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# EU Dairy Markets, Situation and Outlook January-April 2009

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*Special report produced for CLAL*

## Highlights:

- Increase of milk supplies in 2009 only modest and behind quota increase
- EU demand relatively stable
- Exports reduced
- Market surpluses have to be cleared by intervention
- Reference prices will largely determine price levels
- The EU milk and dairy markets are under severe pressure because of
  - Increased milk supplies in early 2008
  - Reduced export opportunities which seem more and more affected by the economic crisis and increasing production in the United States, Oceania and Asia
  - Slower growth of the domestic demand after the 2007 “price-shocks”.
  - Build up of stocks in 2008
  - Reduced support of the market by the EU following the farm policy reforms of 1999 (Agenda 2000 decisions), 2003 (Mid-term Review) and 2008 (Health-Check)

Until autumn 2008, farmers received still relatively high prices as result of the bullish market situation of 2007 which had continued in some market segments far into 2008. And in the mid of 2008, a temporary recovery of the market had firmed the prices for a short period both on the European and the international market. But since September almost all prices are on the downward road. The strongest price reductions were reported from the spot market of raw milk and in the sector of butter, milk powders and ingredients. Since competition is almost free and no specific regulations exist to protect the markets of liquid milks and



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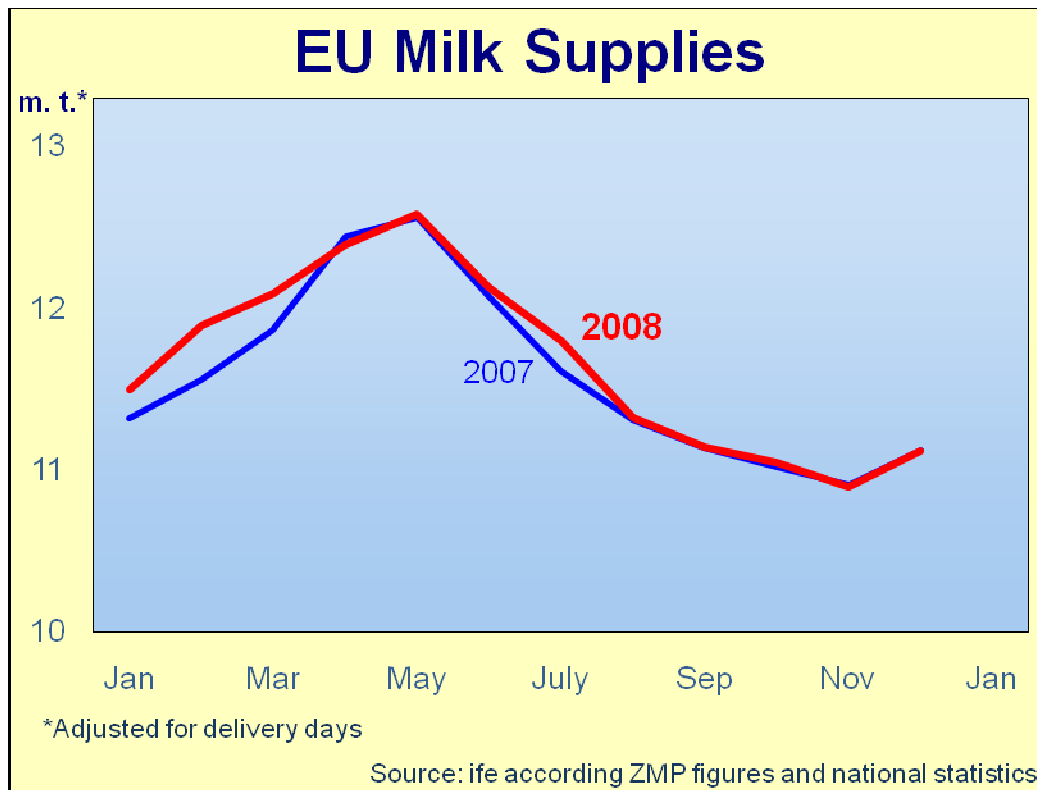
fresh products from the influence of price fluctuations of the industrial dairy products inevitably also these markets came under pressure, in particular where private labels have strong market shares in the liquid milk and cheese sector. The markets of butter and milk powders were not released in sufficient volumes from the surpluses exceeding the domestic demand by exports to markets outside the EU. But still butter and SMP have the key role in price formation in particular in the Northwestern and Central European countries.

In December 2008, the Raw Milk Value of milk processed into butter and SMP, which is calculated by IFE, reached a historical low level, just 14 months after the historical peak. In January the situation has become even worse and it remains to be seen whether this is only due to the cumulative effects of the general market situation and the specific situation over the Christmas and the year-end holidays.

### Milk Supplies

Modest increase of Milk Supplies expected: milk production follows more the market forces than quotas.

For 2009 only a modest increase of milk supplies is expected, and they are likely to trail more behind the available quotas than the years before. Already in 2008 milk deliveries increased in the size of just 1.2 or 1.3 m. tones, despite attractive farm milk prices, falling concentrate feed prices and increased quotas for the 2008/09 quota year. For the current quota year the milk delivery quotas had been increased by 0.5% following the 2003 reform decisions in 11 member countries and in general by 2% as result of the “Health Check” decisions. **With poor milk price prospects for 2009 less farmers will be encouraged to invest in expansion of milk production, whereas the number of farmers discontinuing milk production might increase.**



Considered by countries it seems to be likely that more milk will be produced in the Netherlands, Denmark, Germany, Ireland, Poland and the Baltic countries, but not everywhere in the pace of the quota increases. After exceeding significantly their national quotas in 2007/08 it looks now that in Germany and Austria milk supplies will be in line with the available quotas. The increase for Italy in the period ahead, anticipating the 5% decided for the other member countries over 5 years, has been given to adjust the quota volumes to the reality and is unlikely to transform itself into a similar growth of milk deliveries. After strong increases from autumn 2007 to autumn 2008, the French milk production is declining significantly and this can also be seen as one result of the strong reduction of farm milk during the past autumn. In the U.K. the long-term downward trend of milk production continues. Production in Sweden and Finland has stabilized, but it remains to be seen whether this stabilization is sustainable. The decline of Irish milk production also might be a first result of reduced milk prices, in particular because the returns for milk in Ireland were the fastest reduced by falling prices in the dairy commodity markets. No recovery of milk production is likely in Hungary, Romania and Bulgaria.



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Therefore it seems to be a relatively optimistic estimate to expect EU milk supplies increase by just 1 million tonnes in 2009.

### **Domestic Demand with modest Growth**

In terms of milk volumes, the domestic demand might even follow the long year trends of slight increases. This opinion might be surprising in view of the economic crisis, but it can be underpinned with the following arguments:

- the population is still increasing slightly;
- consumer prices have been reduced significantly in the second half of 2008, and it is not sure that the downward spiral has come to a standstill. Market monitoring shows that consumers have reacted on higher prices by reduced purchases, why should they not do so when prices come down? Some results of consumer surveys already confirm this;
- in the New Member States of Central and Eastern Europe the catching up of consumption to come closer to Western levels will continue, but possibly at slower pace;
- the industrial dairy commodity prices have already fallen since autumn 2007 and it seems to be likely that in this sector the domestic demand has recovered in 2008. With even lower prices at least in the first half of 2009 it can be expected that the consumption in food and feed will be stable.
- In terms of volumes the demand for dairy products is less dependent on the economic situation than in emerging markets outside the EU and North America, but it might be more sensitive in the sector of brands and products of higher added values. Consumer spending is likely to decline anyway.

### **Milk Processing: More Butter and SMP**

- Milk processing for liquid products is expected to increase slightly.
- [Cheese production](#), however, cannot follow the trends of the last years because of reduced demand from export markets.
- Also [for WMP](#) no increase can be expected 2009 in view of the economic difficulties of importing countries.

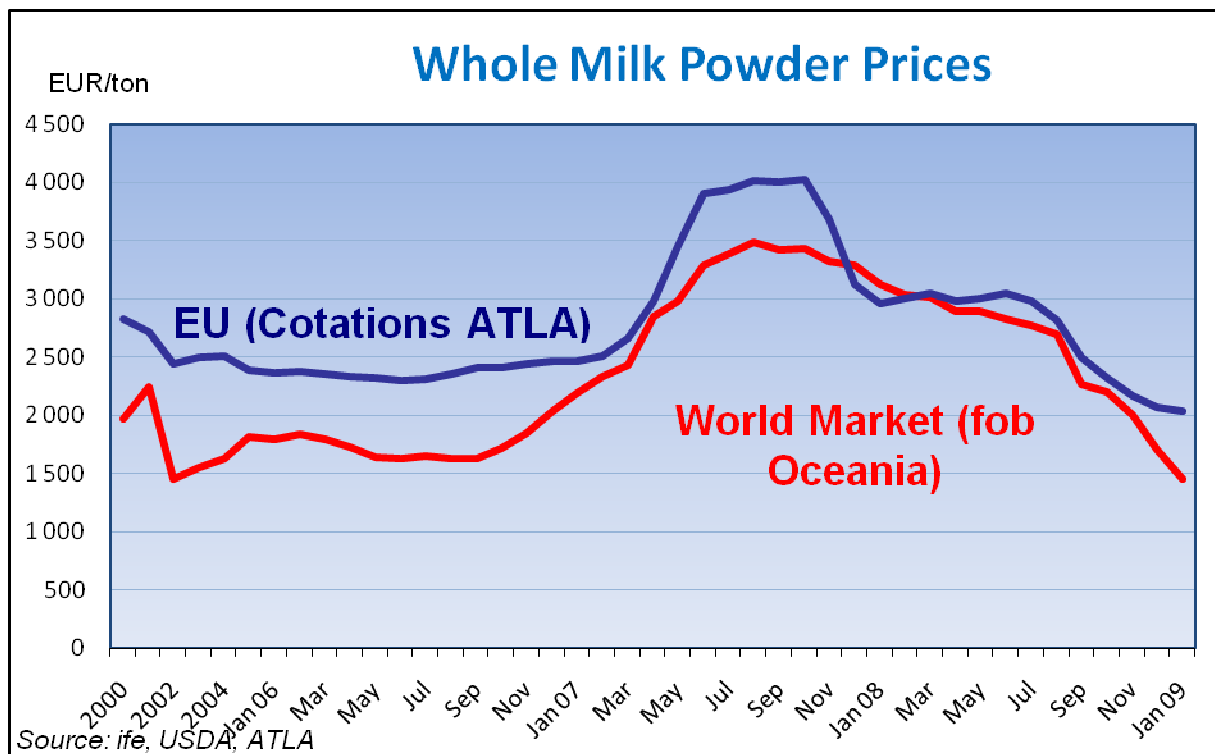
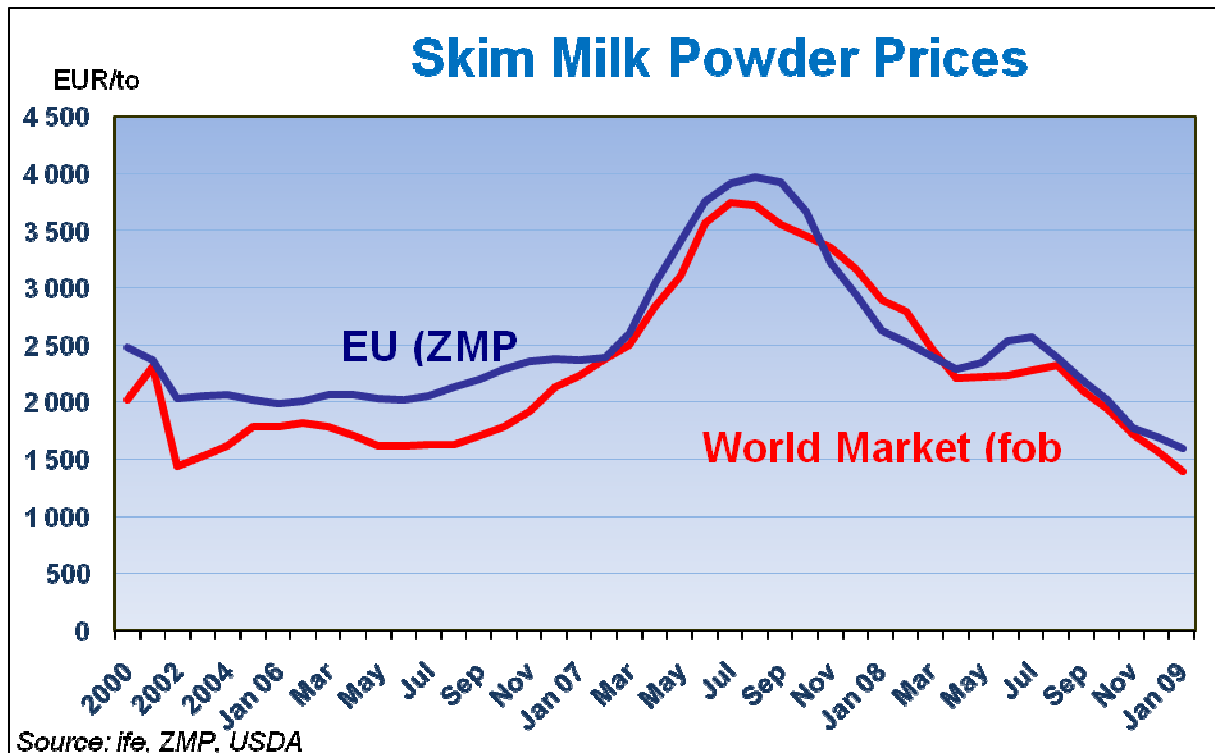
Therefore most of the additional milk volumes will be transformed into butter and SMP. As result, the butter and SMP market will remain under pressure at least until the mid of 2009.

The re-introduction of the EU support measures, (private storage, intervention purchases, export refunds) foreseen for early 2009, will enable the EU market to keep prices above the World Market levels. At present, the EU is not competitive at the market prices which are quoted because of constantly fallen international prices and a certain recovery of the Euro rate.



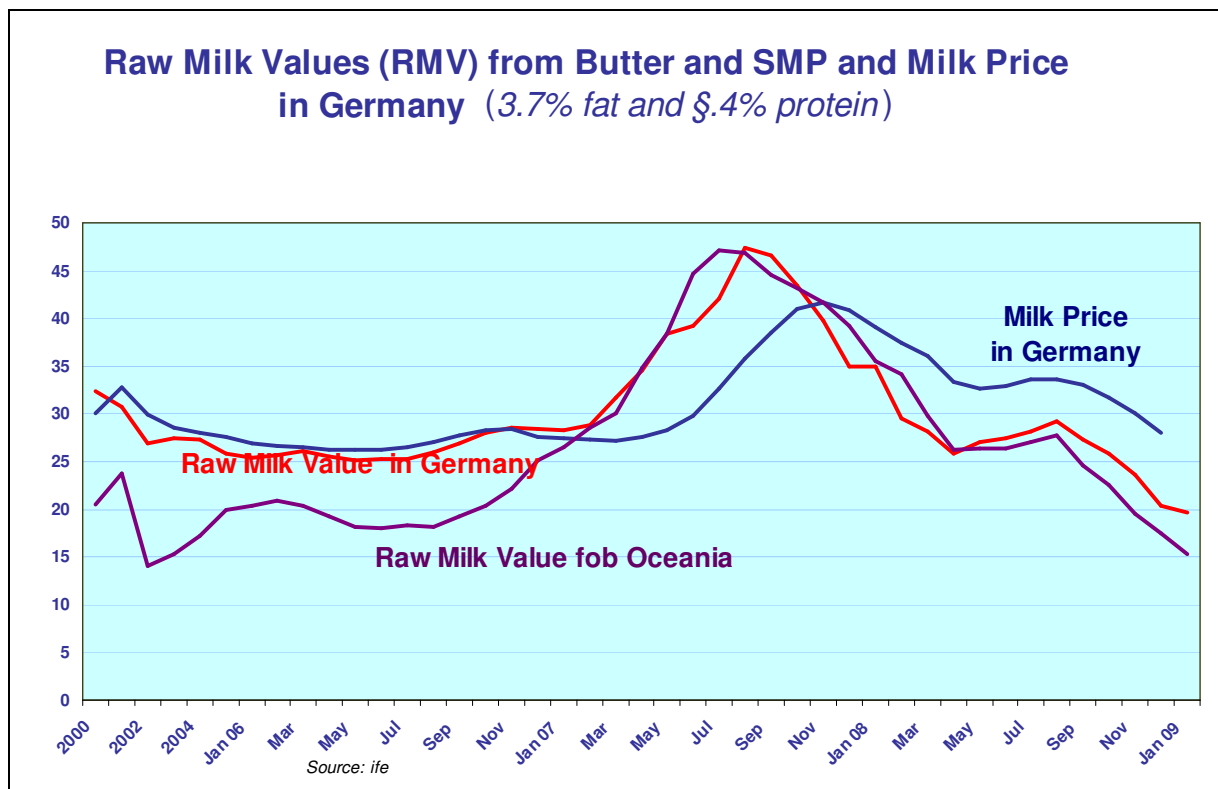
The PSA butter scheme has already been started in January – earlier than ever in the EU history- , but the question is whether the combined effects of the PSA scheme and 30.000 t eligible to be sold at the intervention price of 221.75EUR/100kg will be sufficient to clear the market over the summer period.

In the case of SMP, the situation is less dramatic. 109.000 t can be bought in (provided enough funds are available). This might be sufficient to clear this years' surpluses if exports do not decline further. But also here and for WMP further price cuts or export refunds are necessary to re-establish competitiveness on the international market.



## Impacts on Milk Prices

When transformed into a value for raw milk at 3.7% fat and 3.4% protein, the [returns from butter and SMP production](#) are significantly lower than farm milk prices at the end of 2008. The raw milk value's evolution, however, does not determine the level of the other market prices and the producer prices, but it gives the direction on the medium and the long term. In a similar way as it went ahead of other prices in 2006 and 2007 on the road upwards it shows now the downward direction. But it is clear that farm milk prices have to follow more than they did so far. In particular if the EU Commission does not pay export refunds again the EU prices will follow the fluctuations of the international markets with the same volatility in the case of industrial dairy products but more moderately in the case of the liquid sector and cheeses and, of course, in the case of farm milk prices.



Annex tables:

Table 1:

<b>EU Dairy Market: Overview 2007 - 2008 and forecast 2009</b>			
in '000 t	2007	2008*	2009**
<b>Milk Deliveries</b> to dairies	133.730	135.000	136.000
<b>Consumed as fresh products</b> <sup>1)</sup>	46.512	46.600	46.800
<b>Butter</b>			
Production	2.065	2.080	2.120
Consumption	1.960	1.950	1.970
<b>Cheese</b>			
Production <sup>2)</sup>	8.976	9.020	9.070
Consumption	8.721	8.760	8.800
<b>Skim Milk Powder</b>			
Production	1.090	1.040	1.100
Consumption	870	850	900
<b>Whole Milk Powder</b> production	775	850	850
<b>Population</b> (million head)	496	498	500
*) Provisional. **) Estimated. 1) Liquid milk, consumption cream, yogurts, milk drinks etc. 2) Incl. farmhouse production and cheese made from other animals milk, excluding processed cheese.			
Sources: ife, Kiel; partly based on data from ZMP, Bonn.			

Table 2

<b>EU Butter Balance Sheet</b>			
'000 t	2007	2008*	2009*
Total production	<b>2.065</b>	<b>2.080</b>	<b>2.120</b>
Imports	85	80	80
Exports	210	150	150
Final stocks	80	160	170
- in intervention	0	0	30
Disappearance	<b>1.960</b>	<b>1.950</b>	<b>1.970</b>
*) Provisional/Forecast.		Updated Dec. 2008	



Table 3

<b>EU Cheese Balance Sheet</b>			
'000 t	2007	2008*	2009*
<b>Production</b>	<b>8.976</b>	<b>9.020</b>	<b>9.050</b>
Imports	94	90	90
Processed cheese			
impact	265	260	260
Exports	594	550	550
Stock Change	+20	+60	-10
<b>Consumption</b>	<b>8.721</b>	<b>8.760</b>	<b>8.860</b>
- per capita (kg)	17,7	17,8	18,0
*)Provisional/Forecast.		Updated Dec. 2008	

Table 4

<b>EU SMP Balance Sheet</b>			
'000 t	2007	2008*	2009*
Production	1.090	1.040	1.100
Imports	10	5	5
Consumption	870	850	900
Exports	196	150	170
Ending stocks	129	173	168
- in intervention	-	-	100
*)Provisional/ Forecast.		Updated Dec. 2008	

*Figures are based partly on ZMP informations.*

January, 2009