DAIRY ECONOMIC CONSULTING FIRM
WWW.CLAL.IT

EU Dairy Markets, Situation and Outlook
January – April 2013

by Erhard Richarts, Dairy Market Consultant, Chairman of IFE (Institut für Ernährungswirtschaft e. V., Kiel)

Special report produced for CLAL

Highlights:

- Milk production in the EU will stay below 2012 volumes until spring and might later revert to expansion again. Growth in other parts of the world is also reduced.
- With reduced milk supplies and increased requirements for cheese manufacturing and fresh markets the availability of milk for the production of the exportable commodities will be lower than in 2012 until May. After that time, it could be ahead of the year 2012, but annual totals will hardly exceed those of 2012.
- In the markets of the commodities butter and skim milk powder only seasonal price reductions are possible in spring, but no cyclical turn and no buildup of year-end stocks is in sight over the year 2013.
- The recovery of the Euro rate will limit the potential for rising commodity prices in 2013. But in general dairy product prices will move above the 2012 levels, including milk prices paid to farmers.

Milk production continues to be reduced

Milk production in the EU is growing seasonally since December, 2012. But when compared to the year before, slightly reduced volumes are likely until April at least. For the first half of the year 2013, the average reduction will be 0,9%; in the semester from July through December the average reduction rate has been similar with 1,0%. In absolute terms and taking the leap day impacts into account it might be around 1,1 mio. metric tons less than in the first half of 2012. Under normal conditions this could be more than compensated by higher production through the summer and autumn ending with an increase of roughly one million tons over the year.

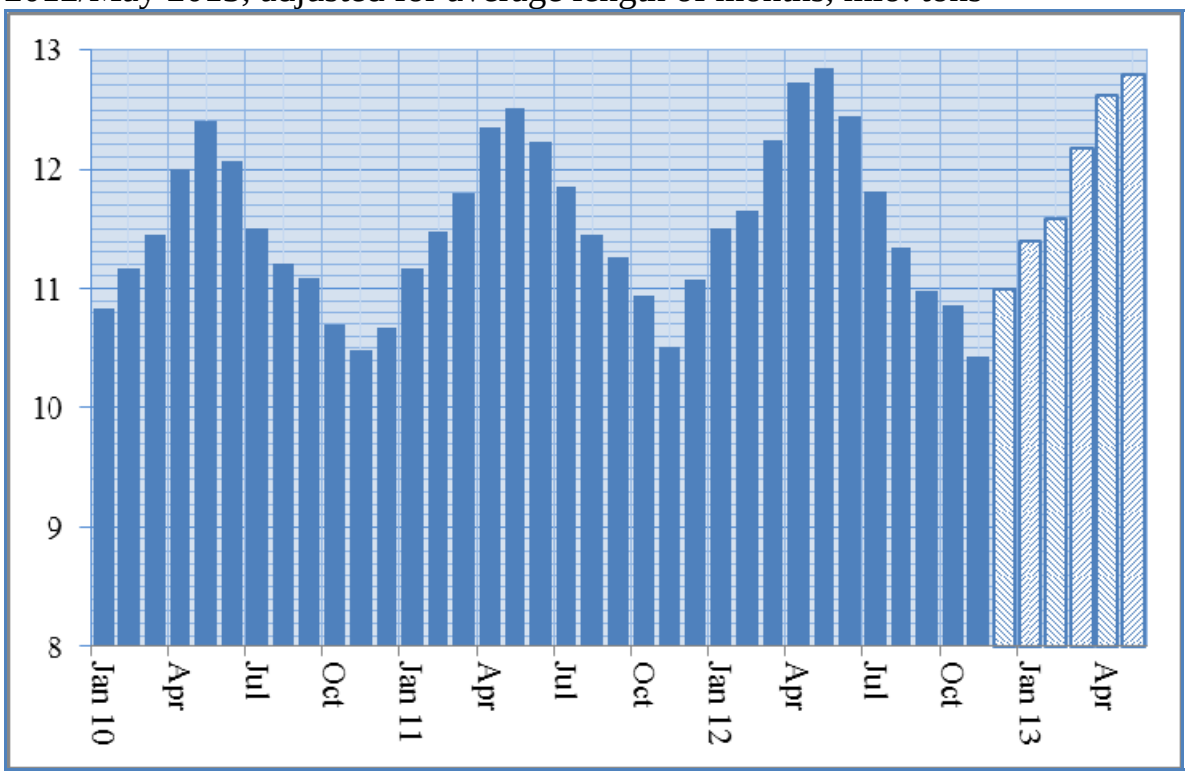
Reduced milk supplies can mainly observed in Western Europe, in particular in the United Kingdom, Ireland, France and Italy. Other areas with strong growth in the first half of 2012 have slowed down the expansion significantly. A special case is Romania where milk deliveries are reduced as many producers stop milk sales because they cannot meet the quality requirements for milk supplied to

dairies according to EU rules. The major reasons for the decline of milk production in some West Europe areas are the unfavorable conditions resulting from

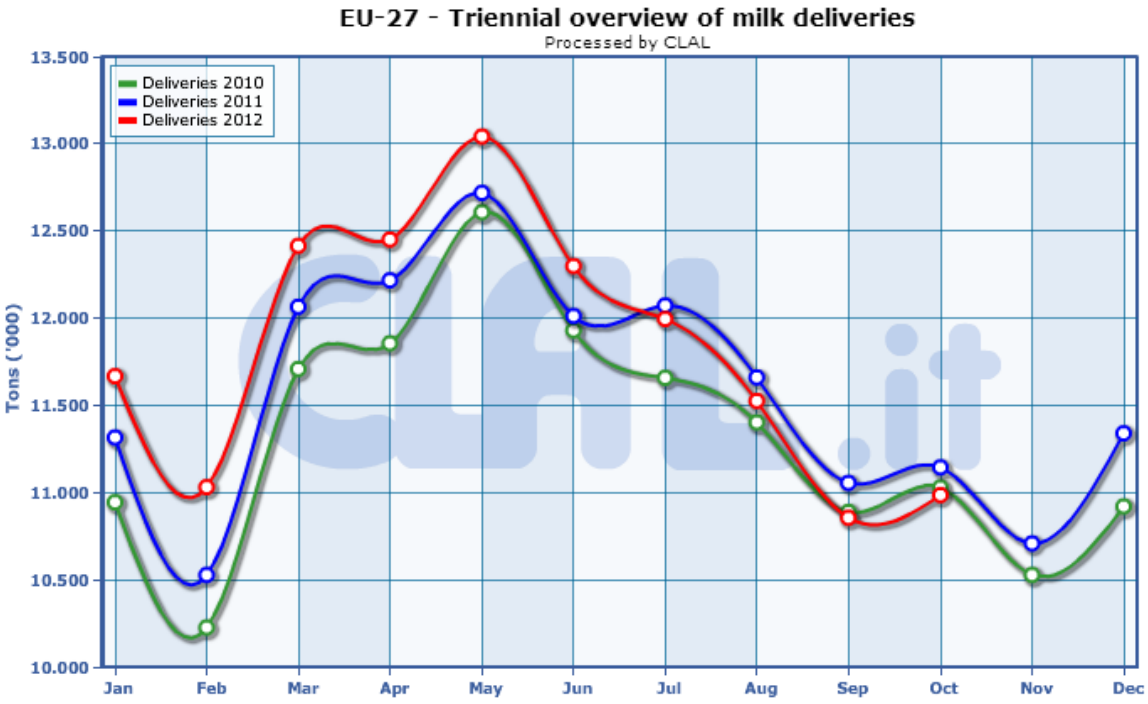
- in terms of quality and volumes poor forage supplies from the 2012 harvest,
- until recently reduced milk prices when compared to 2011 and
- increased prices for feed concentrates or their components like grain and soybeans.

The poor economic situation is likely to improve with rising ex farm gate payout prices for milk and the easing of concentrate prices. The feed situation will improve also in spring and early summer if, other than 2012, the weather conditions for the growth and harvesting of feed crops are normal, which means for many areas better than they were the year ago. Assuming this, the milk supplies of the EU will find back to growth on a year to year basis at least in the second half of the year and might end up in an increase of 1,1 million metric tons over 2012.

EU-27 Milk Deliveries, January 2010/November 2012 and estimate December 2012/May 2013, adjusted for average length of months, mio. tons

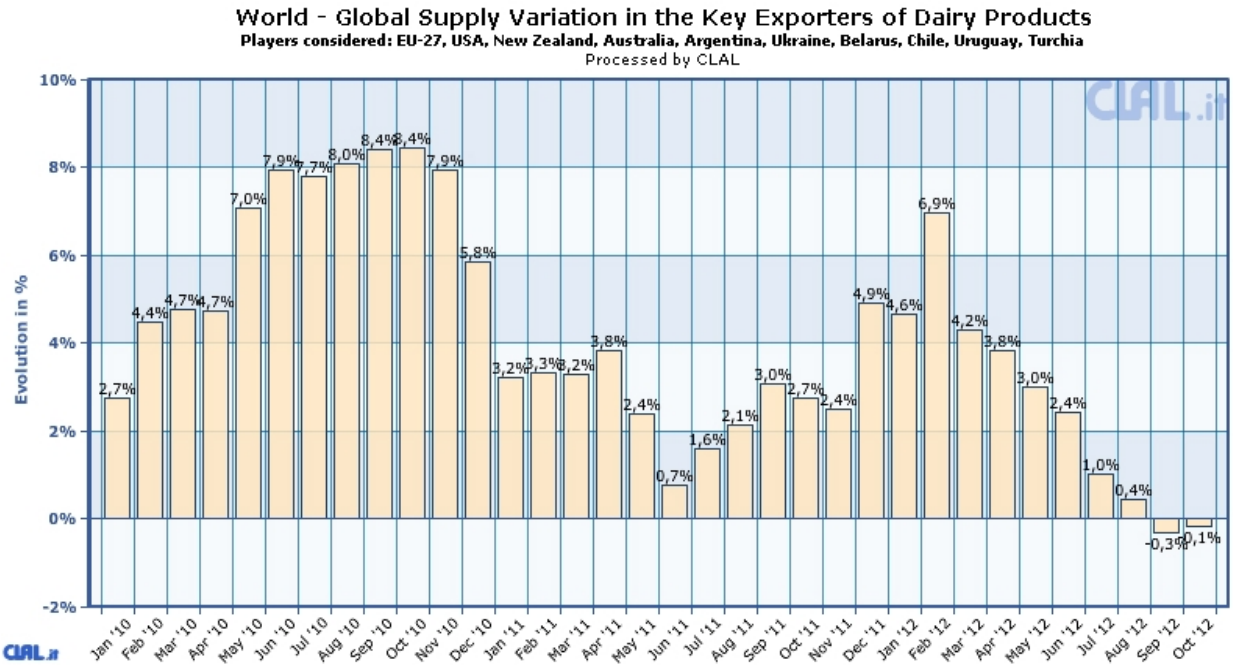


Triennial overview of EU milk deliveries (mio. t)



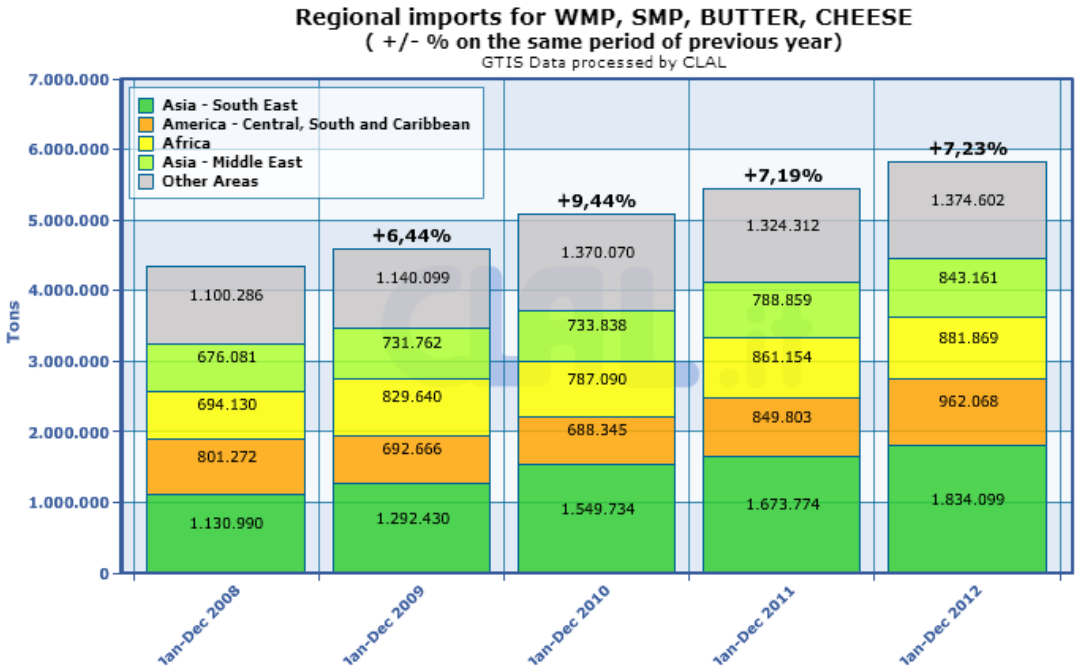
Growth of World milk production reduced, international trade in dairy products cannot hold its speed.

Also in other parts of the world expansion of milk production has been reduced, in particular the production of the **major exporting countries** with the exception of New Zealand. Here the first half of the dairy year 2012/13 saw an increase of 6%, which is ahead of earlier forecasts and is the second strong increase within two subsequent years. Lower rates are expected for the other half of the current dairy year. Australian milk production has been increased at lower rates and has trailed behind the expectations. Argentinean milk production has temporarily been reduced but a recovery is forecast for this year again. So far productions in Belarus and Ukraine continue their recovery. After expansion until mid-2012 the milk supplies in the United States oscillate around year ago volumes and this is expected to go on at least until late spring. Because of the unfavorable milk/feed price ratio a soon reverting to the former strong expansion does not seem to be likely later, and the U.S. Department of Agriculture has forecast recently an almost unchanged milk production for 2013.



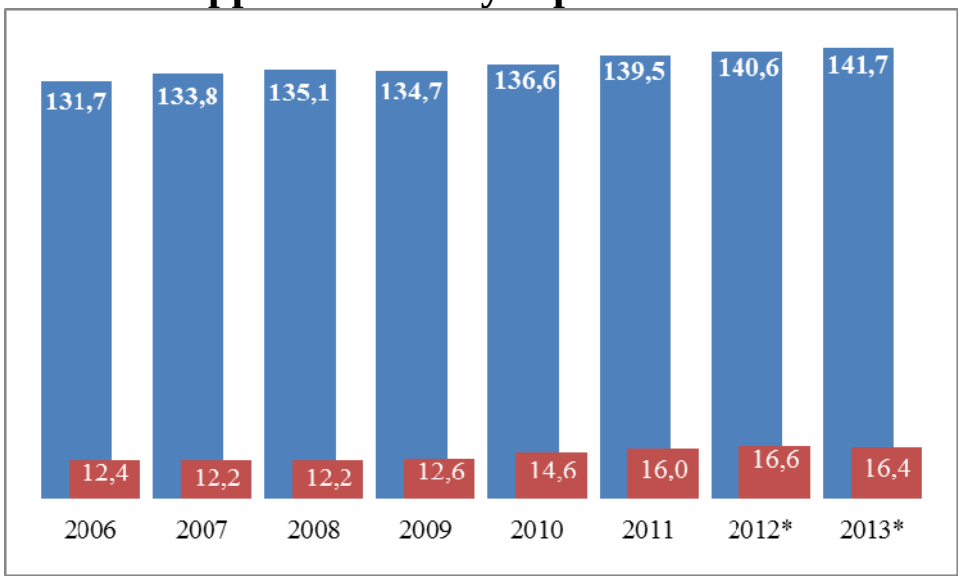
In most of the **major importing** countries the domestic milk production continues to grow modestly and not in a pace that might lead to a substantial reduction of import needs. So far many efforts of the Russian government in favor of milk production did not significantly change the situation; only small gains can be expected for 2013.

Of special interest is the Chinese situation, since China has become one of the top importing countries. Despite a strong increase of milk production, imports, notably those of milk powders and whey derivatives are expected to grow again this year, in particular because a stronger economic growth is expected. Because of their political difficulties North African and Middle East countries probably will not curb down imports.



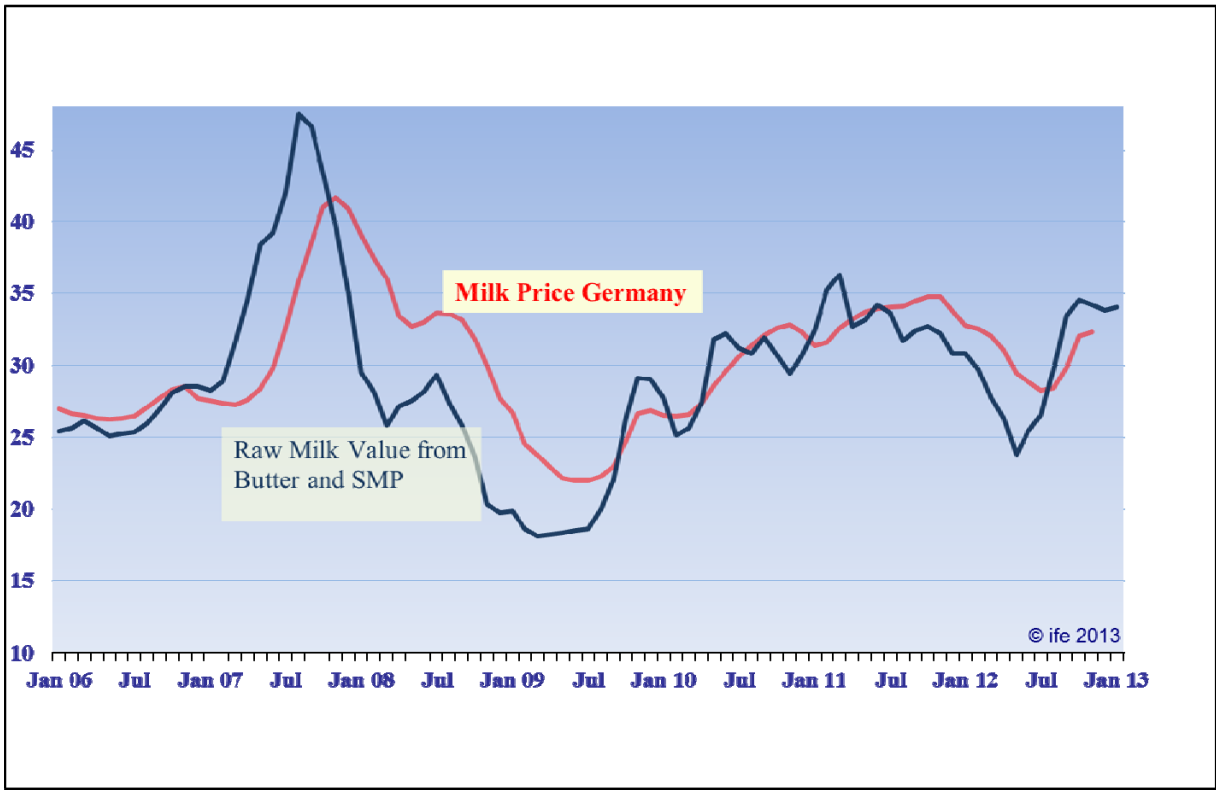
Not everywhere the economic fundamentals are the driving force of growing dairy consumption. In Europe the structural change of consumption habits in favor of dairy and in particular in favor of cheese consumption is going on, obviously regardless of the financial and economic crisis. Therefore it can be estimated that only half of the additional milk volumes will become available to produce more cheese and butter for export purposes, but less milk powders can be produced and exported. Also the United States will not be in the position to boost milk powder exports.

EU milk supplies and dairy exports



- **EU Milk Supplies**: mio tons
- **Exports**: mio tons, milk equivalent

Market return from butter and skim milk powder in Germany (Ct/kg, 3,7% fat, 3,4% protein)



Growth of trade and price movements less spectacular

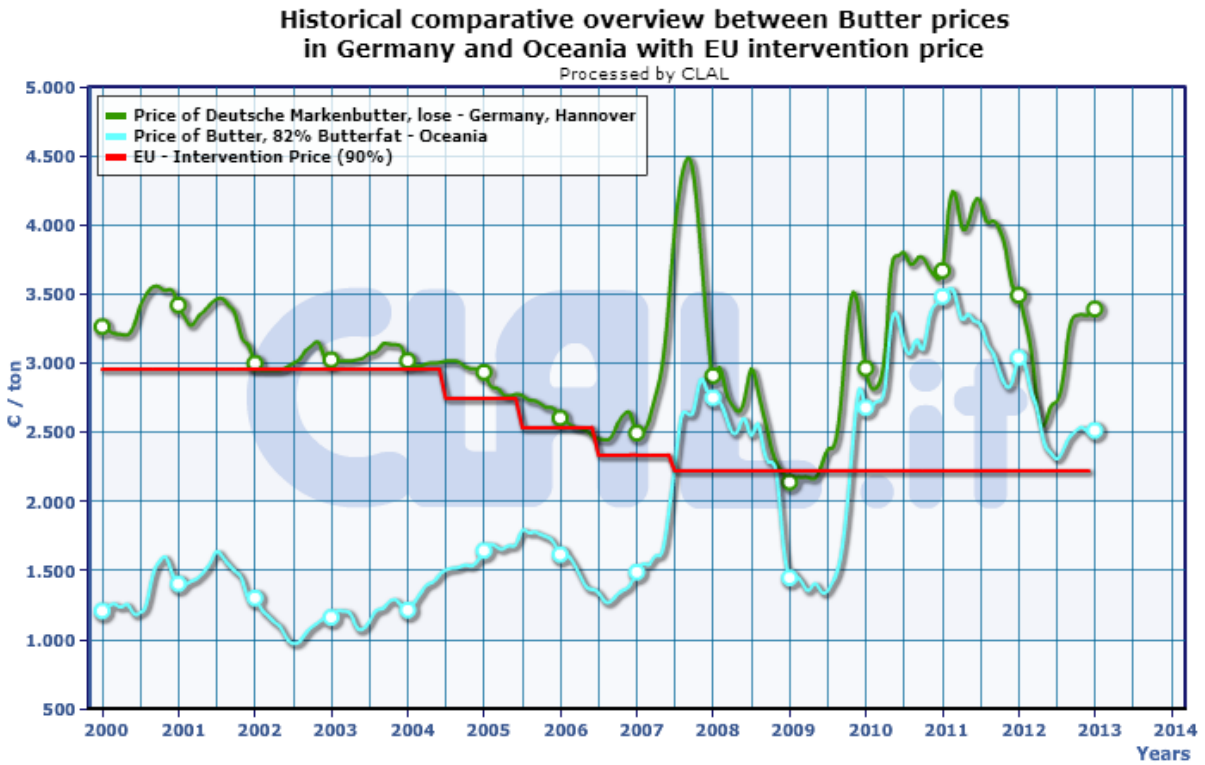
As result of the slower increase of milk production only a modest increase of the international trade in dairy products is possible when compared to 2012. This will mean that international dairy product prices will stay at high levels not only in the next months, it can also expected for the time later in the year.

However, how this transforms itself into the price levels for the major commodities like milk powders, cheese and butter in Euro terms will much depend on the currency situation and the general relation between supply and demand. The fiscal problems of the United States seem to be more dramatic than those of the Euro-Zone and this might already reflected by the recent recovery of the Euro against the US-Dollar. If this continues, the scope for further price increases in Euro terms is modest. But also the scope for a soon reduction of the European prices is poor: If the international demand for dairy is more focusing to the available supplies of the EU since not sufficient volumes can be taken from other origins, stable domestic European prices will mean higher prices

when they are expressed in US-Dollar, provided the Euro rate continues to recover or stay at levels of January, 2013.

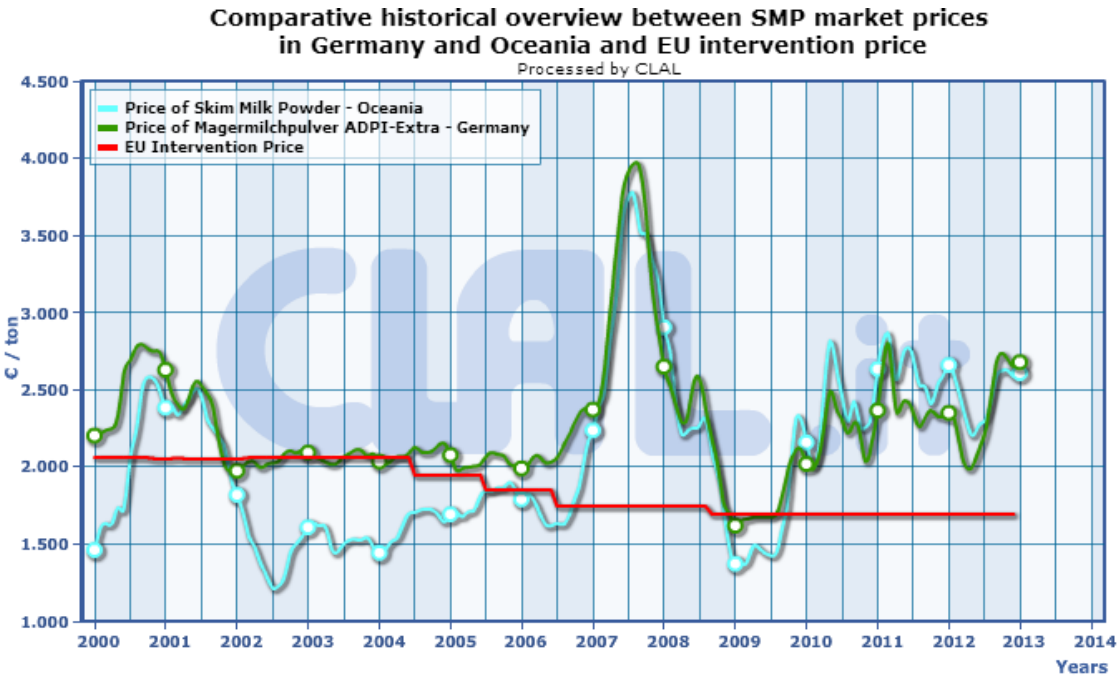
Despite temporay price reductions in spring almost firm butter market

Butter production of the EU has taken a relatively stable evolution in the recent years and the same is expected for 2013. Since the markets of cheese, liquid consumption milk and related products and the industrial use of bulk cream absorb most of the additional milkfat from increasing milk deliveries, butter production grew only modestly in the times of expanding milk volumes and has been reduced when less milk was delivered. This explains why the PSA butter stocks of 2012, which were much bigger than the years before have been cleared to almost similar year-end levels in 2013. Also the lower butter prices had favorable effects on domestic demand, whereas less butter has been exported. However, somewhat higher export opportunities can be expected in the current year because other countries might have more limited volumes on hand for export markets. At present, however, the EU supplies of bulk butter are not competitive, but this might change in spring. Temporarily lower prices in spring would also be a good incentive to balance the market between seasonal surpluses and deficits. But under the described general market conditions lower prices, should it happen, will be only seasonal rather than a cyclical phenomenon this year.

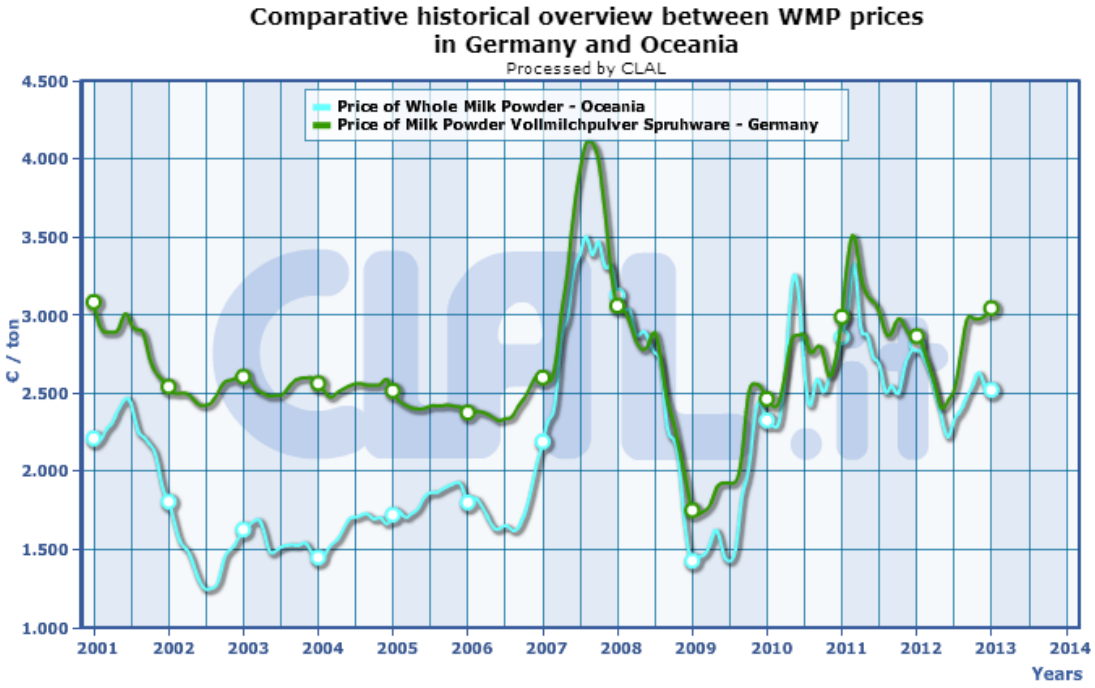


Milk Powders: Lower volumes for export

After a strong increase of skim milk powder production and exports in the first half year of 2012 both were reduced significantly in the second half, which was the result of the reduced milk supplies and the increase of cheese production. Nevertheless the year ended with substantially lower stocks at the end of 2012, and the intervention stocks which had been accumulated in 2009 were finally cleared. As no intervention stocks are available any more, even the expected increase of SMP production will not change the generally firm market situation, and the EU will not be in the position to export similar volumes as 2012. Therefore only temporary but modest price reductions could be possible in spring, if any. No buildup of year-end stocks is likely even if domestic consumption and exports are reduced.



The demand from international markets for whole milk powder continues to be strong, in particular from China. But the EU will probably not participate of this market growth by higher exports, because EU-origins continued to be less competitive The main reason is the higher value of butterfat in the whole milk powder compared to other than EU origins.



Annex

Table 1

EU Dairy Market 2007 -2012 and forecast 2013

1.000 t	2007	2008	2009	2010	*2011**	*2012**	*2013***
Milk deliveries	133.767	135.108	134.713	136.579	139.494	140.600	*141.700*
Liquid Products	44.242	43.772	44.157	44.440	44.555	44.800	*45.000*
Butter							
Production	2.110	2.100	2.050	2.010	2.080	2.090	*2.080*
Consumption	1.994	1.968	1.984	1.974	1.966	2.000	*1.990*
Cheese							
Production	9.248	9.339	9.333	9.480	9.545	9.685	*9.770*
Consumption	8.728	8.868	8.840	8.891	8.932	9.010	*9.050*
Skim Milk Powder							
Production	1.090	1.040	1.160	1.080	1.220	1.210	*1.230*
Consumption	870	770	800	800	810	810	*780*
Whole Milk Powder Production	773	835	735	755	733	700	*680*
Population m. head	495	498	500	501	502	504	*505*

*) Provisional. **) Forecast. *ife January 2013*

Table 2

EU Butter Balance Sheet

1.000 t	2007	2008	2009	2010	2011*	2012*	2013*
Production	2.110	2.100	2.050	2.010	2.080	*2.090*	*2.080*
Imports	85	65	62	40	47	*50*	*50*
Exports	211	147	143	161	131	*130*	*140*
Final stocks	100	150	135	50	80	*90*	*90*
- in intervention	0	0	79	2	0	0	0
Consumption	1.994	1.968	1.984	1.974	1.966	2.000	1.990
**)Provisional/ Estimated.*							*ife January 2013*

Sources: ife, Kiel; ZMB, Berlin; EU Commission

Table 3

EU Cheese Balance Sheet

1.000 t	2007	*2008*	2009	2010	2011*	2012*	2013*
Production	8.983	9.084	9.083	9.220	9.300	9.450	*9.530*
Imports	94	89	85	82	74	80	*80*
Processed cheese impact	265	255	250	260	245	235	*240*
Exports	594	555	578	676	682	760	*800*
Stock change	+20	+10	+0	-5	+5	-5	*0*
Consumption	8.728	8.868	8.840	8.891	8.932	9.010	*9.050*
-per capita (kg)	*17,6*	*17,8*	*17,7*	*17,7*	*17,8*	*17,9*	*17,9*
**)Provisional/ Estimated.*							*ife January 2013*

Sources: ife, Kiel; ZMB, Berlin; EU Commission

Table 4

EU WMP Balance Sheet

1.000 t	2007	2008	2009	2010	2011*	2012*	2012*
Production	773	835	735	755	733	700	680
Imports	2	2	2	2	2	2	2
Exports	366	485	463	447	390	370	350
Stock change	20	15	-55	-20	10	0	0
Consumption	389	337	329	330	335	332	332
**)Provisional/ Estimated.*							*ife January 2013*

Sources: ife, Kiel; ZMB, Berlin; EU Commission

Table 5

EU SMP Balance Sheet

1.000 t	2007	2008	2009	2010	2011*	2012*	2013
Production	1.090	1.040	1.160	1.080	1.220	1.210	1.230
Imports	6	8	6	4	0	4	4
Exports	199	179	227	378	518	500	460
Final stocks	121	220	359	265	157	60	54
- in intervention	-	-	260	195	50	0	0
Consumption	870	770	800	800	810	810	780
- as Feed	*245*	*150*	*160*	165	175	170	165
**)Provisional/ Estimated.*							*ife January 2013*

Sources: ife, Kiel; ZMB, Berlin; EU Commission