

# EU Dairy Markets, Situation and Outlook January-April 2011

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*Special report produced for CLAL*

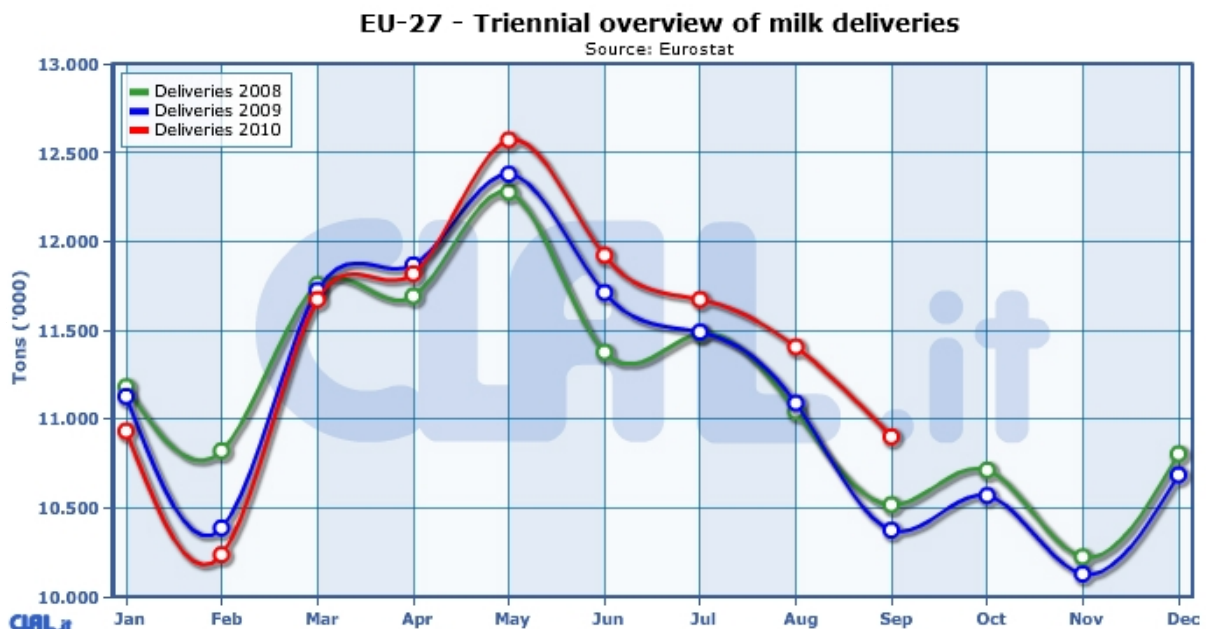
## Highlights:

- Milk and dairy markets are mainly characterized by prices at high levels and growing production.
- EU milk supplies growing seasonally until May and above 2010 levels.
- Rising farm milk prices give incentives to increase milk production, but also rising feed costs might slow down the growth speed.
- Nevertheless higher milk supplies are short of stronger demand from international and internal markets.
- Outside EU milk production is increasing in many parts of the world, but obviously not fast enough to cover additional demand.
- Cheese production will absorb most of all additional milk supplies. Therefore no significant increase of butter and skim milk powder production is likely.
- Dairy commodity prices on the international market and in the EU are in full convergence.
- The availability of intervention stocks is obviously no more able to create stability for skim milk powder and skim milk as component of many dairy products.
- Butter and milk fat supplies are tight in relation to demand, because no butter stocks are available, and therefore prices of butter, bulk cream and other milk products with high fat contents will stay at high levels for most of the year 2011.
- For the European scene much is depending on the Euro exchange rate.
- Easing of the tight supply situation might be possible later in the year.

## Milk Production

EU milk supplies have expanded significantly since May 2010. 91 million tonnes were delivered to dairies in the period May through December, 2.0 million tonnes or 2.2% more than in the same period of 2009. This increase resulted both from favorable climatic conditions in major parts of the EU,

though not everywhere, and from a quick response of farmers to the improved market situation and the ongoing easing of the quota rules. Relative strong increase rates of milk production could be observed in Ireland, France, Germany, the Netherlands, Denmark, Austria and the United Kingdom, whereas production in other areas, and in particular in the Eastern member states and in Italy stagnated or trailed behind last year's volumes. The growth slowed down towards the end of 2010. In view of rising feed costs and also with some countries, in particular those with recent expansion, coming close to their quotas at the end of the quota year 2010/11, the pace of growth might continue to be slower also in the next months.



In other parts of the world milk production is developing differently. It continues to rise in the United States and many other countries, but not in Oceania as the main supplier to the international market. The increase in Australia is only modest, but drought in the north of New Zealand has reportedly created severe problems to dairy farming. Also milk production in Russia and Ukraine is stagnating or even reduced and a recovery with volumes ahead of 2010 is not likely before May/ June. Consequently Russia will continue to import more cheese. In China milk production is expected to rise again but trailing more behind demand than ever, which will result in record imports of whole and skim milk powder.

## **Unusual firmness of prices in early 2011**

The assessment that milk production is behind demand despite ongoing growth has been confirmed at the beginning of 2011: normally dairy commodity prices go down over the turn of a year, but recently just the adverse happened. The commodity prices mainly soared because of the strong demand from international markets. Consequently also the spot market prices for milk, skim milk concentrates have started in the New Year with rising tendencies. Bulk cream, however, was quoted lower, but this is not in compliance with the situation of the bulk butter market and might change soon.

## **Ongoing demand growth**

The recovery of demand is less spectacular in the European market. Main areas are cheese and fresh dairy products. And it is the question, whether the new difficulties in financial markets will end in a new economic crisis or not. At present it is mainly a problem of the fiscal situation of some member states. However, the policies to cut state debts might force also many consumers in the respective countries to reduce spending, whereas in other countries and in particular in Germany the consumer mood and the economic expectations are better than many years ago. But when expenditures are reduced it is under European (and other countries with developed dairy markets) conditions not the purchasing of food items which is suffering first.

This is different in the emerging markets all over the world, where Western food consumption is concentrated in industrial agglomerations: if economies are running well, significantly more people are employed than in recession periods; consequently much more consumers have access to Western food including dairy products than in the recession. And China has taken a major role as importing country now with significant volumes of milk powder.

All that explains that in emerging markets for dairy products after the recession demand has outpaced supplies within a very short period and all available sources from domestic productions and major exporting countries, to which add up the problems of unexpected bad climatic conditions in some countries. Therefore it seems to be very unlikely that an easing of the situation might occur before the mid of the year. Thus the statement of the last CLAL forecast

published in October that it would not be “...*the right time yet for price reductions*” has been well confirmed. The turn of the cycle will come later in 2011 than it was expressed three months ago.

### **EU and World markets of dairy commodity prices almost in full compliance**

EU exported substantially more cheese and SMP in the first nine months of 2010 than the year before, whereas butter exports were slightly reduced and whole milk powder exports recovered relatively late. Price levels of commodities in EU and in international markets were close to each other. The reduced rate of the Euro in US-Dollar terms since mid-October has brought the EU-supplies in a good competitive position. Therefore the world market prices have adopted the EU levels again.

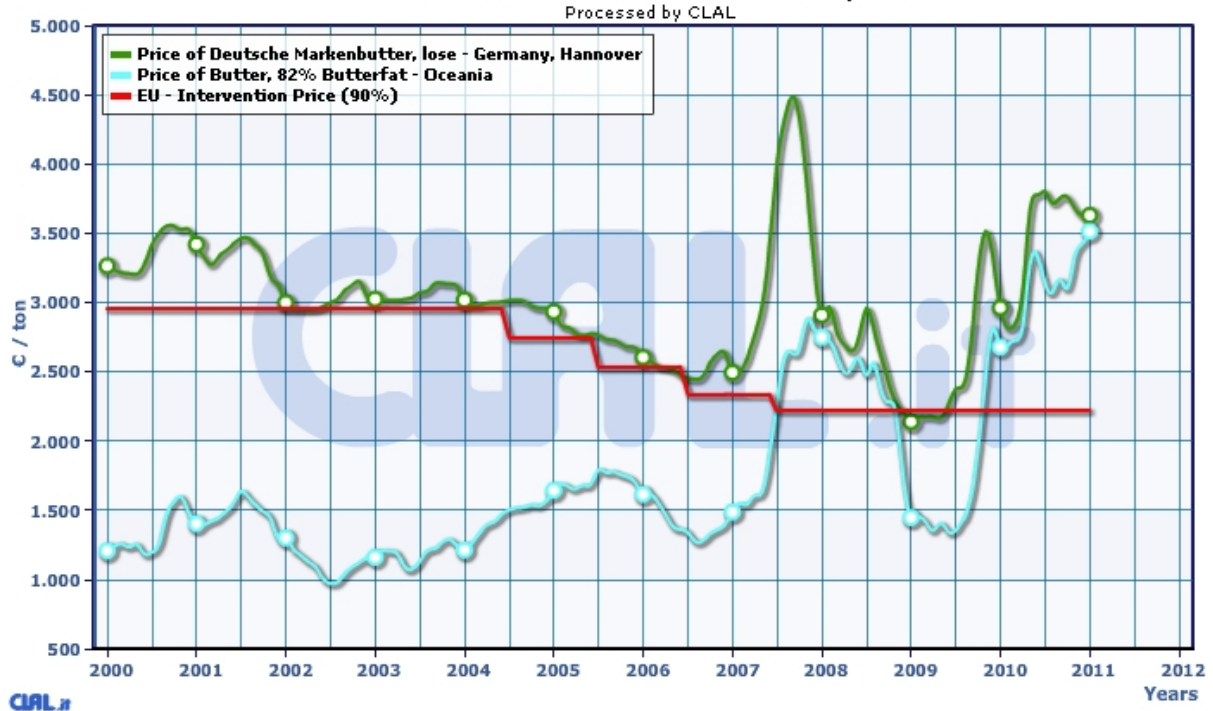
### **No scope for significant increase of EU production of butter and skim milk powder**

As EU cheese production is boosted both by domestic and growing export opportunities most of the additional milk supplies will be absorbed for cheese manufacturing. Also more milk will be required for whole milk powder and fresh dairy products. Therefore only a modest increase of skim milk powder and butter production over last year's volumes is likely.

### **Firm Butter Market**

With a stagnating butter production, a stable domestic consumption in the EU and attractive price offers for exports a firm market is expected. Parts of the stocks in intervention are cleared by the scheme of butter donations. Inventories in private stocks which are needed to fill supply gaps later in the year will be reduced because taking of butter into storages at high prices is not attractive anyway and in particular if there are good export opportunities. The question will be whether on the medium and long term demand is reacting negatively on high prices, but the difference to the 2008 situation is that there is no economic recession. Moreover, also the prices of other vegetable fats have increased.

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

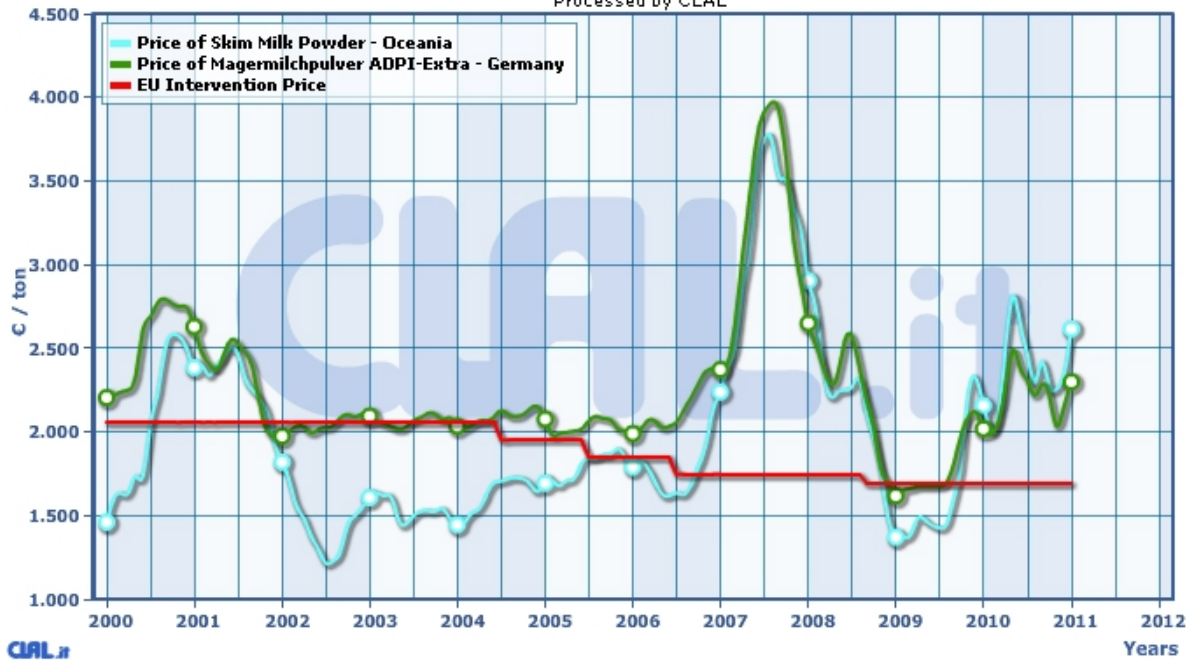


### Less stability in the market of skim milk powder than expected, whole milk powder catching up

Only for a few months the expectation of more stability in the milk powder sector, which was expressed in the earlier CLAL forecast, came true. The EU food industries started first to move forward trading when prices had eased a bit, followed by the demand for exports and then by demand from the side of calf feed producers. And it is reported that many producers are sold out for several months ahead. The demand for skim milk powder from producers of calf feed is supposed to be stronger because attractive farm milk prices might lead to more consumption of milk replacers for rearing, to have more raw milk available for deliveries. Already at the start of 2011 demand is exceeding supplies from current production which has set the EU authorities in the position to sell around 10.000 t from intervention stocks at rising prices. At present, 195.000 t are still in intervention, of which 94.000t are committed for the program to support needy people. The European Commission is not in a hurry to sell, which is evident by the volumes of offers which were not accepted in the recent tenders.

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

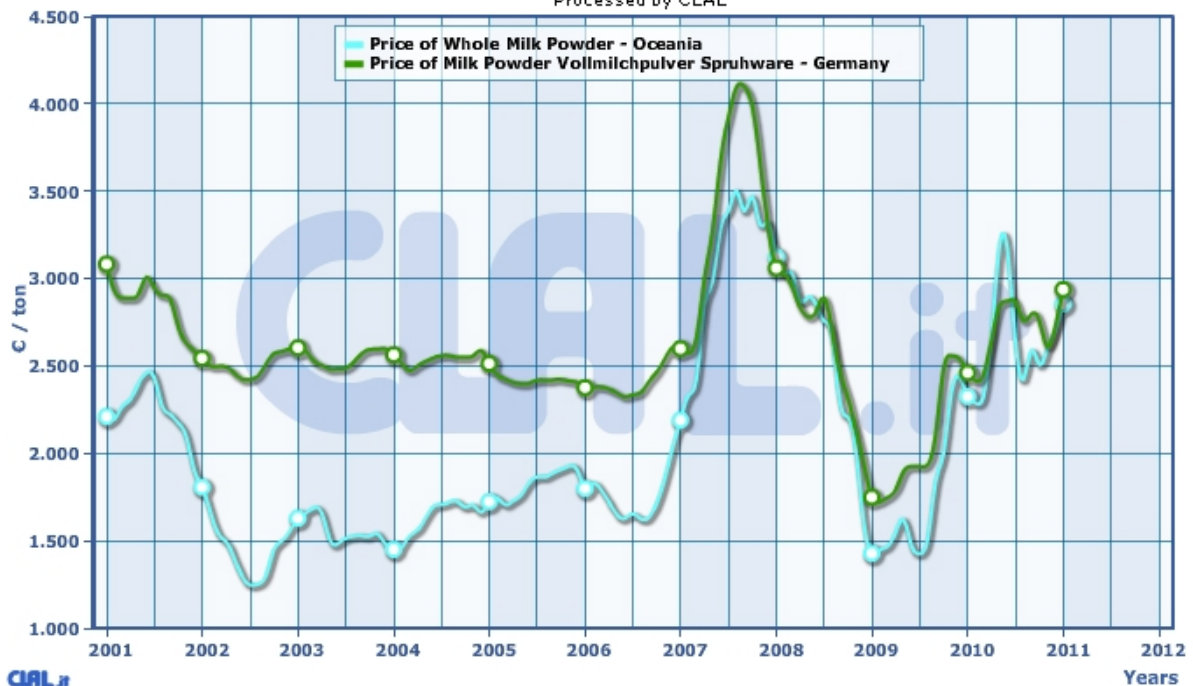
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For a longer period whole milk powder prices did not correspond to the full extent to the prices of skim milk powder and bulk butter, which has changed now with increased demand for exports of EU origin powders.

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

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## Other sectors

Since it is obvious that the prices of basic dairy commodities are high for a longer period than initially expected it is the question which other sectors of the dairy market will be influenced. It might be different from country to country in the EU, depending on the margins in the supply chain. But where these margins are short, i. e. in the part of private labels in Germany, the pressure to adjust prices upwards are stronger than in other markets.

As consequence of the firmer situation in the bulk butter market retail prices for packaged butter should be increased if they have to be in line with the bulk butter market. But it seems to be difficult to do so in some EU countries. For instance in Germany the most recorded retail butter prices are at 99Ct/250g package, and there are concerns of negative consumer reactions when prices move over the threshold of 1,00€

So far the cheese market was in the best position, but with the recent and possibly more price increases for butter and milk powders in the next future also cheese prices might become again the subject of discussions. It remains to be seen what the outcomes will be.

### Statistics

Table 1

#### EU Dairy Market: Overview 2007 - 2010 and Forecast 2011

1.000 t	2007	2008	2009	2010 Estim.	2011 F-cast
<b>Milk Deliveries</b>	134.018	135.698	135.081	136.900	138.500
<b>Liquid Products</b>	45.145	44.817	44.756	45.000	45.200
<b>Butter</b>					
Production	2.110	2.100	2.050	2.010	2.035
Consumption	1.994	1.968	1.984	1.980	1.970
<b>Cheese</b>					
Production <sup>1)</sup>	9.248	9.305	9.298	9.420	9.500
Consumption	8.728	8.829	8.836	8.865	8.900
<b>Skim Milk Powder</b>					
Production	1.090	1.040	1.100	1.060	1.080
Consumption	870	770	780	785	800
<b>Whole Milk Powder</b>					
Production	775	840	740	770	820
Consumption	369	351	341	340	340
<b>Population (m. head)</b>	496	498	500	502	503

Source: ife Kiel, according figures collected from ZMB and EU Commission publications.

Table 2

**EU Butter Balance Sheet**

1.000 t	2007	2008	2009	2010*	2011*
Total production	2.110	2.100	2.050	2.010	2.035
Imports	85	65	62	45	55
Exports	211	147	143	140	140
Final stocks	100	150	135	70	50
- in intervention	0	0	80	2	0
<b>Consumption</b>	1.994	1.968	1.984	1.980	1.970
*) <i>Estimated. ife Jan. 2011</i>					

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

Table 3

**EU Cheese Balance Sheet**

1.000 t	2007	2008	2009	2010*	2011*
Production	8.983	9.050	9.048	9.170	9.250
Imports	94	89	84	85	80
Processed cheese impact	265	255	250	250	250
Exports	594	555	576	650	680
Stock change	+20	+10	-30	-10	+0
Consumption	8.728	8.829	8.836	8.865	8.900
-per capita (kg)	17,6	17,7	17,7	17,7	17,7
*) <i>Estimated. ife Jan. 2011</i>					

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

Table 4

**EU WMP Balance Sheet**

1.000 t	2007	2008	2009	2010*	2011*
<b>Production</b>	773	840	740	770	820
Imports	2	2	2	0	0
Exports	366	481	451	440	480
Change in stocks	40	10	-50	-10	0
<b>Consumption</b>	369	351	341	340	340
*) <i>Estimated. ife Jan. 2011</i>					

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

Table 5

**EU SMP Balance Sheet**

1.000 t	2007	2008	2009	2010*	2011*
Production	1.090	1.040	1.100	1.060	1.080
Imports	10	8	6	6	0
Consumption	870	770	780	785	800
Exports	201	179	230	370	370
Ending stocks	124	222	318	229	139
- in intervention	-	-	260	195	100
*) <i>Estimated. ife Jan. 2011</i>					

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