

EU Dairy Markets, Situation and Outlook, March 2015

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Highlights:

- EU milk production will continue to grow until May and will expand again after the quota system is over.
- The growth of World milk production has slowed and almost halved in the total of the major exporting countries.
- In the domestic market of the EU modest increases of dairy consumption can be expected.
- The demand of importing countries will continue to grow, but the EU has lost the major market of Russia.
- Price volatility is boosted by currency fluctuations.
- Prices of butter and milk powders are expected to stay in the next months at present low levels. A recovery might be possible around the mid of the year.
- Cheese prices will not fluctuate as they did since mid-2014 and are expected to recover slowly from present low levels.
- Producer milk prices might go up in the second half of 2015, but are not likely to return to the peak levels of 2013 and 2014.

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EU-milk supplies: Modest growth after March 2015

Milk deliveries of EU dairies are expected to develop with a moderate expansion in the time when the quota system is over. The seasonal increase had started in December, 2014. Many farmers had already reacted to the prospect of high super levy fines by reducing their milk sales, and in January EU milk deliveries fell below year ago volumes by 1 percent, and **the reduction rate is estimated for March to be at 1,5 to 2 percent**. Nevertheless, the total of all super levy bills will be the highest ever in the history of the quota regime at its very end.

Quite unclear is, how milk deliveries will continue in the time starting April 1st. Will they immediately exceed the volumes of the same period of 2014 or will it take time? Much depends on the way how milk sales have been reduced since November, 2014, and also on how farmers are prepared for time immediately after March.

Several options usually are used to reduce milk deliveries:

- Culling of older cows and delayed replacement by new heifers
- Rearing of young calves with whole milk instead of feeding milk replacers
- Reducing milk yields by less feeding of concentrates for dairy cows

There were strong reactions of dairy farmers in France, Ireland, the Netherlands, Denmark, Germany, Austria and finally since February also in Poland.

It is also the question how many dairy farmers have finished milk production at all, also in view of the poor prospects of the low price phase of the cyclical fluctuations. The temporary reducing of herds and the supposed higher rate of farms which have stopped keeping dairy cows resulted in more cows being slaughtered.

However, the question is how fast new investments can offset the effect of this behaviour. Some investments have been made in new heifers which might result in more than “normal” calving numbers in the next month. And also a lot of new investments have been done for complete production facilities or significant

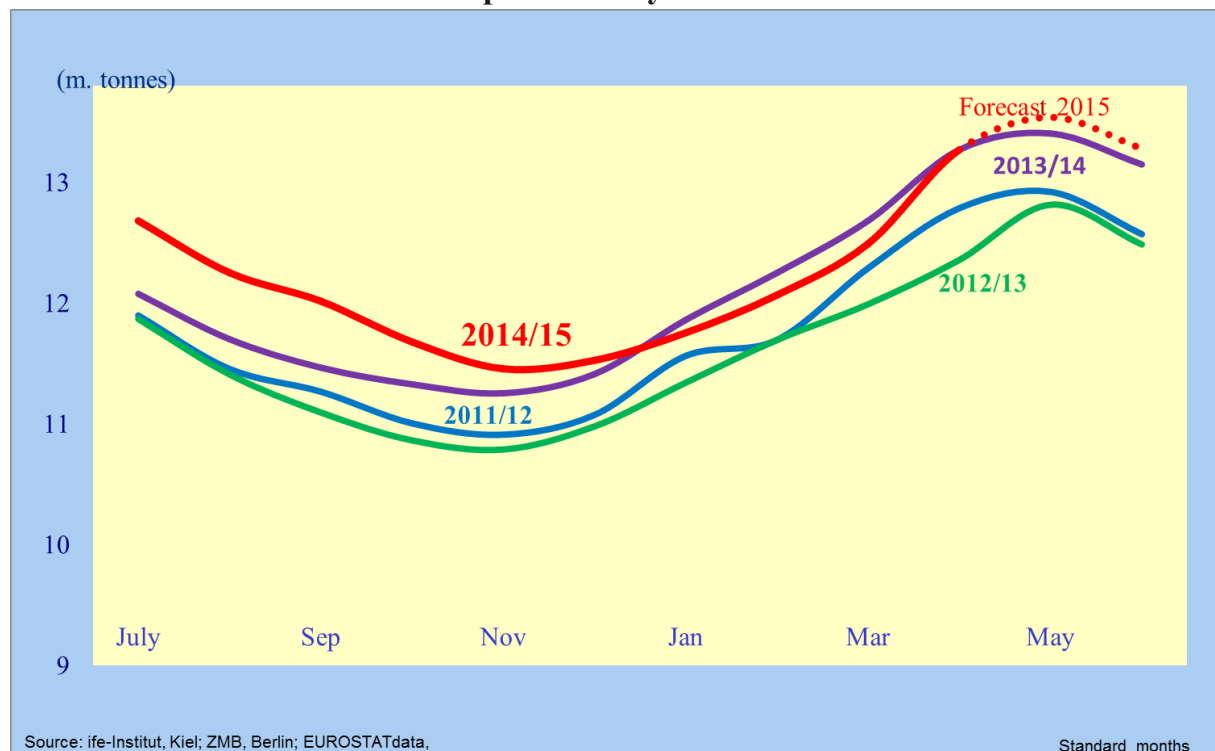
enlargements. Since there are no figures available on all these different scenarios, it is hard to make a reliable forecast on EU milk supplies in the near future. **It might happen that the seasonal spring peak, which is normally mid-May in the EU, can be delayed by a few weeks.** (Anyway, the usual seasonal patterns vary with earlier peaks in Southern and Western European areas and later peaks in some North Eastern countries).

Our view, which is shared by many experts, is that a modest increase of milk supplies on a year to year basis will start with the seasonal peak in May. It cannot be expected that the natural conditions will be as favourable as they used to be in most areas in the year 2014. And so do the economic conditions as well, since milk prices at the farm gate level are 20-25% lower.

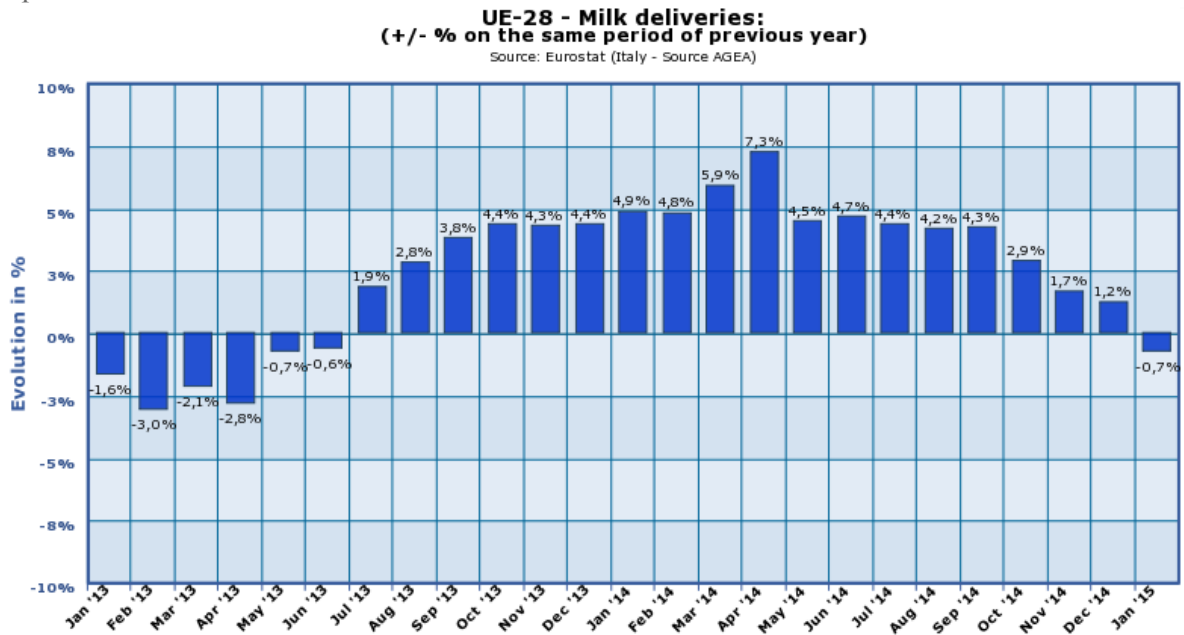
The increase of **EU milk deliveries** by 6,4 million tons or 4,6% in 2014 was a historical record, which is unlikely to be repeated, particularly since milk supplies in the first trimester trailed an estimated 1,5% behind 2014. In April the deliveries are expected to move closer to previous year's volumes and later they might exceed them again.

Graph 1

EU milk deliveries in 12months periods July / June



Graph 2



Anyway, the estimate of 149 million tons will be another historical record, despite the modest increase of less than one million tons. Very favourable conditions provided it might also end up with 150 million tons.

World: Exporting countries are expected to halve growth speed

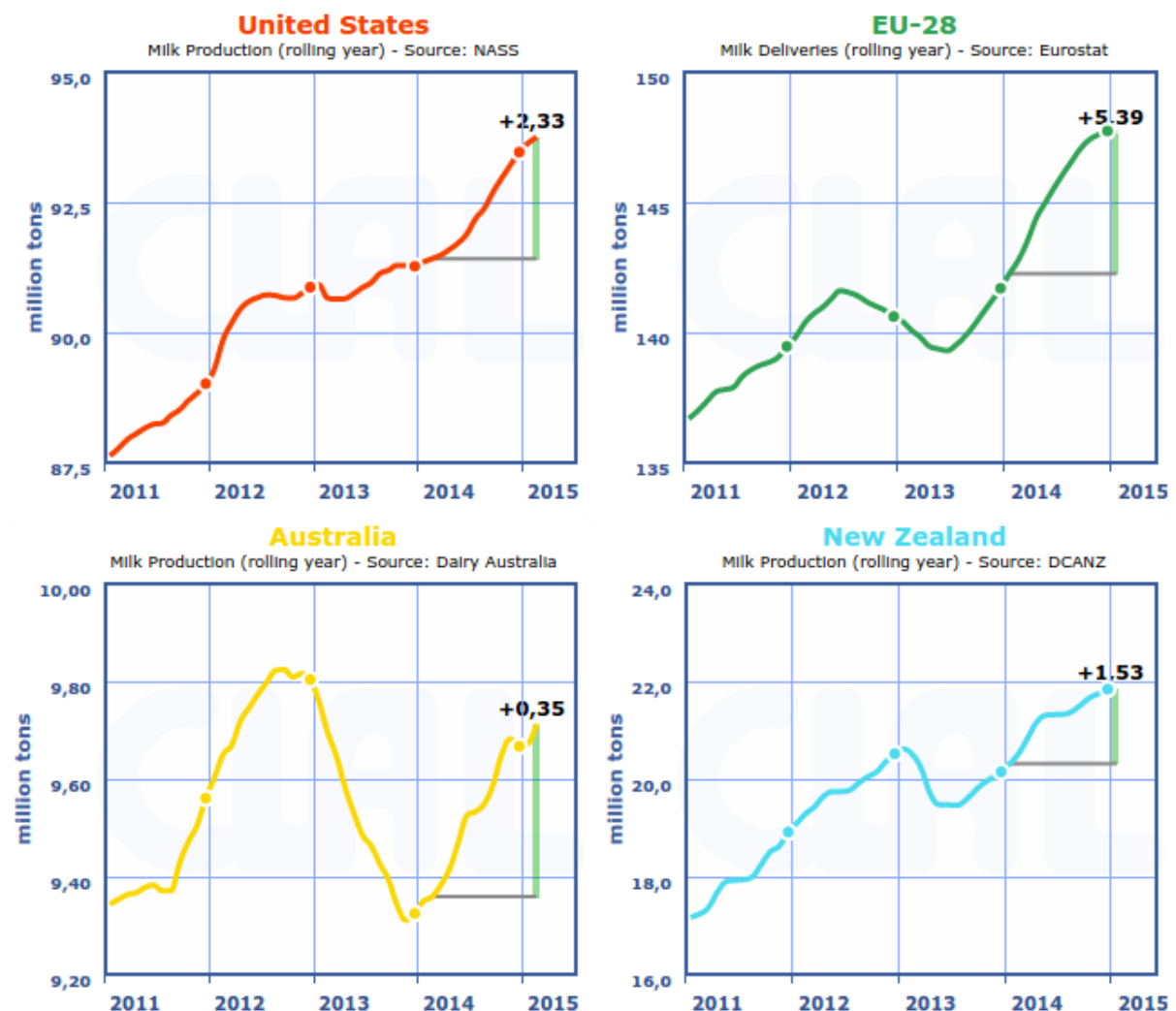
It is unlikely, that worldwide milk production will follow the same outstanding pattern which could be observed in the year 2014: all **major exporting countries** reported fast increases of milk production, ending up in 9 million tons more, when the EU, the United States and Oceania are taken into account. Main factors had been high milk prices and favourable natural conditions. The high milk prices were mainly driven by the influence of the world market. The buoyant demand from export markets in the first half year slowed down in the second half because of the reduced demand from China and Russia. On the other hand, the strongest growth of the combined milk production took place just in that second half, since it takes time for dairy companies to realise the higher values for the main segments of milk processing and transfer it to the farming industry by higher milk prices. Also farmers need a certain time to respond to favourable conditions by increasing output, and that was just the time when the major price indicators were already clearly showing downward movements.

Now, in spring 2015, the situation is a different one but not yet quite clear. As already mentioned **EU milk supplies** have been reduced but are expected to resume a modest growth in late spring and summer. In the **United States**, the strongest growth rates have been observed in the early winter months, but after that time they have slowed down. In **Australia** milk production is characterized by continuous moderate growth but **New Zealand** is reporting significantly lower milk supplies since February. Concerns that the drought might affect also the early new season 2015/16 have been recently dissipated by new rainfalls, which are also reported to be the reason for falling prices at the **GDT auction** of March 17, 2015.

Graph 3

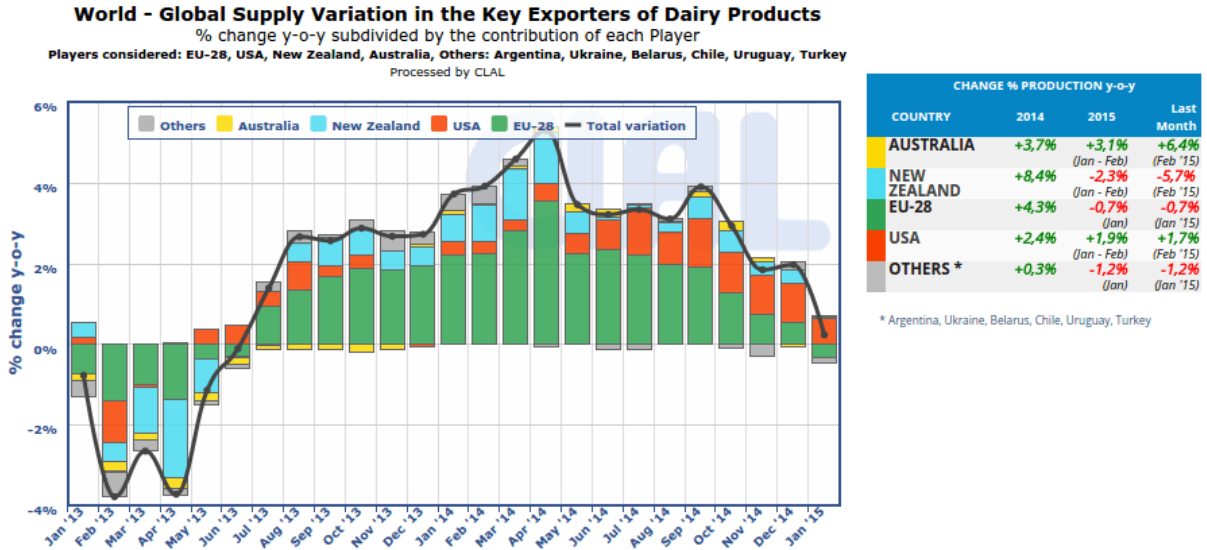
WORLD: Milk Production (rolling year)

Rolling year: for each month the chart visualizes the milk production in that month plus the production of the previous 11 months. With this method is always considered the total production in a time window of 12 months, so it is possible to identify the trend without the effect of seasonality.



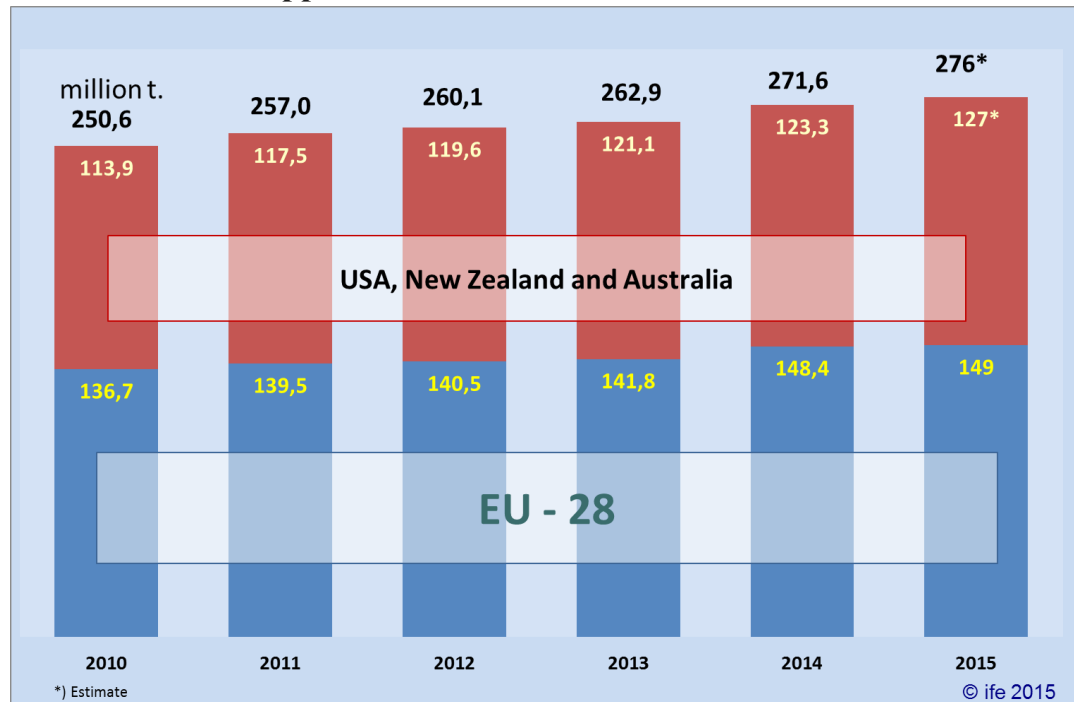
Assuming normal conditions in Oceania, the EU and the United States as well, the total production in the calendar year might be 276 million tons of cow milk, which will end up in just the half of the growth of 2014.

Graph 4



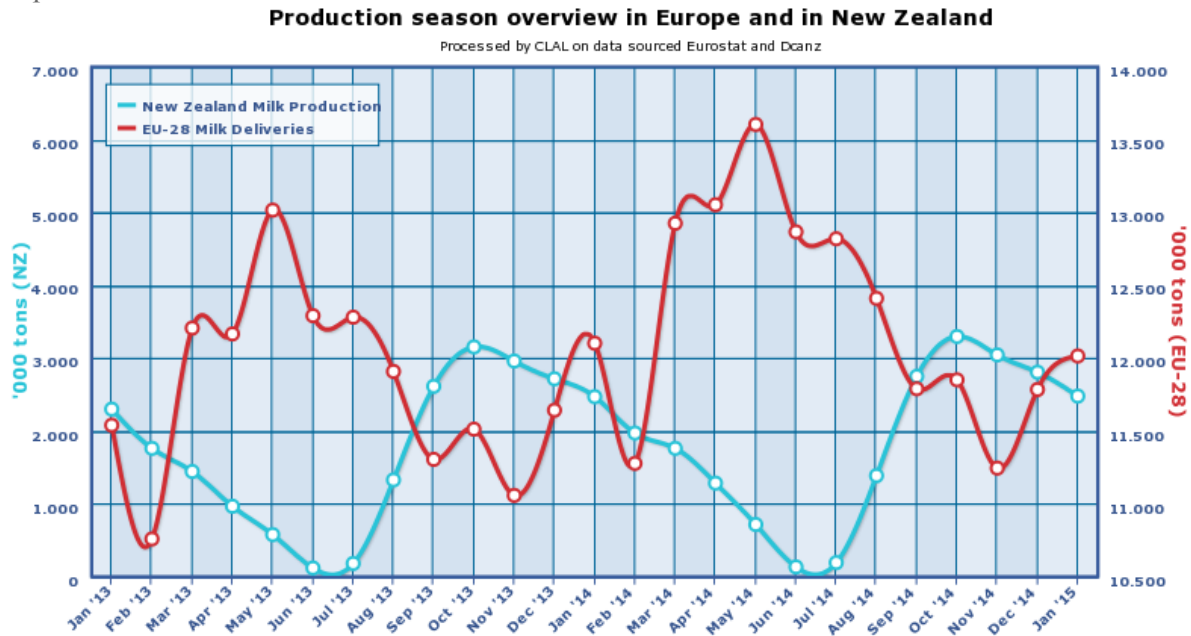
Graph 5

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



The question will be, whether this growth will be sufficient to cover the needs of the major importing countries. With the seasonal peak of milk production in the Northern hemisphere still ahead, expectations are different.

Graph 6

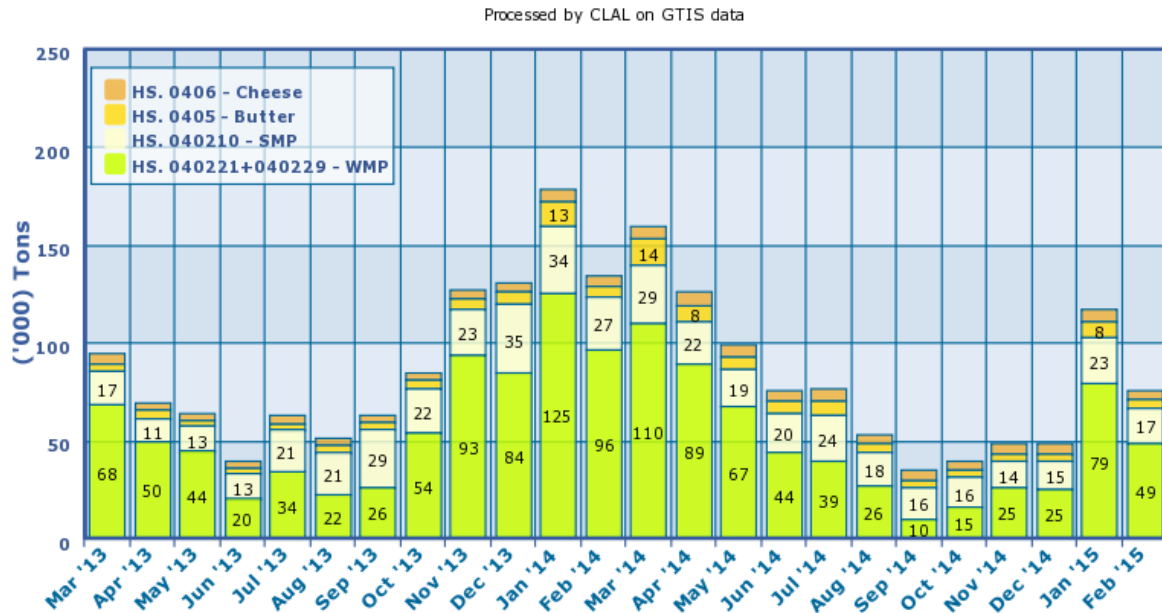


Again prices of dairy commodities have become weaker after an interim recovery in the period from mid-January to mid-March, and this will probably hold on at least until mid-May. Also in the time until August many buyers in the international trade might take a wait and see position until it becomes clearer how milk production will develop in Oceania in the new seasons, which start in New Zealand in June and in Australia in July.

On the part of **importing countries**, **China** and **Russia** hold the key position. If the surplus stocks of milk powders, which partly resulted from the strong import volumes of 2014 are cleared, China will be back with stronger demand in the second half of the year. In spring, Chinese domestic production is seasonally at the peak similarly to other countries of the Northern Globe.

Graph 7

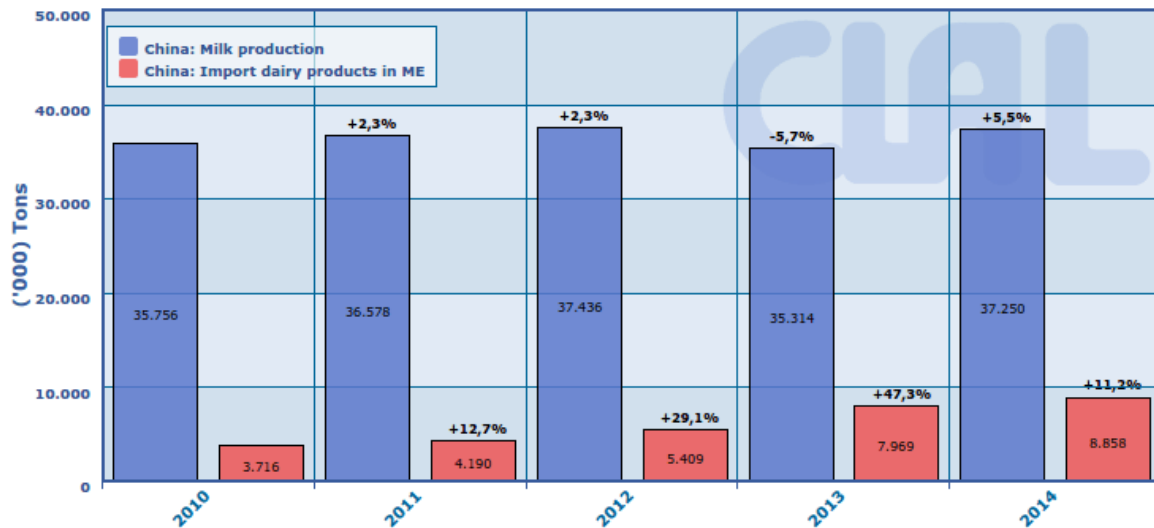
CHINA: Monthly Dairy Product Import over the last 2 years



Graph 8

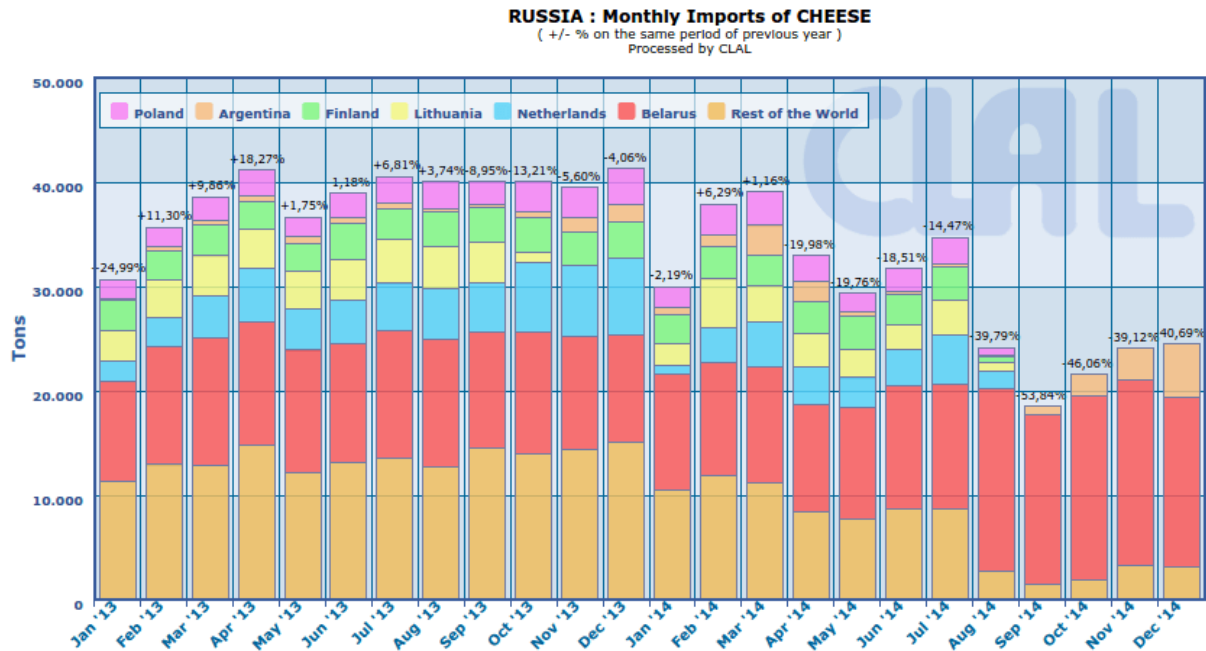
China - Milk production and dairy imports in milk equivalent

Products considered for M.E. calculation: SMP, WMP, Bulk and packed Milk, Cheese, Condensed Milk
Data processed by Clal based on NBS and GTIS sources



The same is the case in **Russia**. But for Russia it seems to be unlikely that the import embargo will be released in August, since the political troubles are far from being settled. Moreover, the devaluation of the Rouble has made all imports very expensive for Russian consumers. Under these circumstances it is hard to believe that Russia will be back as buyer of cheese, butter and milk powders in the EU market.

Graph 9

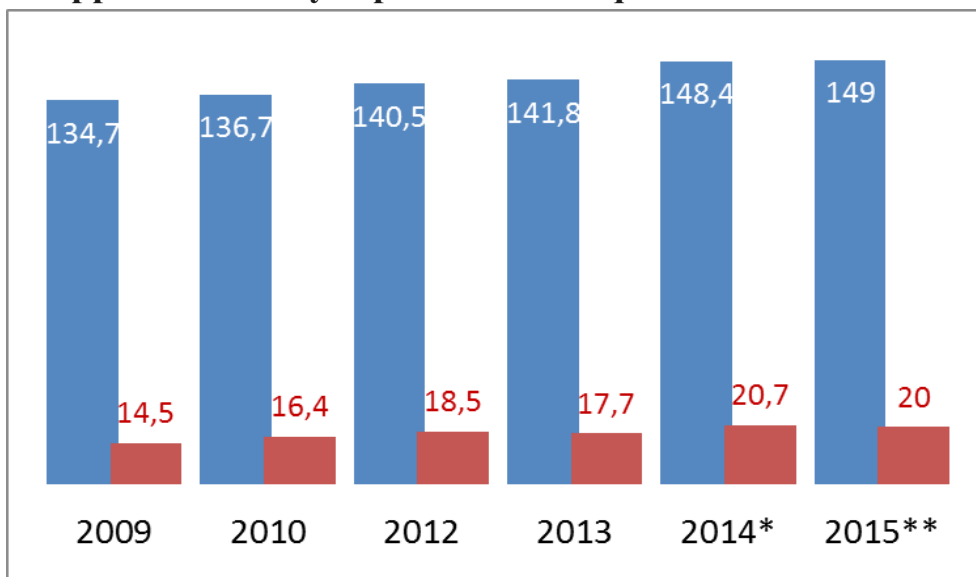


Circumvention of the ban via shipping raw material commodities to Belarus and Turkey for further processing is far from being sufficient to replace former trade volumes. Consequently the embargo offers good opportunities to the Russian dairy industry to regain shares in their domestic market.

It is unlikely that the gap in supplies from the EU and Australia can be filled by imports from other origins which are not banned. Some of these new trade flows to Russia will reduce the export potential to other destinations.

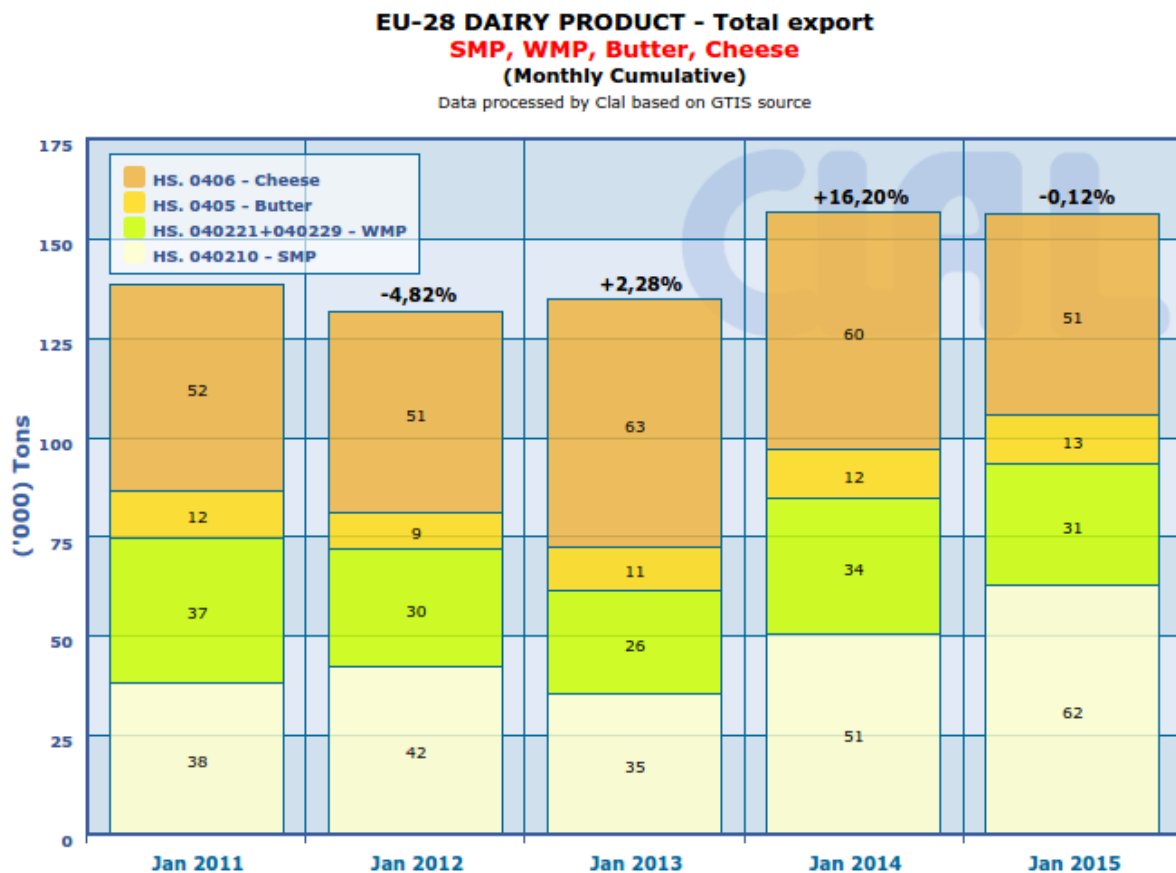
Graph 10

EU milk supplies and dairy exports in milk equivalents



As it happened in recent years, the EU dairy market and the international market are in interaction. Despite the Russian measures, the EU exports grew to historical records in 2014. And parts of export volumes which went lost by the Russian measures could be replaced by other destinations for butter and milk powders. But if Russia will probably be absent for the whole year from the EU market, in particular the cheese market, which has to be taken into account, it seems to be unlikely that the EU will again expand exports in 2015.

Graph 11



More butter and milk powders, less cheese

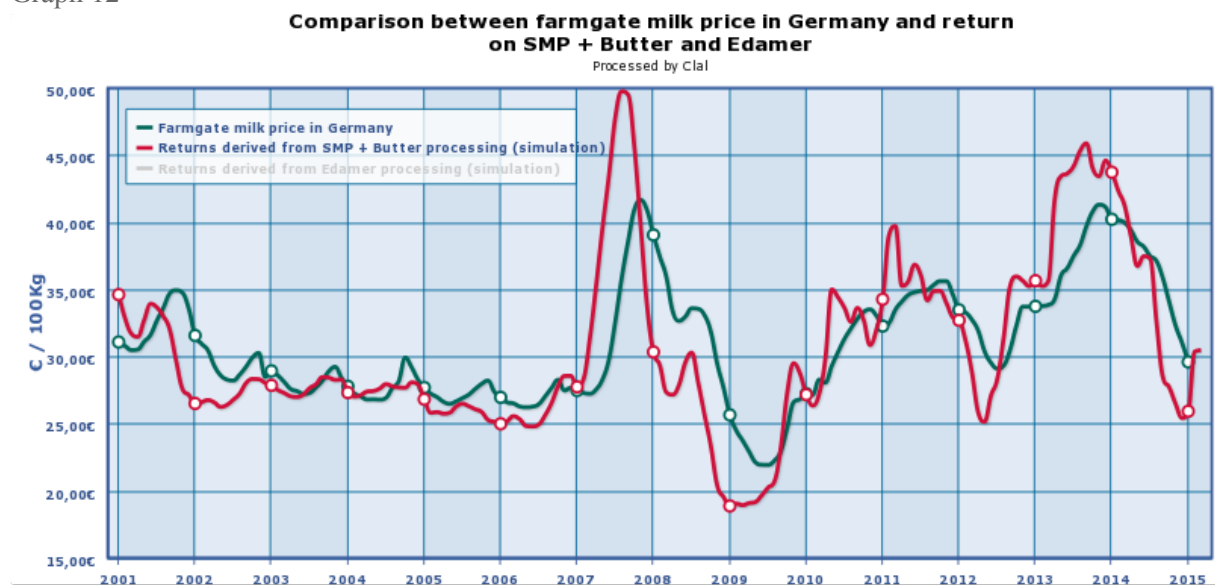
Therefore the **EU cheese** industries might be forced to reduce their production slightly, which would be the first time since at least a decade. Consequently **butter** and **milk powder** production will be increased a bit more than just following only the slight increase of milk supplies.

The sector of **liquid milk and fresh products** is expected to recover from the reduced volumes in 2014, which resulted from unfavourable weather conditions in the summer 2014. The lower consumption in the EU could not be compensated by the growing exports of this category. Even if bad weather conditions should prevail in 2015, a small increase of fresh and liquid production is likely, but by far not enough to absorb the milk volumes which are made available from the reduced cheese manufacturing and which will be used for butter and milk powders.

According to the details of the balance sheets in the annex of this report, ongoing increases of stocks of skim milk powder and butter have to be expected. But under the conditions of the private storage aid scheme this should not necessarily lead to more pressure on prices.

It depends more of the assessments of the market situation taken by sellers and buyers in the period when the views how milk supplies and demand for exports are developing are apart from each other. Anyway, predictions will be easier around the mid of the year. But it seems more likely that prices will stabilize after May and recover, but will not rise to levels of end 2013. With the usual time lag farmgate milk prices will follow the commodity prices.

Graph 12



Rising stocks of butter and skim milk powder

As result of more milk since May or June and lower cheese manufacturing, more butter and milk powders will be produced. In the domestic markets lower prices will have a certain but small positive effect on demand. In foreign markets the effect of low prices might be partly offset by reduced purchasing power in particular in oil and other raw material exporting countries. The effect of the predicted weaker economic growth of China is only minor; it is in fact still substantial and will continue to be a major driving force for growing imports.

Russia took a certain role as importing country of butter and milk powders in recent years with varying quantities from year to year, but only minor when compared to the country's cheese imports. With increasing production, small gains in domestic consumption but stagnating exports, stocks are expected to go up in the period until August.

Therefore the continuation of the European Commission's financial support for private stocks will be helpful in easing the situation. Market prices are probably weaker than they were in the period from mid-January to mid-March until May.

Currencies create uncertainty: The flood of money issued by the European Central Bank has dumped the Euro rate until mid-March when a modest recovery could be observed. Because of the gains in competitiveness this reduced rate had boosted the rising world market prices of dairy commodities in Euro terms, but that has changed again at the end of March by both lower world market prices and the modest strengthening of the Euro vs. the US-Dollar.

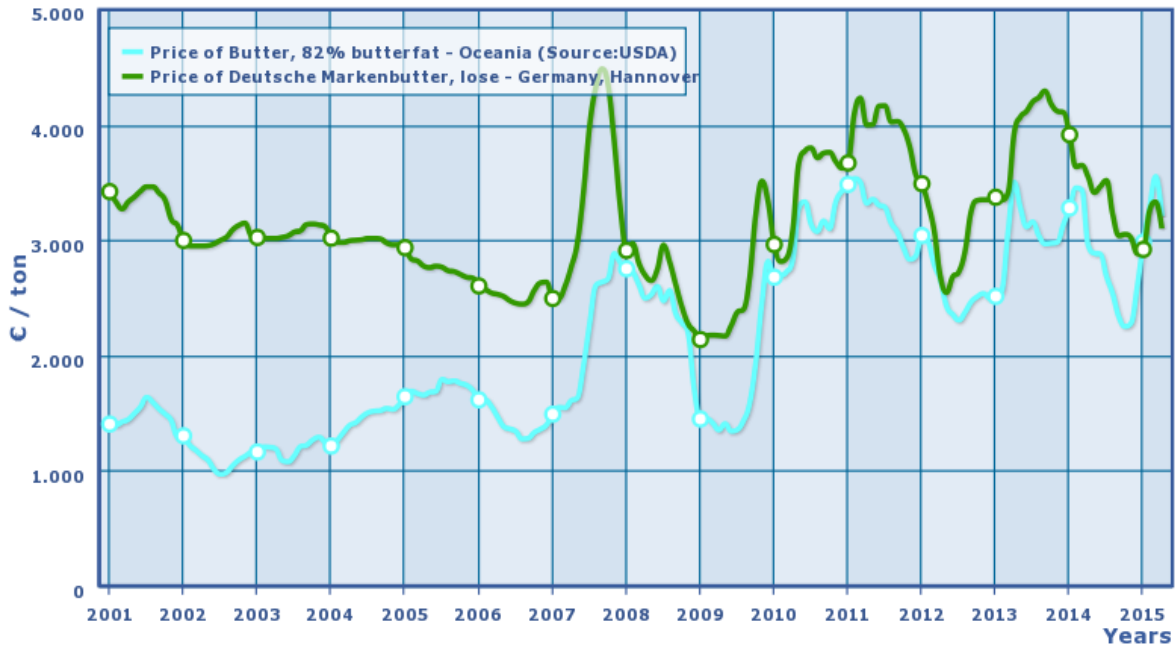
If there is no significant change of the currencies over the next months butter and SMP prices are expected to stay at present levels until the end of May and will be close to the international levels. That has been the case since many years for SMP. Different from many years ago also butter prices will now move much closer to the international levels than they did so far.

Graph 13

Butter prices

Comparative historical overview between Butter prices in Oceania and Germany

Processed by CLAL

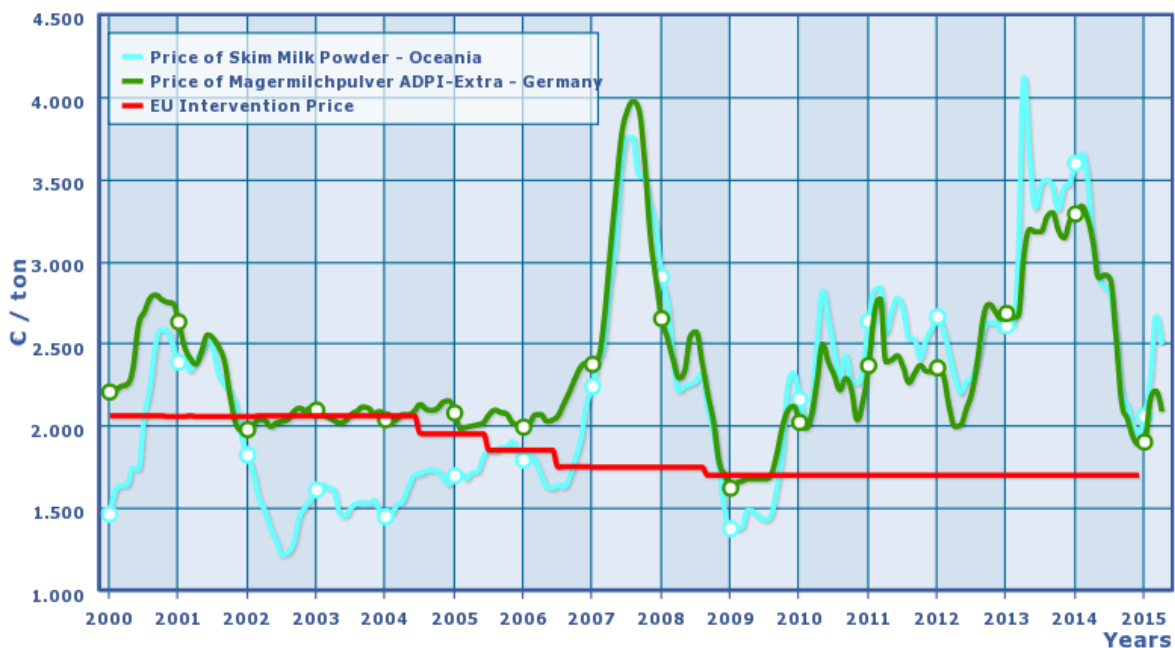


Graph 14

Skim milk powder prices

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

Processed by CLAL

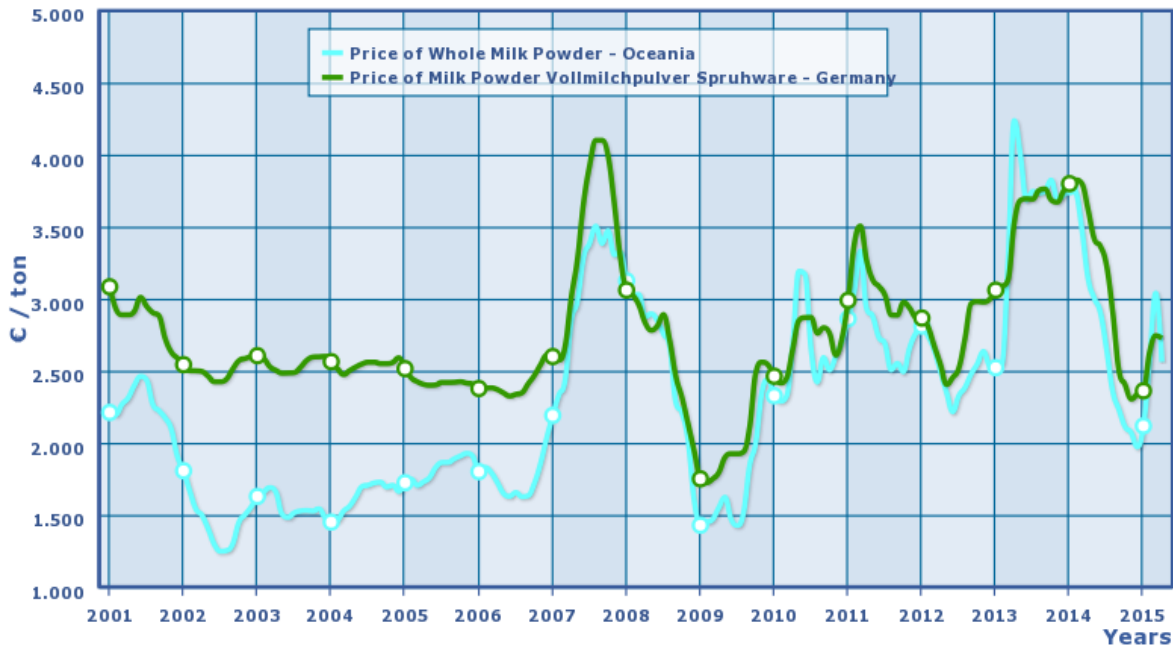


Graph 15

Whole milk powder prices

**Comparative historical overview between WMP prices
 in Germany and Oceania**

Processed by CLAL



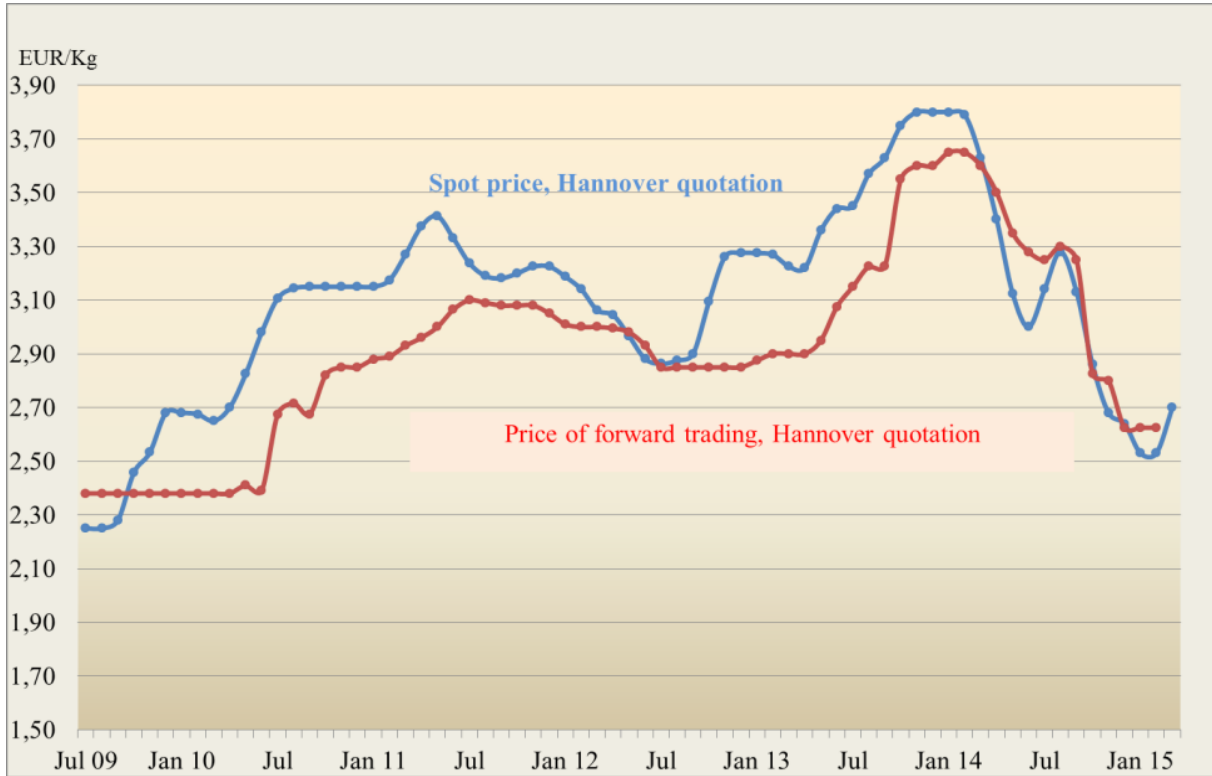
Cheese prices: Slow recovery

EU cheese production is expected to be smaller than in 2014. In the domestic market of the EU a small increase can be expected, because it complies with the trend of the last years and is also logic in view of the small growth in the number of consumers. Reduced exports result mainly from the Russian embargo.

In the market balance of 2014 the absence of Russian buyers lasted five months, whereas for 2015 it has to be taken into account that it might last for the whole year, although the present ban has been decided for twelve months until the end of July. Since Russia used to be the No 1 among the world’s cheese importing countries other destinations cannot immediately compensate the loss of that market. But as EU production is expected to be better in line with sales opportunities, cheese price will not follow the possible downward movement of the other commodities, if that should happen. They have already moved up from the low levels in December.

Graph 16

Prices of Gouda/ Edam Blocks in Germany



Annex

Table 1

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	141.834	148.371	149.000
Liquid Products	44.157	44.440	44.555	44.850	45.080	44.800	45.100
Butter							
Production	2.050	2.010	2.080	2.010	2.015	2.100	2.115
Consumption	1.984	1.974	1.966	1.938	1.933	1.950	1.960
Cheese							
Production	9.333	9.497	9.611	9.687	9.763	9.885	9.810
Consumption	8.840	8.908	8.993	8.993	9.056	9.214	9.240
Skim Milk Powder							
Production	1.160	1.080	1.220	1.230	1.200	1.500	1.520
Consumption	800	805	810	810	804	800	810
WMP Production	735	760	750	715	725	765	730
Population m. head	500	501	502	504	510	511	512

*) Provisional. **) Forecast.

ife March 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	2.100	2.115
Imports	62	40	47	56	43	52	40
Exports	143	161	132	128	128	150	145
Final stocks	135	50	80	100	98	150	200
Consumption	1.984	1.974	1.966	1.938	1.933	1.950	1.960

*)Provisional. **)Estimated

ife March, 2015

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

Table 3

EU Cheese 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	9.083	9.237	9.366	9.452	9.523	9.655	9.580
Imports	85	82	74	77	74,7	76,4	70
Processed cheese							
impact	250	260	245	235	240	230	230
Exports	578	676	682	776	787	727	660
Stock change	+0	-5	+10	-5	-5	20	-20
Consumption	8.840	8.908	8.993	8.993	9.056	9.214	9.240
<i>-per capita (kg)</i>	<i>17,7</i>	<i>17,8</i>	<i>17,9</i>	<i>17,8</i>	<i>17,8</i>	<i>18,0</i>	<i>18,0</i>
*)Provisional. **)Estimated						<i>ife March, 2015</i>	

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

Table 4

EU SMP 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	1.160	1.080	1.220	1.230	1.200	1.500	1.520
Imports	6	4	0	2	5	2	1
Exports	227	378	518	523	407	657	650
Final stocks	359	260	152	50	45	90	150
- in intervention	260	195	54	0	0	0	0
Consumption	800	805	810	810	804	800	810
<i>- as Feed</i>	<i>160</i>	<i>165</i>	<i>175</i>	<i>160</i>	<i>120</i>	<i>130</i>	<i>130</i>
*)Provisional. **)Estimated						<i>ife March, 2015</i>	

Table 5

EU WMP 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	735	760	750	715	725	765	770
Imports	2	2	2	2	3	1	1
Exports	463	447	390	396	374	389	430
Stock change	-55	-20	10	0	0	17	-10
Consumption	329	335	352	321	354	360	350
*)Provisional. **)Estimated						<i>ife March, 2015</i>	

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