

EU Dairy Markets, Situation and Outlook

October – December 2013

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Special report produced for CLAL

Highlights:

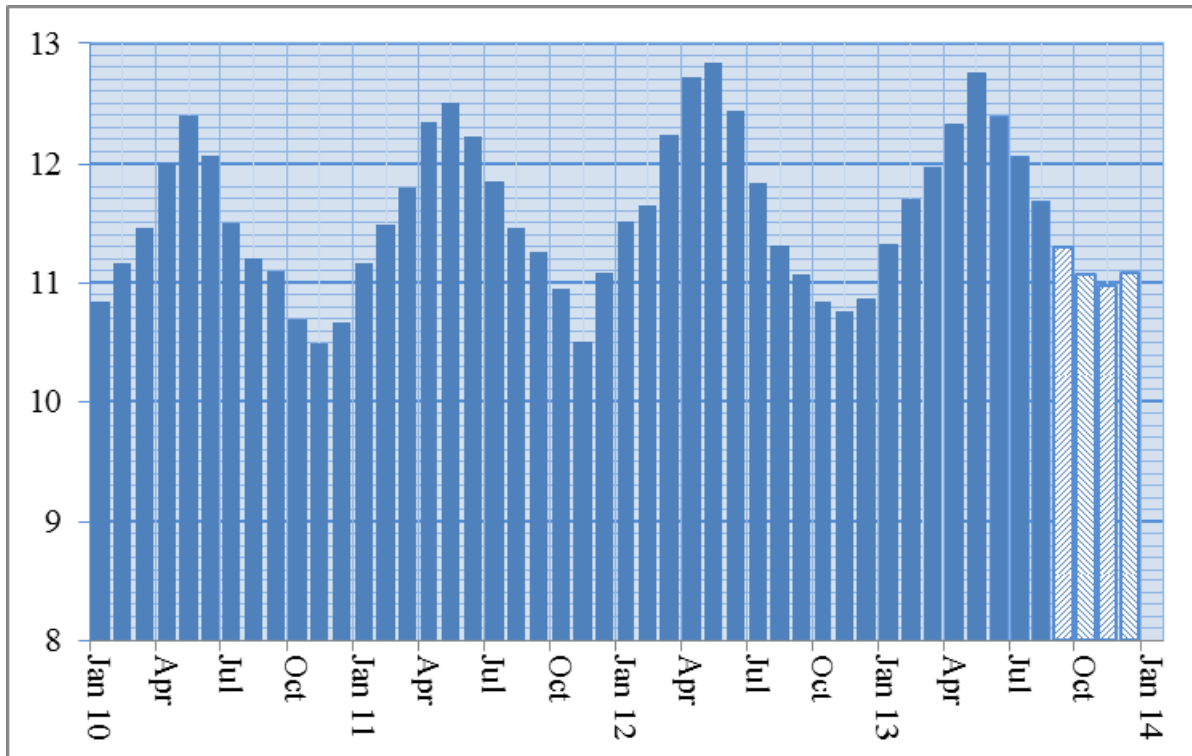
- The cyclical decline of EU milk production has already changed into a phase of expansion, but more milk will be available when the seasonal increase starts at the end of the year 2013, which might ease the short supply situation.
- Also in other major production areas of the world milk production has started to grow, but moderately in relation to the demand on the international market.
- The returns in the different sectors of milk processing are still very different: cheese and the fresh product markets still have to catch up to the returns from industrial dairy items like bulk butter and milk powders.
- Despite the expanding milk collection in the EU and stagnating domestic demand for liquid markets and cheese, supplies of butter and milk powders will grow only modestly because the expanding cheese production is driven by strong demand for exports.
- The prices of the commodities butter and skim milk powder will stay at high levels until the end of 2013. The prospects for price reductions are only small for early 2014.
- Currency rates are still one major source of uncertainty, in particular in view of the US budget crisis.

Seasonal bottom of EU milk production in November

European milk production continues to go down following the usual seasonal pattern with the bottom at the end of November. It has started to expand on year-to-year basis in July, 2013, after twelve months trailing behind the year before. Therefore, despite the growth rates which can be observed since July, an easing of the relative shortage of milk supplies will just start in December. The year was split in two halves, of which the first half was characterized by the seasonal larger production but reduced when compared to 2012. In the second half things

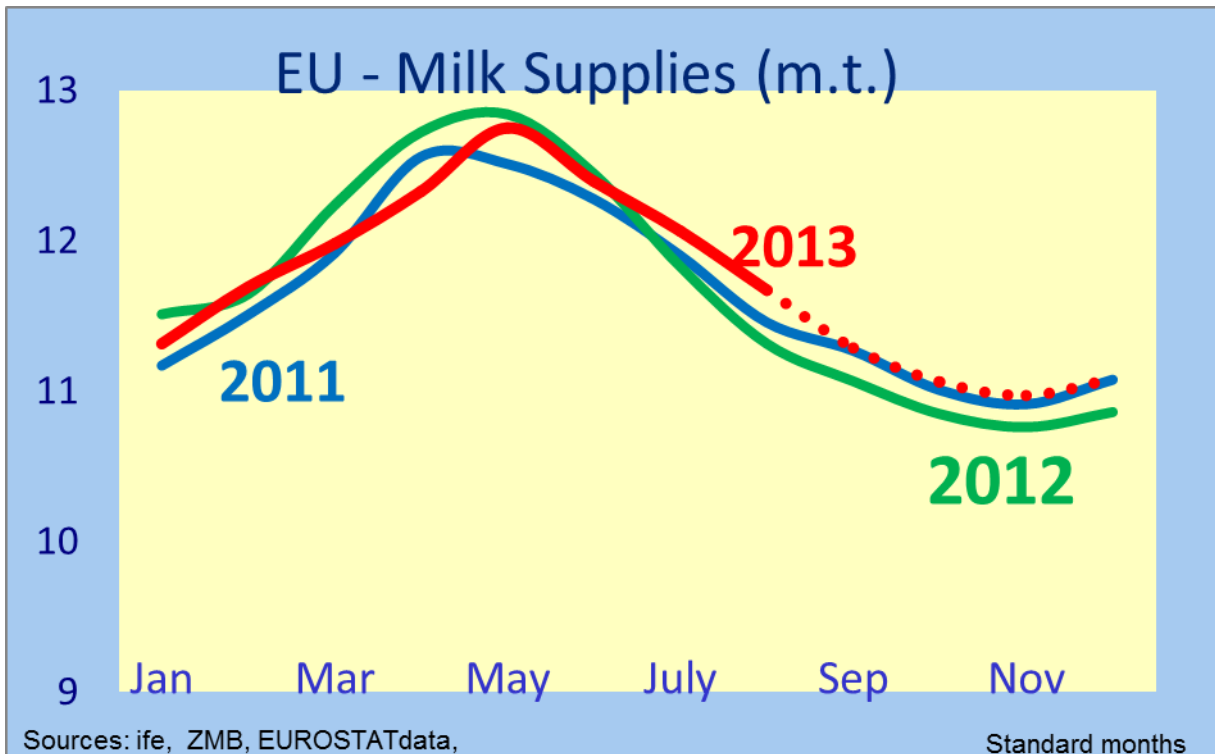
go on just the other way with larger volumes than in 2012. In particular in late July and August, the growth rates were relatively strong, which is due to the low levels just twelve months ago.

EU-27 Milk Deliveries, January 2010/August 2013 and estimate September 2013/December 2013, adjusted for average length of months, mio t.



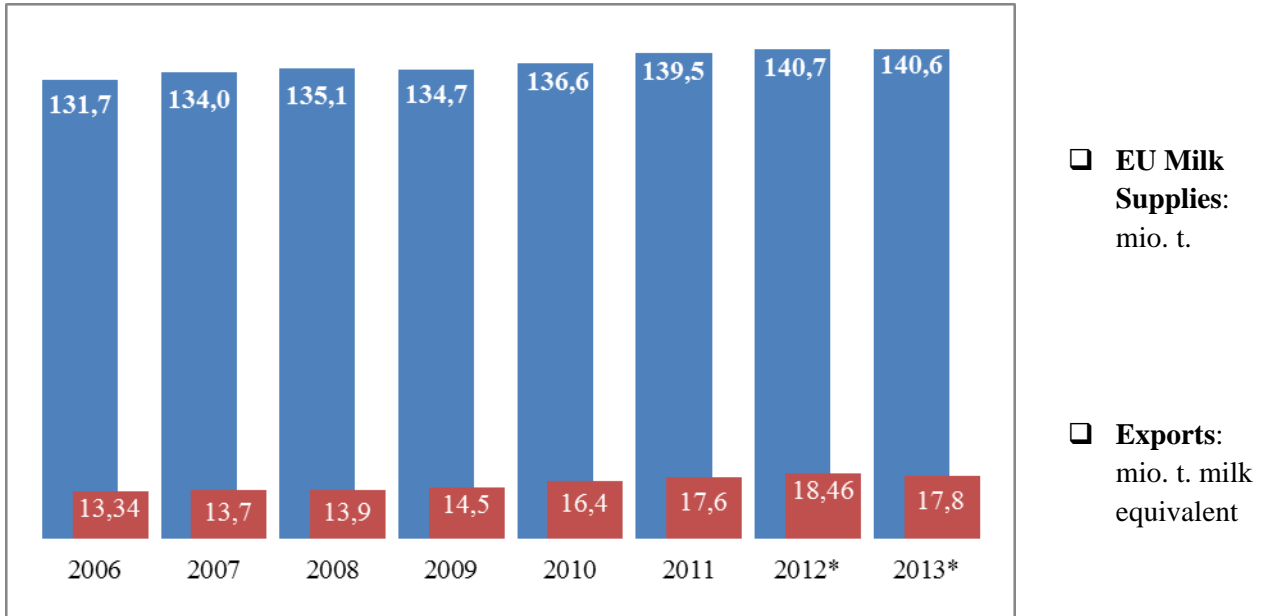
For the whole year 2013 total deliveries in the EU-27 are expected to reach 140,6 mio. tonnes, which is slightly below the volumes of the year before but is an increase of average daily milk deliveries by 0,2%. Taking into account the new member state Croatia, total deliveries will be 141,1 mio. tons.

Triennial overview of EU milk deliveries (mio. t)



Also for the first months of 2014 the expansion of EU milk deliveries will continue, but towards the end of the quota year 2013/14 in March farmers have to curb down deliveries to avoid super levy payments in some member countries, notably in Germany, the Netherlands and Austria. The economic situation of dairy farmers has improved significantly by rising milk prices and reduced costs of concentrate feed. Forage stocks for the winter period ahead are very different from region to region in terms of quantities and qualities. Therefore favourable concentrate prices are certainly highly welcomed by dairy farmers in particular in those regions with poorer basic feed supplies, be it by volumes and/or nutrient content.

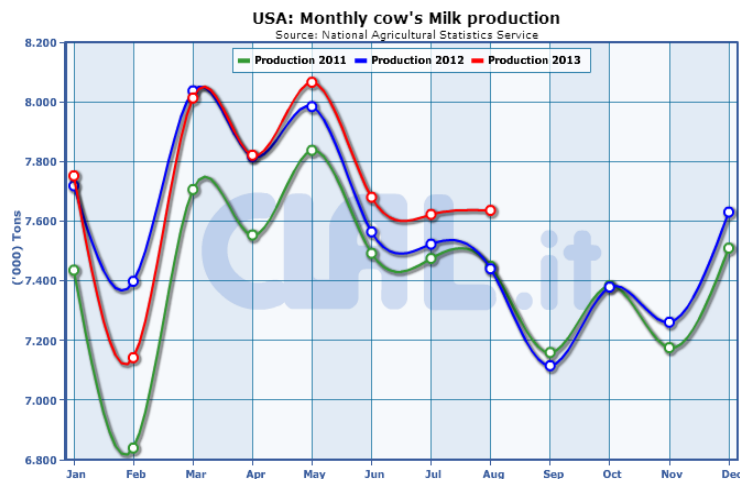
EU milk supplies and dairy exports



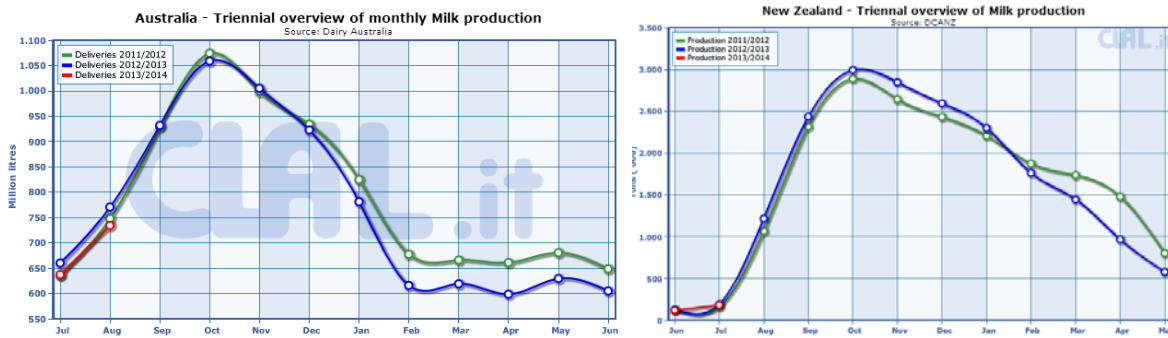
Despite reduced exports and the only small decline of milk collection, less milk and dairy products have been available for the domestic market, because no stocks were available any more as supplementary supply, as it had been the case in 2012. Statistical figures are not complete: the absence of intervention stocks is only one part of the picture. Less butter has been taken into private stores in the spring and summer, and reportedly also cheese stocks in ripening stores are significantly lower.

Moderate expansion in other parts of the world

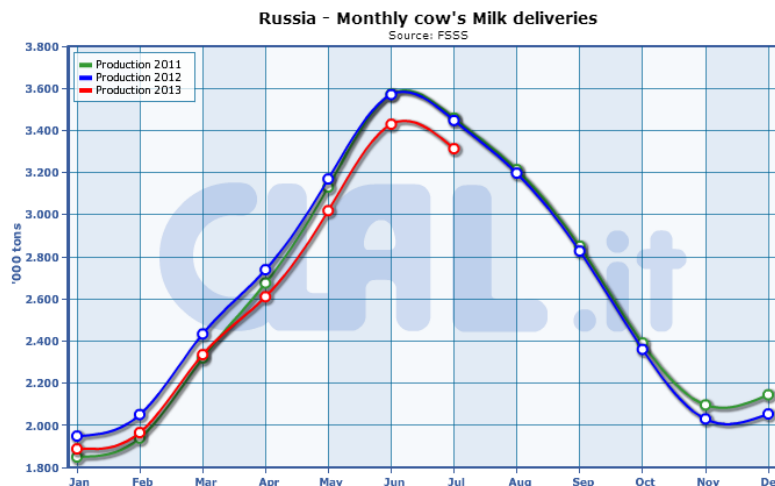
In most other areas of the world with major milk production and export capacities similar evolutions can be observed in the second half of 2013. In the **United States** milk supplies have started their expansion earlier than in Europe, but so far the rates are moderate and the USDA has recently revised down the milk production forecast.



In **Oceania** the start of the new season – June in New Zealand and July in Australia - was behind expectations. Later the expansion on year to year basis started in New Zealand with the expected growth speed. But so far the figures which are available for Australia reveal lower milk production than in July and August, 2012.



No actual figures are available for **Argentina**, but it is reported that supplies are lower than the year before. The situation in major importing countries is not quite clear. The figures which are available from **Russia** indicate a still ongoing decline.



And it is not clear whether the strong import demand of **China** for milk powders is resulting from stagnating domestic milk production or booming internal demand or both.

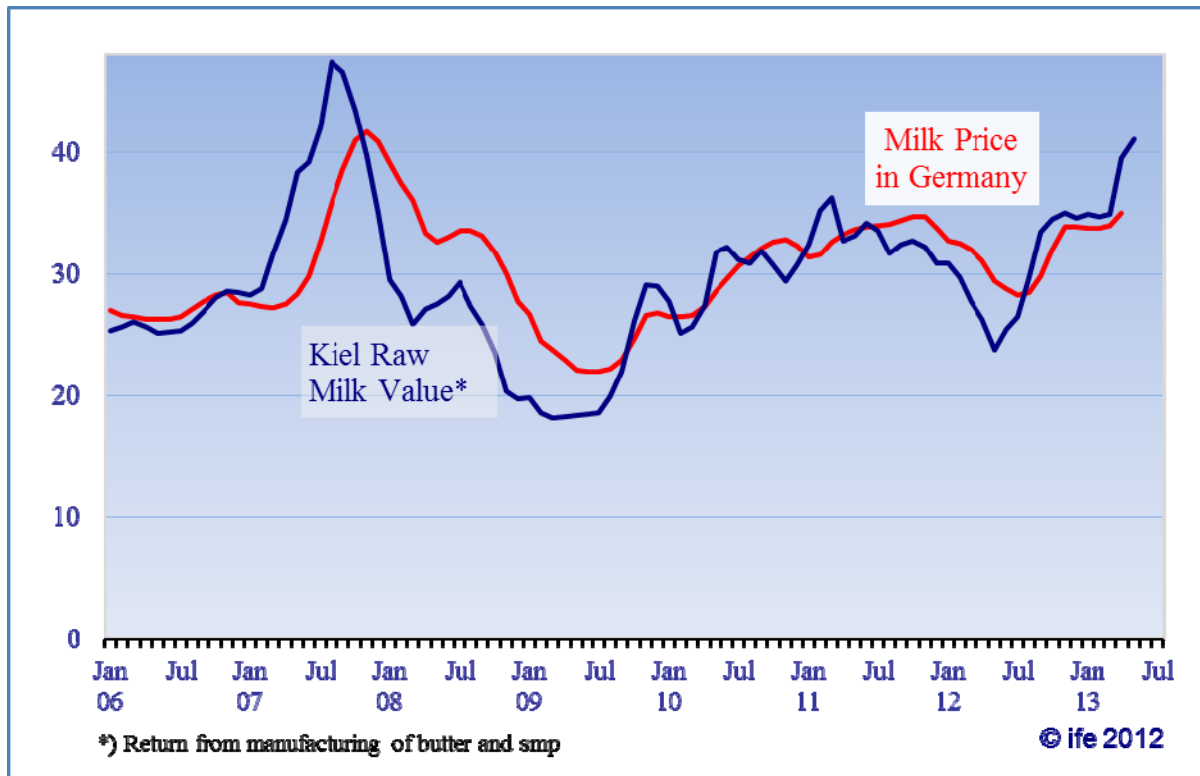
Anyway, the time of reduced worldwide milk production is over now. But it remains to be seen whether this will already curb down the very firm price levels significantly. So far, large parts among buyers and sellers have taken a wait-and-see position. By forward trading and futures, prospective demand both within the EU and on the international market has been covered to limited amounts. Therefore it seems to be unlikely that prices will go down quickly after the turn

of the year, if any. This view is confirmed by the recent results of the *Global Dairy Trade* auctions in New Zealand, forward trading resulted only in modest price reductions for January and February contracts, with the exception of skim milk powder for which prices were slightly higher. Despite the strong rates of the Euro versus US and Oceanian Dollars conversion into Euro prices also shows stability at high levels for the next months, after some weaknesses could be observed in the EU markets in September. If there is no significant change in the currency rates this stability might still go on for some time.

Milk prices paid to farmers have still to catch up to what happened in the markets of the industrial dairy products milk powder and butter in blocks.

Market return from butter and skim milk powder in Germany

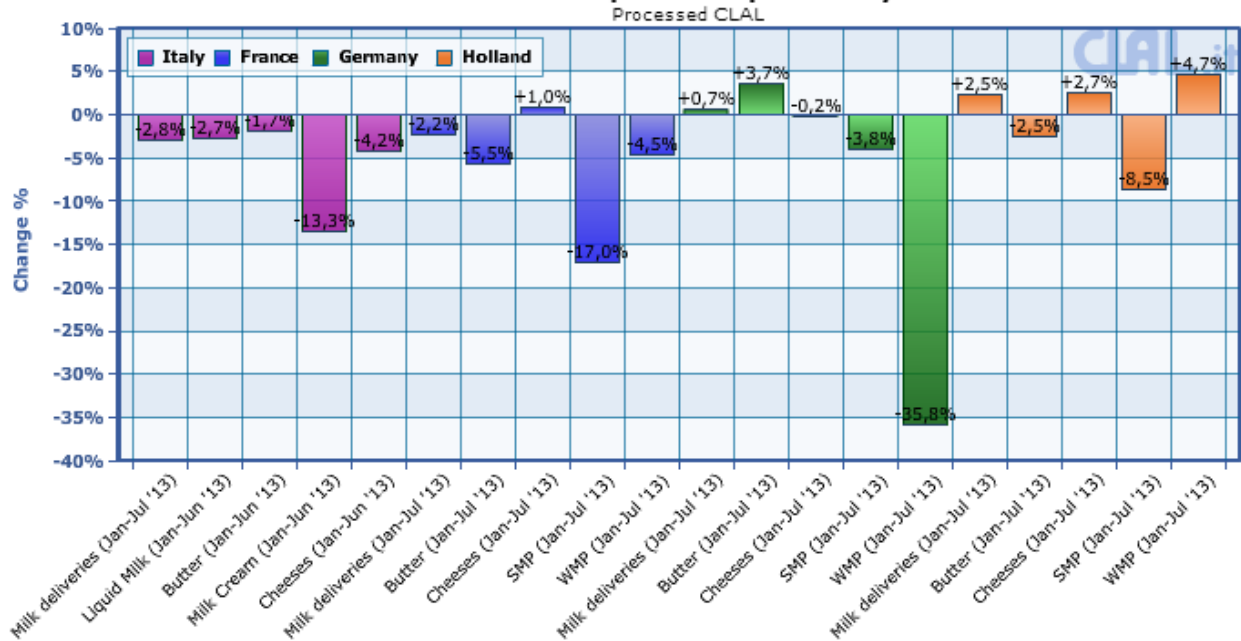
(Ct/kg, 3,7% fat until 2009, afterwards 4,0% fat, 3,4% protein)



More milk powders, butter and cheese

In the first half year of 2013, the productions of almost all dairy products has been reduced in the EU, notably those of skim milk powder, cream, butter and liquid milks. Although the cheese sector was the last to benefit from high prices, cheese production was only reduced slightly which might result from long-term contract commitments, and might exceed year before volumes in the second half of 2013. But the most attractive financial returns could and can be achieved this year from the processing of milk to skim milk powder and butter.

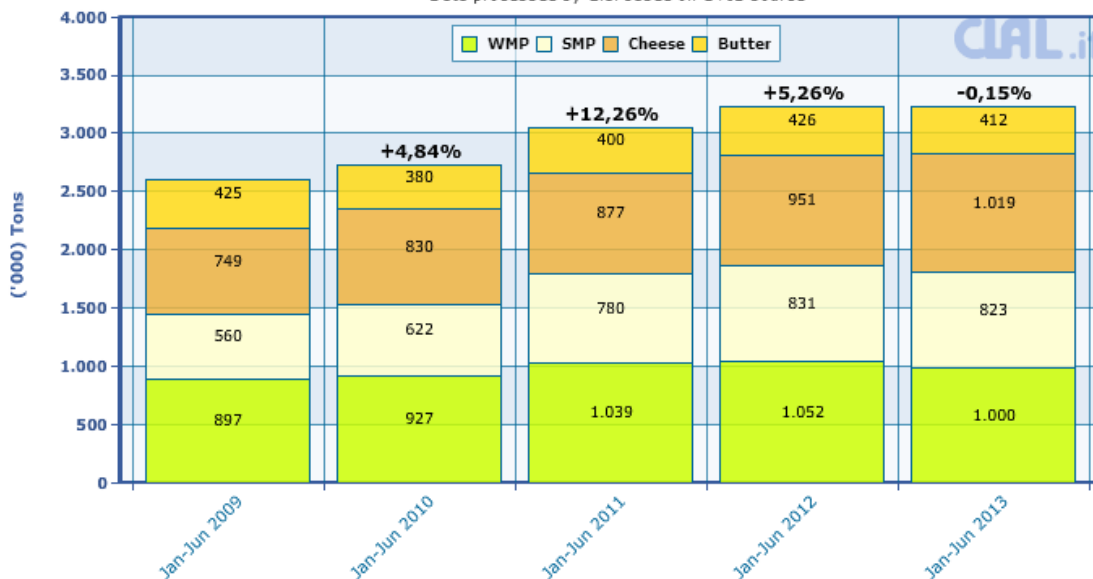
EU-28 states: share of production compared to the same period of previous year

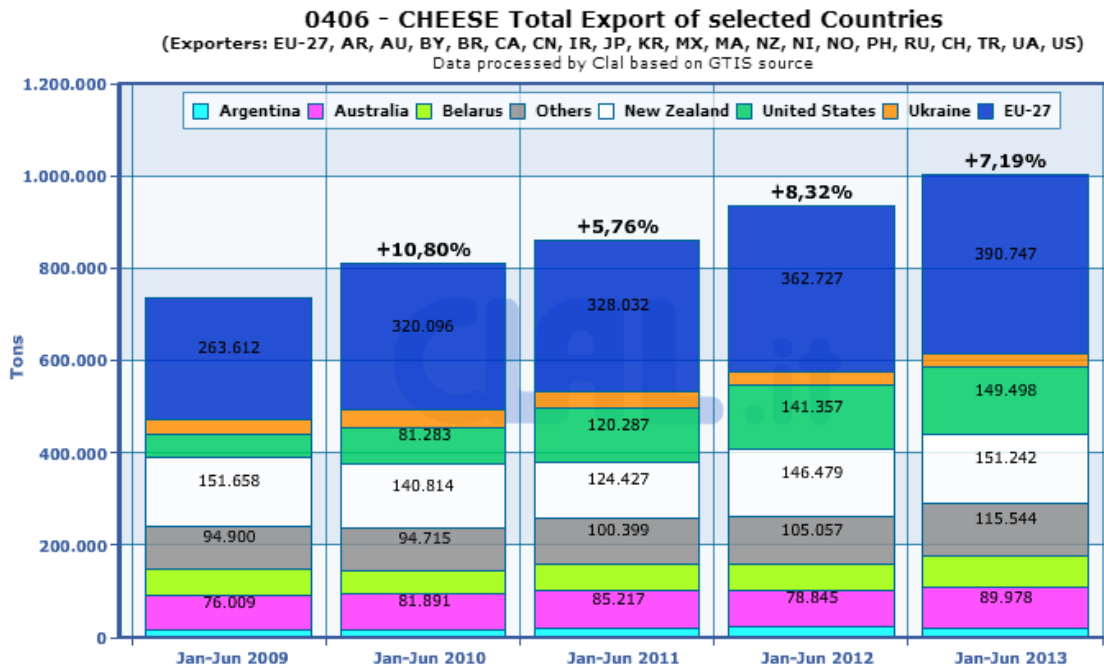


International trade of dairy products reduced

In the first half year, less milk powders, butter and butter products were traded internationally, which clearly resulted from reduced availabilities and which was also the reason for the very high price levels. Only trade in cheese grew again, with EU being the major supplier worldwide.

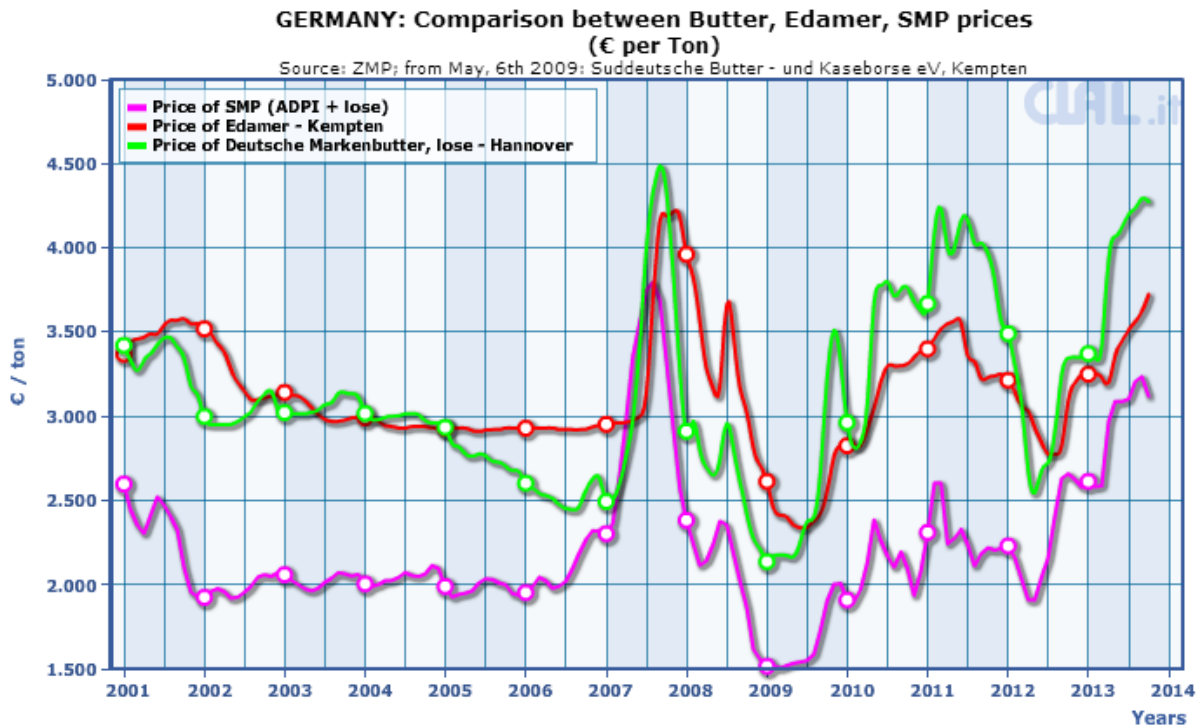
WORLD - DAIRY EXPORT (Jan-Jun)
(Exporters considered: see note below the graph)
Data processed by Clal based on GTIS source





Commodity prices at the peak

In July and August, the prices of bulk butter in the EU continued to go up and reached levels close to the records of 2007. Therefore also the prices of butter small packages had to follow, but they trailed behind those of the 25 kg blocks, whereas normally they should be a bit higher. The EU bulk butter prices are moving significantly above the world market level, too. Also whole milk powder prices, which depend partly on the fat value derived from butter prices are somewhat higher in the EU than on the international market. Skim milk powder, however, was quoted higher in the international market in recent months than in the EU. This might have to do with the fact that Oceania, as major supplier, was almost sold out and the prices which have been reported might refer only to contracts of lower volumes. With the ongoing production season this might change again. Moreover, New Zealand and Australia are both in a favourable competitive situation since their currencies have lost in value against the US Dollar and the Euro. The question is what could be the impacts of the US budget crisis.

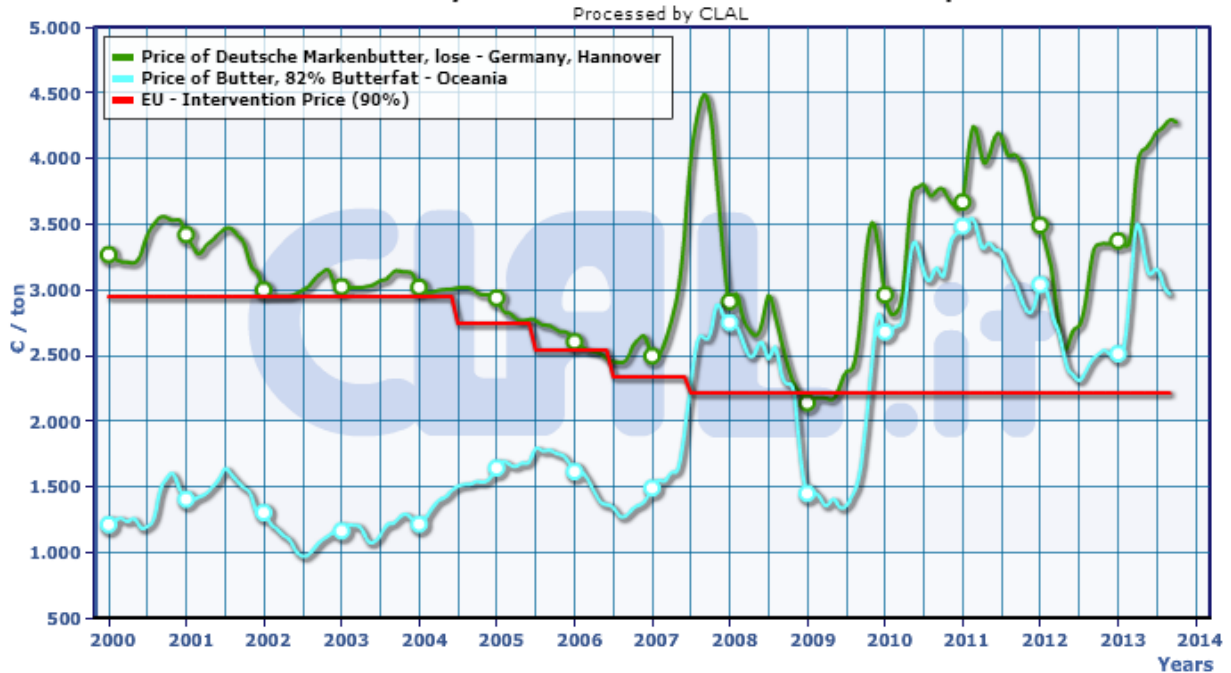


Butter prices at high levels over the turn of the year

In particular supplies of butter in the EU will be short in relation to demand, even if production is expanded above the last year's quantities, which might happen as result of attractive market prices. But the butter stocks which are stored under the PSA scheme are significantly lower than they were in the last years; 42,000 tonnes less than 2012 by the end of August. Part of the deficit might be replenished by an expanding production in the last months of this year, following the attractive price levels.

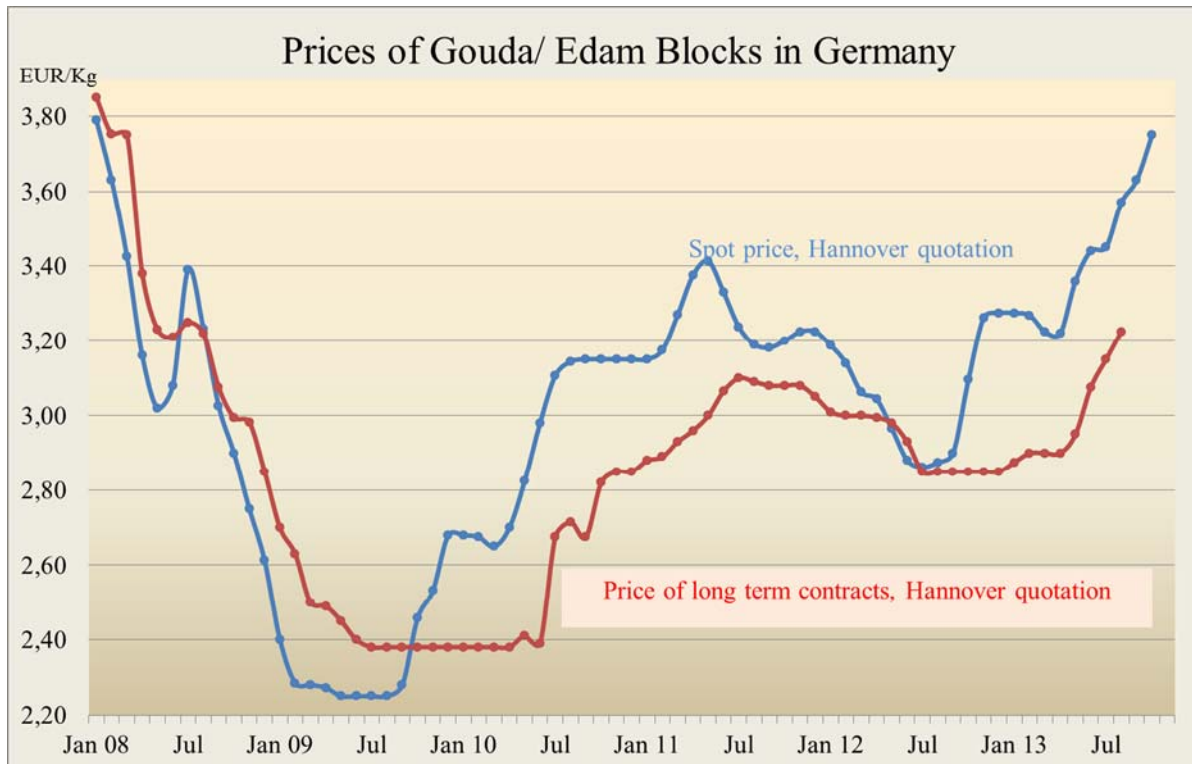
Despite the higher European price level some exports will continue since in some areas of the world butter with specific characteristics is required, which is mainly available in the EU. But the major role in the international butter trade is held by New Zealand.

Historical comparative overview between Butter prices in Germany and Oceania with EU intervention price



Commodity cheese prices will continue to go up

Commodity cheese prices have followed the rising prices of bulk butter and milk powders, but not yet to the full extent. Therefore they will continue to rise a certain time even if butter and SMP prices should go down. With stagnating demand within the expansion of EU production is mainly driven by the demand for export. Stocks in ripening warehouses are reported to be low. Therefore it is likely that the holiday period around Christmas will be used to replenish stocks towards volumes which are regarded to be more normal. In other years, to some extent cheese manufacturing was discontinued over these days, which led to increasing pressure of raw milk supplies which had to be delivered to butter and milk powder production facilities and often ended with pressure on prices of industrial cream, skim concentrate, SMP and butter. If that should happen also at the end of 2013, the effect on prices of butter and milk powders will be less than usually.

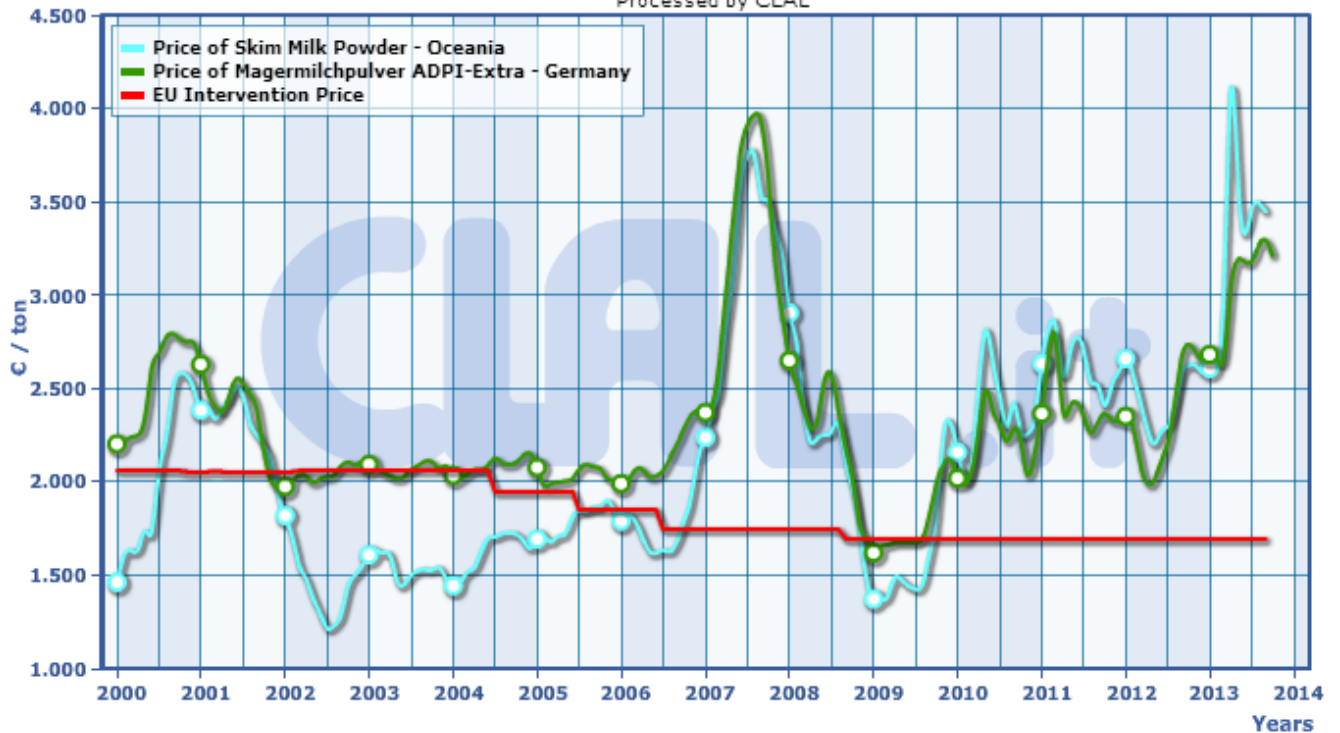


Milk powder prices over the peak?

Milk powder prices have already been quoted lower in September. The question is whether these slight reductions happened because this has been regarded by all partners in the business as a usual movement for this time of the year, regardless of the supply and demand relation or whether it is really resulting from stronger supplies offered by the United States and Oceania. But the space for price reductions in the next months seems to be narrow since in the first half of this year and possibly also July and August less milk powders were traded on the international market because of the worldwide reduced production. This however might have changed already now, but it create more space for lower prices possibly after the turn of the year, but not yet immediately. The results of the Global Dairy Trade auctions confirm this view.

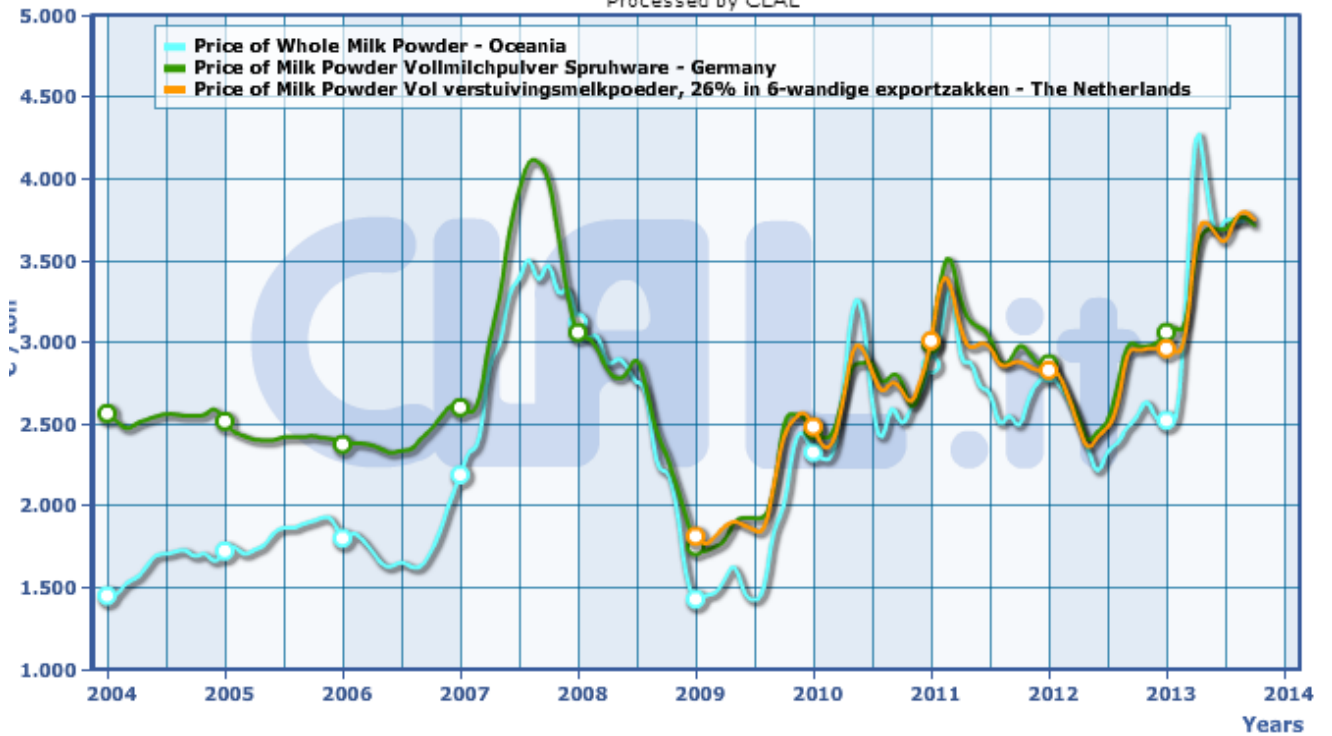
Comparative historical overview between SMP market prices in Germany and Oceania and EU intervention price

Processed by CLAL



Comparative historical overview between WMP prices in Germany, Oceania and The Netherlands

Processed by CLAL



Annex

Table 1

EU- Dairy Market 2007 - 2012 and Forecast 2013

1.000 t	2007	2008	2009	2010	2011	2012*	2013**	2013***
Milk deliveries	134.047	135.108	134.713	136.579	139.494	140.680	140.600	141.100
Liquid Products	44.242	43.772	44.157	44.440	44.555	44.850	44.800	45.200
Butter								
Production	2.110	2.100	2.050	2.010	2.080	2.110	2.070	2.075
Consumption	1.994	1.968	1.984	1.974	1.966	2.014	2.000	2.005
Cheese								
Production	9.248	9.339	9.333	9.480	9.545	9.675	9.710	9.745
Consumption	8.728	8.873	8.840	8.891	8.931	8.986	8.970	9.010
Skim Milk Powder								
Production	1.090	1.040	1.160	1.080	1.220	1.240	1.180	1.180
Consumption	870	770	800	800	810	810	790	793
Whole Milk Powder								
Production	773	835	735	755	733	700	690	690
Population m. head	495	498	500	501	502	504	505	510
*) Provisional. **) Forecast. ***) Forecast, Croatia included.								<i>ife Sept 2013</i>

Sources: ife, Kiel; ZMB, Berlin.

Table 2

EU Butter Balance Sheet

1.000 t	2007	2008	2009	2010	2011	2012*	2013*	2013**
Production	2.110	2.100	2.050	2.010	2.080	2.110	2.070	2.075
Imports	85	65	62	40	47	55	40	40
Exports	211	147	143	161	132	131	120	120
Final stocks	100	150	135	50	80	100	90	90
- in intervention	0	0	79	2	0	0	0	0
Consumption	1.994	1.968	1.984	1.974	1.966	2.014	2.000	2.005
*)Provisional/ Estimated. **)Estimate including Croatia.								<i>ife Sept 2013</i>

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

Table 3

EU Cheese Balance Sheet

1.000 t	2007	2008	2009	2010	2011	2012*	2013*	2013**
Production	8.983	9.084	9.083	9.220	9.300	9.440	9.470	9.505
Imports	94	89	85	82	74	77	80	80
Processed cheese								
impact	265	255	250	260	245	235	240	240
Exports	594	555	578	676	683	776	820	810
Stock change	+20	+10	+0	-5	+5	-10	0	0
Consumption	8.728	8.873	8.840	8.891	8.931	8.986	8.970	9.010
-per capita (kg)	17,6	17,8	17,7	17,7	17,8	17,8	17,8	17,7

*)Provisional/ Estimated. **)Estimate including Croatia.

ife Sept 2013

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

Table 4

EU SMP Balance Sheet

1.000 t	2007	2008	2009	2010	2011	2012*	2013*	2013**
Production	1.090	1.040	1.160	1.080	1.220	1.240	1.180	1180
Imports	6	8	6	4	0	4	4	4
Exports	199	179	227	378	518	523	400	397
Final stocks	121	220	359	265	157	68	62	62
- in intervention	-	-	260	195	54	0	0	0
Consumption	870	770	800	800	810	810	790	793
- as Feed	245	150	160	165	175	160	120	120

*)Provisional/ Estimated. **)Estimate including Croatia.

ife Sept 2013

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

Table 5

EU WMP Balance Sheet

1.000 t	2007	2008	2009	2010	2011	2012*	2013*	2013**
Production	773	835	735	755	733	700	690	690
Imports	2	2	2	2	2	2	3	3
Exports	366	485	463	447	390	387	380	378
Stock change	20	15	-55	-20	10	0	0	0
Consumption	389	337	329	330	335	315	313	315

*)Provisional/ Estimated. **)Estimate including Croatia.

ife Sept 2013

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