supply and demand will move in another relation than they have right now in the second half of 2015. Within the EU, on the medium term demand will be stronger than anticipated in earlier projections which is simply due to the larger number of consumers resulting from immigration.

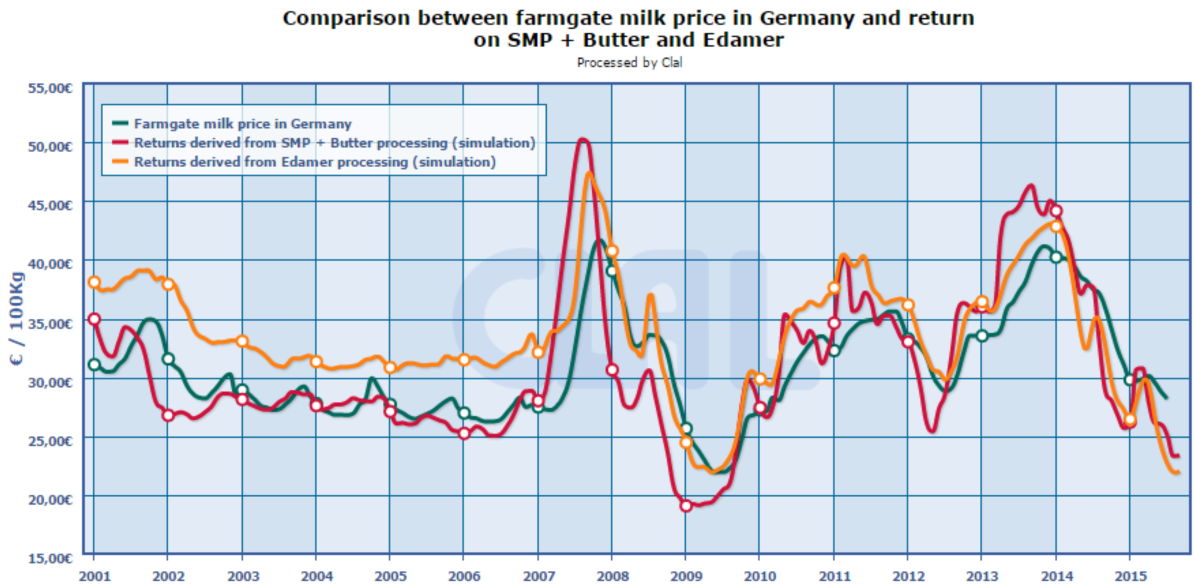
The international trade has been curbed down by the Russian embargo and reduced Chinese imports, but other markets have partly offset the losses, and the question is when China is back with strong demand, once the supposed stocks of milk powder are cleared. The prospects that Russia might come back to former import volumes are not so promising with the weakness of energy prices and the Rouble and in view of the competitive advantages of domestic producers who aim at gaining more shares in their domestic market.

An early indication of a change in the market towards more firmness might be the recovery of prices of the Global Dairy Trade at the last August and first September auctions in New Zealand, but whether this is already the change has still to be confirmed. However, with the recent slight strengthening of the Euro it seems to be hard for EU suppliers to compete. So far this year, more fluid milk products, butter and skim milk powder have been exported by the EU. Total cheese exports have been reduced by the Russian ban, but more has been supplied to other destinations.

More butter, milk powders and cheese

Following the expected, though moderate expansion of milk deliveries, more butter, milk powders and cheese will be produced in the second half of 2015 than in the year before. The fluid markets had stagnated in the first half but have been boosted in July and August by several phases of extremely hot weather in Europe. After butter and even cheese productions had grown slightly when compared to 2014, the rates will be stronger in the second half but volumes will decline seasonally. **Skim milk powder production will continue its growth over last year**. Parts of the strong milk supplies have to be cleared temporarily by the private storage scheme carried out by the European Commission and intervention buying of skim milk powder.

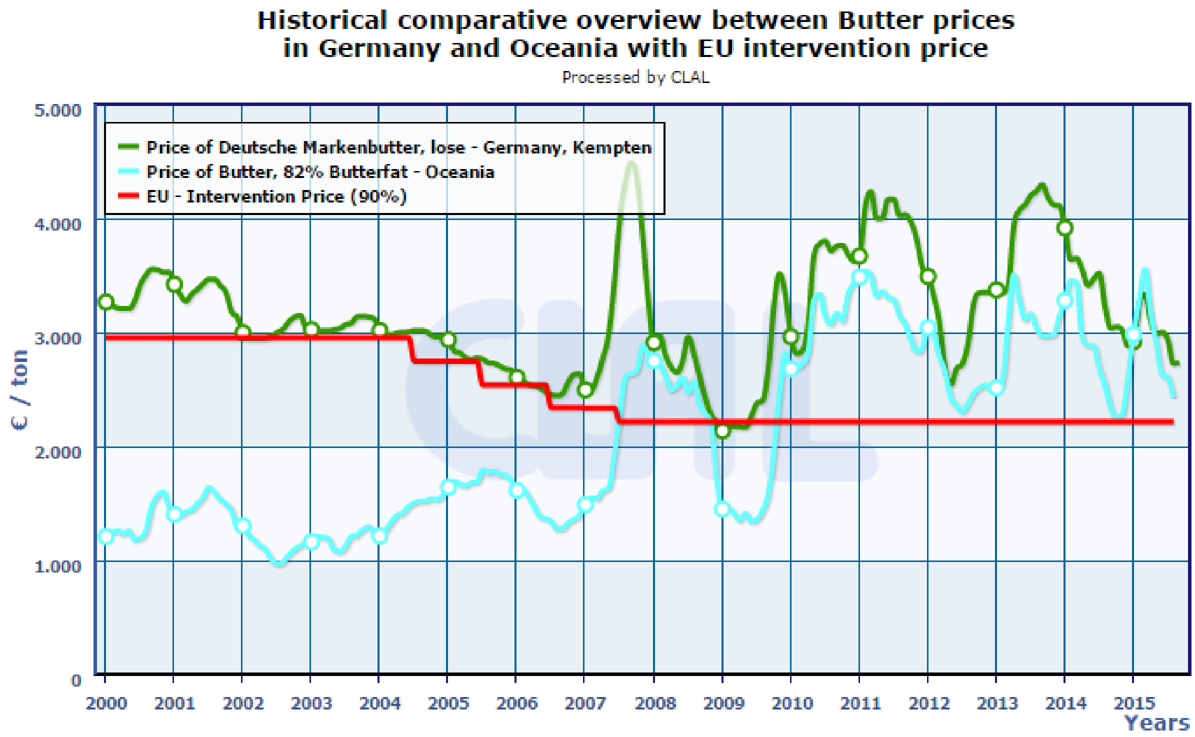
The views of buyers and sellers regarding the prospective price developments in the commodity markets are still different; consequently the business is less focussed on long term contracts for butter and milk powders than usually. But in the fluid products and cheese markets longer contracts on the basis of returns from butter and skim milk powder at present prices create a situation in which most returns from milk processing will stagnate longer times at low levels even if the commodity markets should recover. Because of the time lag to commodity prices the farm milk prices will stay at low levels or might be more reduced in the next months, against the usual seasonal pattern with milk prices going up in the second half of a year even if a recovery should occur in commodity markets.



Butter market stabilizing

The recent firming of the prices of bulk butter when the holiday season came to its end is an indication that the butter market is balanced at prices which above intervention and that towards **the end of the year a recovery cannot ruled out**. The market is mainly cleared by the private storage scheme. The assessment of the market participants seems to be driven by strong concerns regarding the prospective developments: The quantities which are physically taken into the storages always lag largely behind the quantities which are offered.

Butter prices



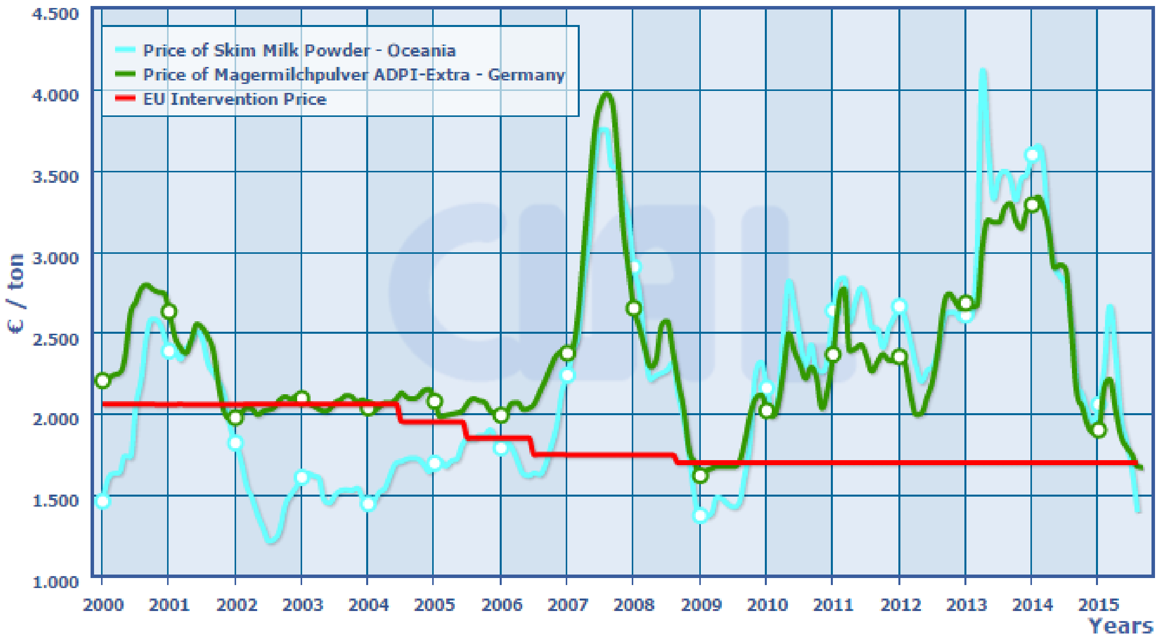
Milk powder prices stabilizing at low levels

The skim milk powder prices have obviously reached the bottom. **But if there should be a recovery it will start very slowly**. The actual sideward movement is due to the intervention in the EU which has cleared some of the surpluses on top of the volumes which have been taken into private storages with support of the EU emergency measures but could not stop the price reductions. Also here the volumes of physical stocks lag behind the offered quantities.

Now market prices are close to the intervention level. Also the recent slight firming up of **Oceania prices is an indication for more stable markets at low levels**, and it might reduce the position of many buyers to wait and see. On the side of producers the attitude might be different, since they have the option to sell to intervention or to the market at prices which are at least comparable to intervention if not even higher. EU output has been expanded in the first half of the year particularly because significantly less whole milk powder was produced. Also in the second half more will be produced and significant volumes have to be taken into storages. Therefore a significant recovery of prices within the next months is not in sight yet. It might happen with a stronger response of milk production to the low milk prices and/or when the world market is developing more demand for supplies from the EU.

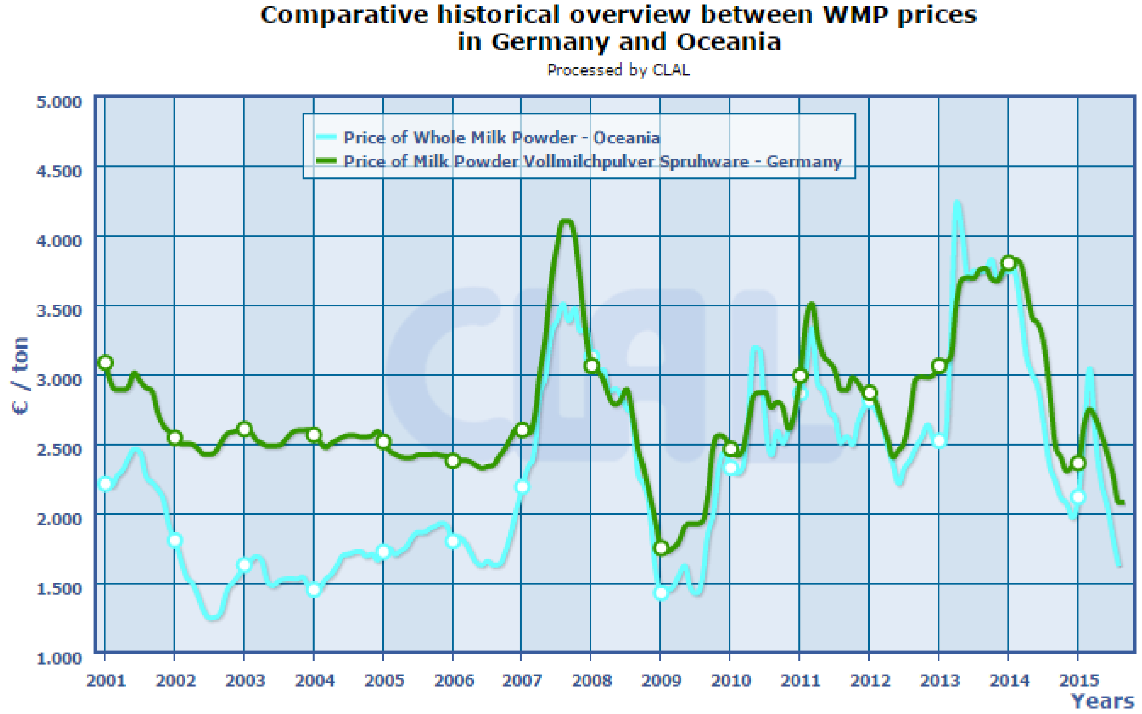
Comparative historical overview between SMP market prices in Germany and Oceania and EU intervention price

Processed by CLAL



An increase of whole milk powder prices seems to be possible if butter prices should become firmer, which should not be ruled out since here the surpluses are mainly cleared by the private storage scheme above the price levels of intervetion.

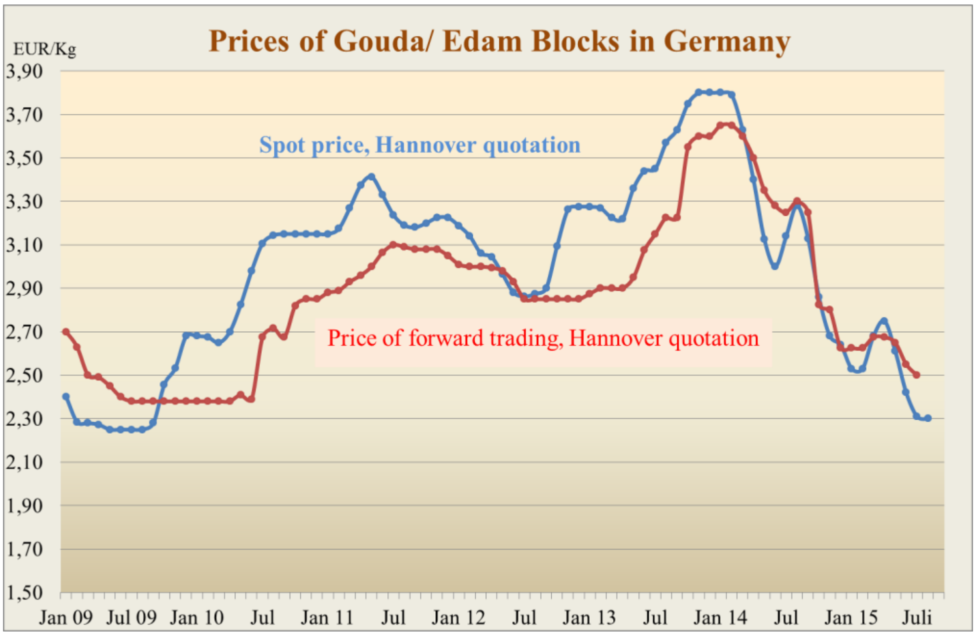
Whole milk powder prices



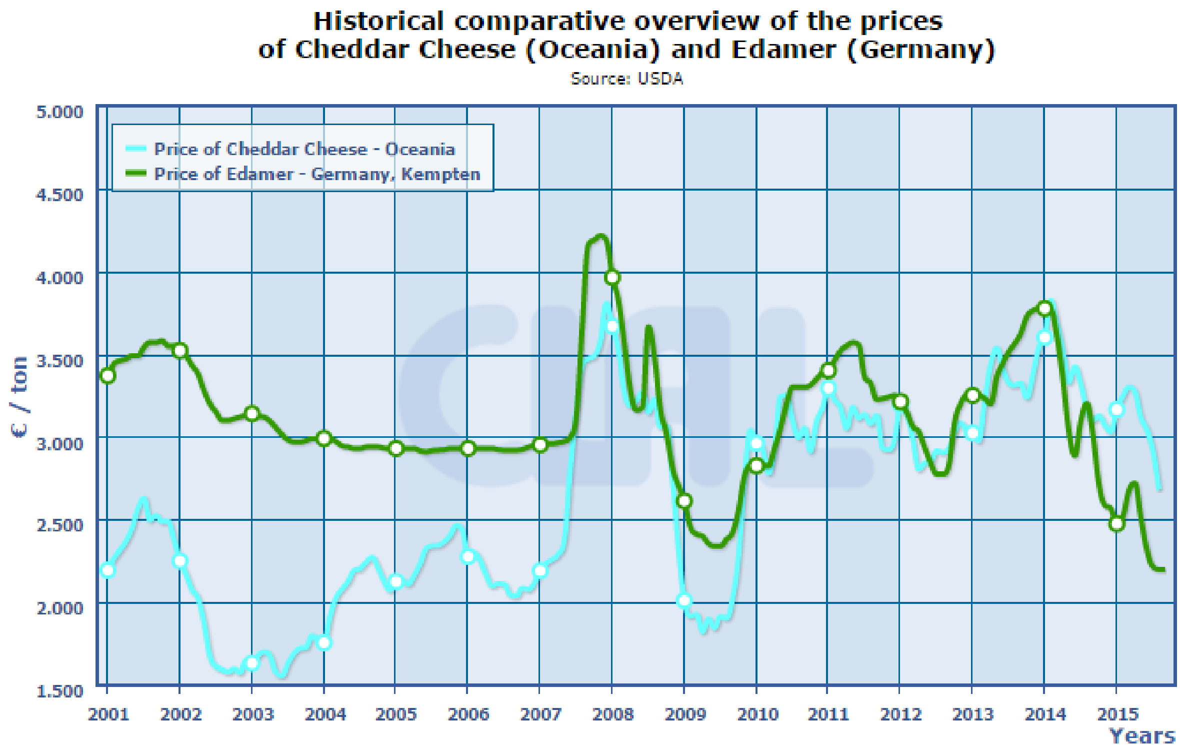
Cheese market: Increasing volumes

Surprisingly EU cheese production is expected to go up in 2015 despite the absence of Russia as former major export destination. Already in the first half of 2015 more cheese was produced compared to the first half of the year ago, when Russia was still on the market. **This increase was mainly the response to the ongoing growth of the domestic market of the EU**. For the second half more exports can be expected, as other export markets are developing. Also the reduced price levels are helpful to increase demand. But long term contracts have led in the past to a delayed reaction of cheese prices to changes in the returns from other dairy products, and that will also happen if the other dairy prices are recovering.

Prices of Gouda/ Edam Blocks in Germany



Prices of Edamer Blocks in Germany/Cheddar in Oceania



Annex

Table1

EU- Dairy Market 2009 - 2014 and Forecast 2015

1.000 t	2009	2010	*2011*	*2012*	*2013*	*2014**	*2015***
	EU 27	EU 27	EU 27	EU 27	EU 28	EU 28	*EU 28*
Milk deliveries	134.702	136.666	139.526	140.538	141.816	148.291	*150.000*
Liquid Products	44.157	44.440	44.555	44.850	45.080	44.800	*45.200*
Butter							
Production	2.050	2.010	2.080	2.010	2.015	2.095	*2.170*
Consumption	1.984	1.974	1.966	1.938	1.930	1.967	*1.970*
Cheese							
Production	9.333	9.497	9.611	9.687	9.763	9.910	*9.950*
Consumption	8.840	8.908	8.993	8.993	9.056	9.209	*9.320*
Skim Milk Powder							
Production	1.160	1.080	1.220	1.230	1.225	1.540	*1.650*
Consumption	800	805	810	810	783	800	*837*
WMP Production	735	760	750	715	750	785	*740*
Population m. head	500	501	502	504	510	511	*513*

*) Provisional. **) Forecast. *ife September, 2015*

Sources: ife, Kiel; according to EU-Milk Market Observatory, Brussels; ZMB, Berlin, own calculations.

Table 2

EU Butter Balance Sheet

1.000 t	2009	2010	2011	2012	2013*	2014*	*2015***
	EU 27	EU 27	EU 27	EU 27	EU 28	EU 28	*EU 28*
Production	2.050	2.010	2.080	2.010	2.015	2.095	*2.170*
Imports	62	40	47	56	45	52	*20*
Exports	143	161	132	128	130	150	*170*
Final stocks	135	50	80	100	100	130	*180*
Consumption	1.984	1.974	1.966	1.938	1.930	1.967	*1.970*

**)Provisional. **)Estimated* *ife August, 2015*

Sources: ife, Kiel; according to ZMB, Berlin; EU Milk Market Observatory, Brussels.

Table 3

EU Cheese Balance Sheet

1.000 t	2009 EU 27	2010 EU 27	2011 EU 27	2012 EU 27	2013* EU 28	2014* EU 28	*2015** EU 28*
Production	9.083	9.237	9.366	9.452	9.523	9.700	*9.730*
Imports	85	82	74	77	74,7	76,4	*50*
Processed cheese impact	250	260	245	235	240	210	*220*
Exports	578	676	682	776	787	727	*700*
Stock change	+0	-5	+10	-5	-5	50	*-20*
Consumption	8.840	8.908	8.993	8.993	9.056	9.209	*9.320*
-per capita (kg)	*17,7*	*17,8*	*17,9*	*17,8*	17,8	18,0	*18,2*

**)Provisional. **)Estimated* — *ife August, 2015*

Sources: ife, Kiel; according to ZMB, Berlin; EU Milk Market Observatory, Brussels.

Table 4

EU SMP Balance Sheet

1.000 t	2009 EU 27	2010 EU 27	2011 EU 27	2012 EU 27	2013* EU 28	2014* EU 28	*2015** EU 28*
Production	1.160	1.080	1.220	1.230	1.225	1.540	*1.650*
Imports	6	4	0	2	5	2	*2*
Exports	227	378	518	523	408	646	*720*
Final stocks	359	260	152	50	89	185	*280*
- in intervention	260	195	54	0	0	0	*50*
Consumption	800	805	810	810	783	800	*837*
- as Feed	*160*	165	175	160	120	120	*140*

**)Provisional. **)Estimated* — *ife August, 2015*

Sources: ife, Kiel; according to ZMB, Berlin; EU Milk Market Observatory, Brussels.

Table 5

EU WMP Balance Sheet

1.000 t	2009 EU 27	2010 EU 27	2011 EU 27	2012 EU 27	2013* EU 28	2014* EU 28	*2015** EU 28*
Production	735	760	750	715	750	785	*740*
Imports	2	2	2	2	3	1	*1*
Exports	463	447	390	388	374	393	*390*
Stock change	-55	-20	10	0	10	20	*-20*
Consumption	329	335	352	329	369	373	*370*

**)Provisional. **)Estimated* — *ife August, 2015*

Sources: ife, Kiel; according to ZMB, Berlin; EU Milk Market Observatory, Brussels.