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# EU Dairy Markets, Situation and Outlook May-August 2009

by Erhard Richarts, Dairy Market Consultant, Chairman of IFE (Informations- und Forschungszentrum für Ernährungswirtschaft e. V., Kiel)

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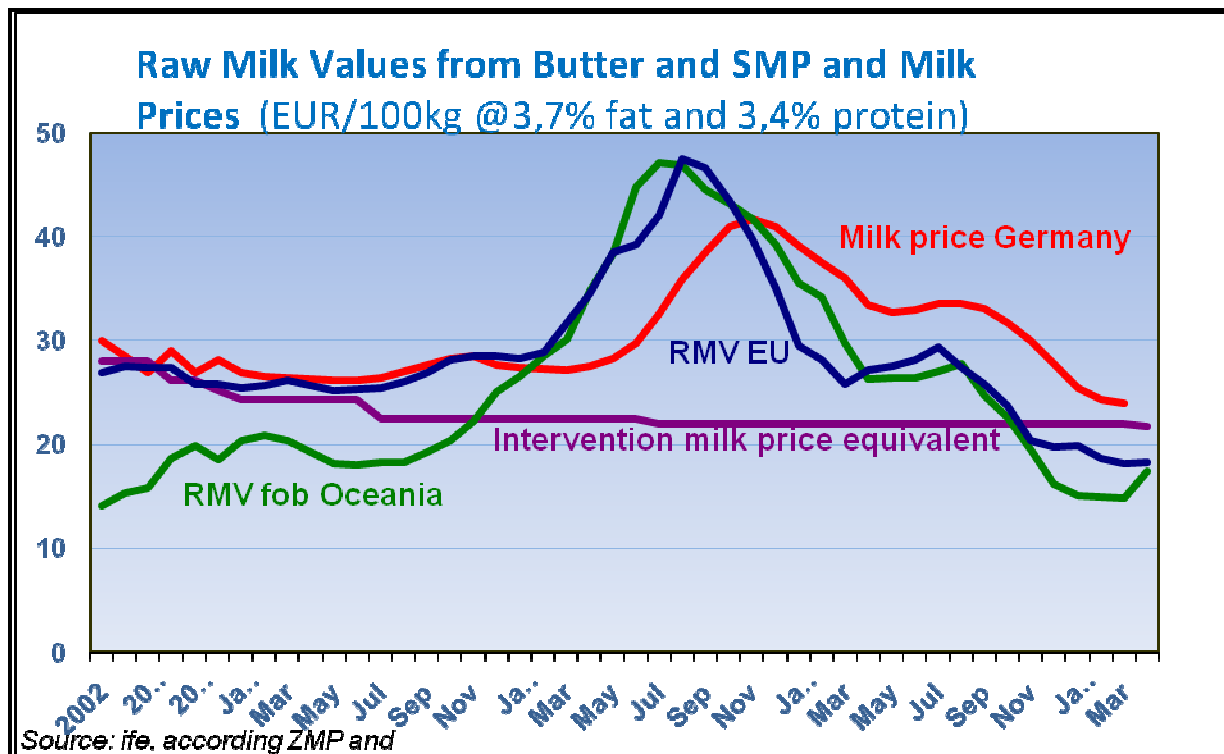
## Highlights:

- Increase of milk supplies in 2009 only modest, if any, and behind quota increase
- EU demand partly weaker
- Exports reduced and not sufficient to absorb the excess of supplies over domestic demand
- Market surpluses have to be cleared by intervention
- Reference prices will largely determine price levels
- Farm-gate milk prices are expected to remain low or to continue to decline where they have not yet reflected the reduced returns of the dairy industry from the markets

## EU milk and dairy markets: No scope yet for recovery of prices

- No substantial increase of EU milk production is expected despite higher quotas
- Demand stagnating and in some sectors even reduced
- Reduced export opportunities which seem more and more affected by the economic crisis and increasing production in the United States, Oceania and Asia
- Ongoing build up of stocks in intervention
- Low returns from sales to intervention because of reduced market support by the EU following the farm policy reforms

The year 2009 has started with significantly reduced payout milk prices to the farmers, which, however, do not yet reflect the downturn of the dairy commodity markets to the full extent. For the commodities the situation has stabilized now at historically low levels by the sales to intervention which started March 1<sup>st</sup> and allowed to sell butter and skim milk powder which has been produced since February 1<sup>st</sup>. [Export refunds](#) are available since January 23. Although they did not immediately lead to a stronger demand from the international market, it helped to prevent the commodity prices to go down further to the even lower World market levels.



In March and April 2009, the [Raw Milk Value of milk processed into butter and SMP](#), which is calculated by IFE, stayed at historical low levels of 18,1 and 18,2 Ct/kg for milk with 3,7% fat and 3,4% protein. The prices which were paid out were still significantly higher. But for the German market the question is now whether this higher level can be maintained after the severe price cuts for liquid milk and related products resulting from the recent listing talks between dairies and retail companies. Taking this into account and the necessity to clear the market by sales to intervention the prospects for the usual seasonal recovery of milk prices after May are poor. Whether the commodity prices can recover will depend on what happens after August 31, when intervention buying is over and



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PSA butter stocks can be returned to the market two weeks earlier. All this will mainly depend on the demand from domestic and export markets.

### **Demand partly depressed**

The domestic market seems to be depressed by the economic crisis and also to some extent by the substitution effects of 2007/08 which resulted from high market prices. In many sectors the substitution is not fully reversible when prices go down, once other items have been found with similar taste, similar functions and less volatility of prices and supplies. For the consumer products, the market research results of 2007 and 2008 showed a clear reaction of consumers to rising and falling prices. In view of the economic crisis, it can be assumed that the catching up of consumption in the new EU member countries will take a break since some of these countries are much more hit by the crisis than Western member states and the share of the disposable incomes which is spent for food is much higher than in the West. And even in the Western member states the full impacts of the crisis have not reached the consumers, it is likely that many jobs more go lost than did so far.

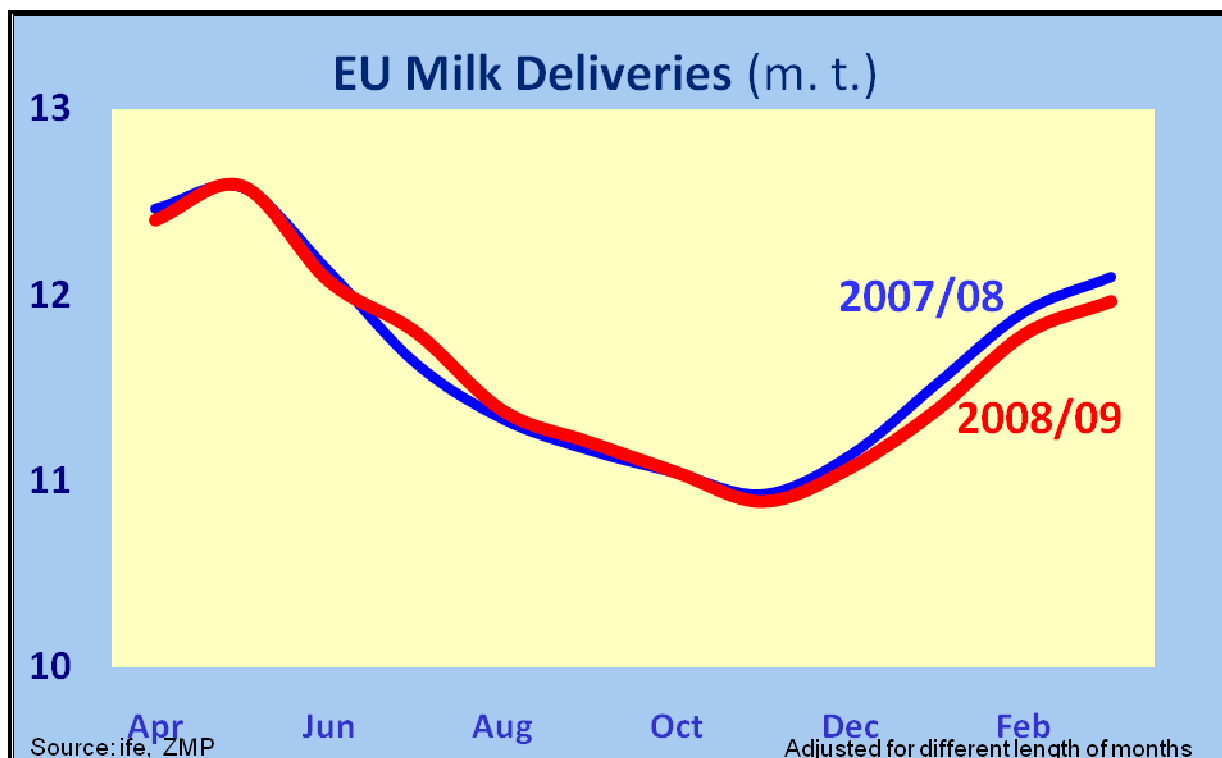
### **Depressed World Market**

Export figures of the EU still display a certain decline with the exception of whole milk powder. For the World market it can be stated that the prices have reached the bottom and they recently firmed up a bit. The increase of the world milk production is expected to slow down, but this might be in line with the reduced growth of demand. The only argument in favour of a stronger demand might be that now the scope for further price reductions is poor and international buyers are prepared to make more forward contracts than they did in the period of falling prices. Therefore it remains to be seen whether more demand might come also back to the European market.

### **No significant Increase of Milk Supplies expected: Milk Production follows more the Market Forces than the Quotas**

For 2009 no significant increase of [EU milk supplies](#) is in sight. So far they have been slightly below 2008 volumes, but they might temporarily go ahead of 2008 in April and May. With low milk prices also the use of concentrates might be less attractive despite also here reduced prices. Additionally the culling rate

for cows might increase and the structural change might accelerate when production costs temporarily can no more covered by the milk prices. Already in the quota year 2008/09 the milk production in the EU was behind the quotas, which had been increased by more than 2%. For 2009/10, the quotas are up by 1%, but additional increases are possible by the reduced fat adjustment. Nevertheless, why should the farmers react to this when they did not the year before, when the space for increases was even larger. Anyway, all this are “on average” considerations: Some farmers might do it, but the majority will not do so.



## Milk Processing: More Butter and SMP, less Cheese

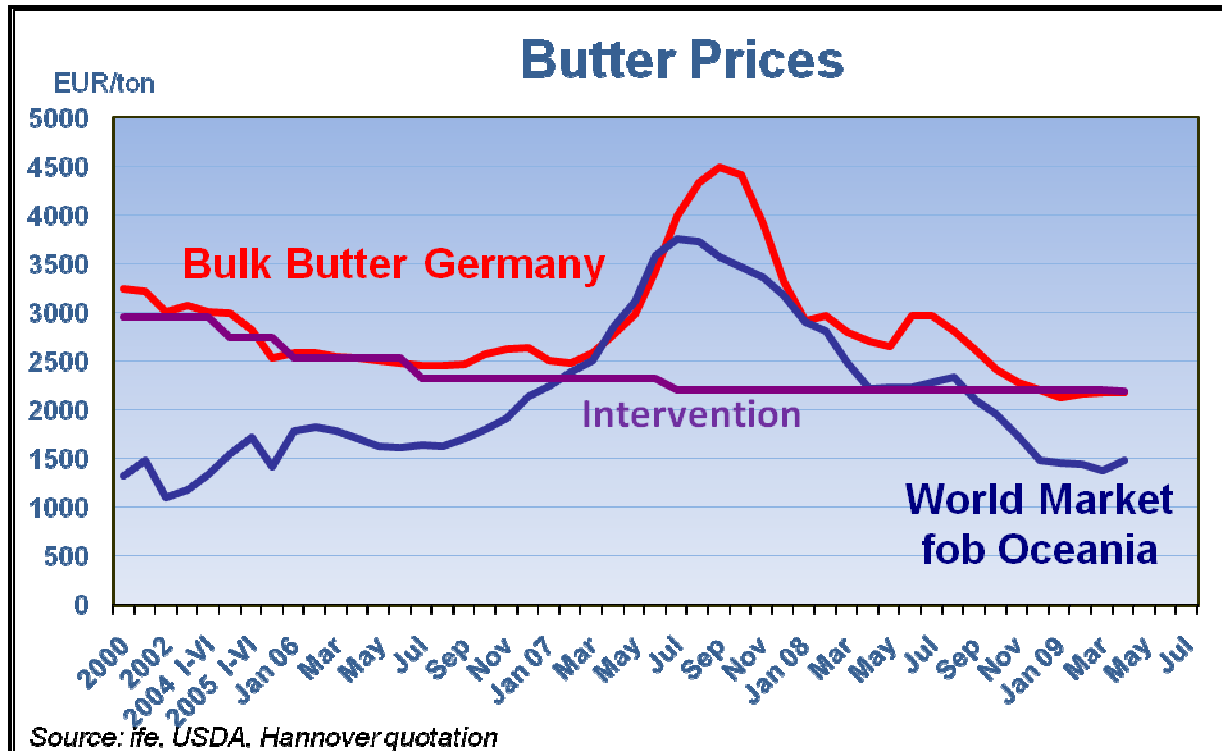
Against earlier forecasts the prospective structure of milk processing has to be revised. In view of the problems from the demand side described above it can be assumed that there will be no increase in the sector of liquid milk and fresh products, and [cheese production](#) will be slightly reduced, even if domestic demand might grow a bit, because exports are expected to be reduced if they



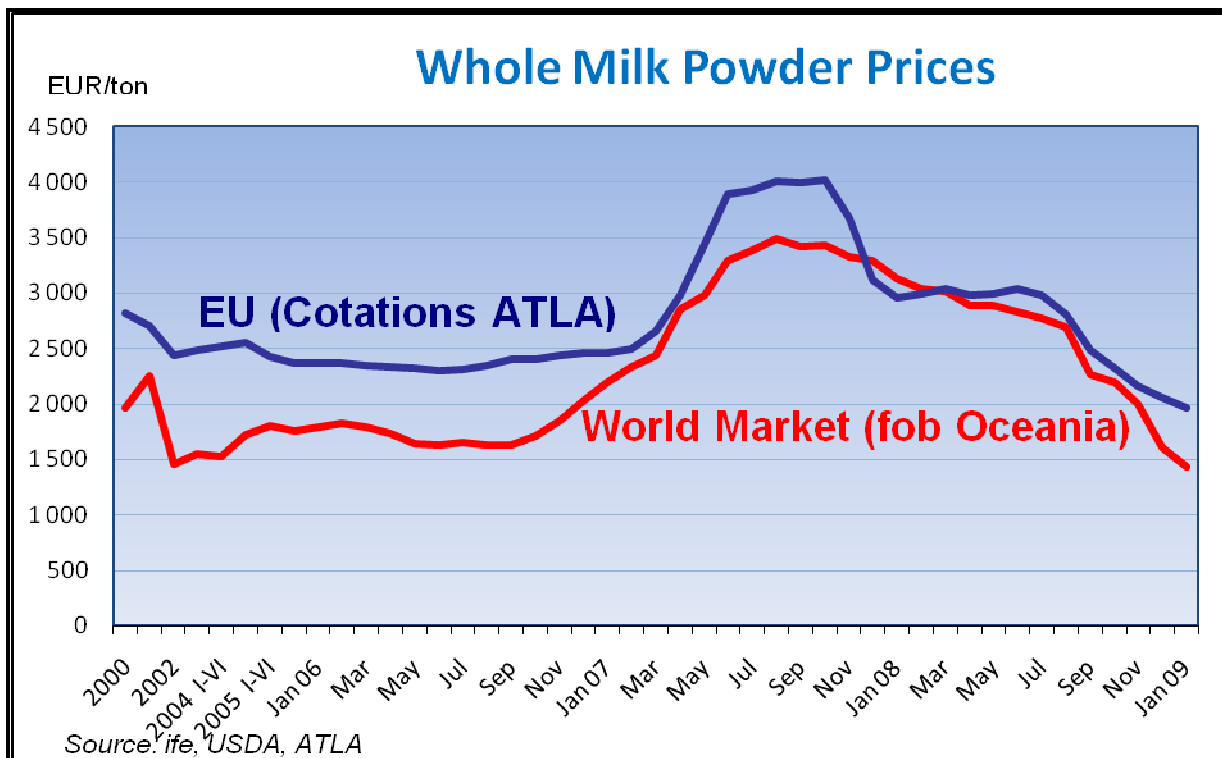
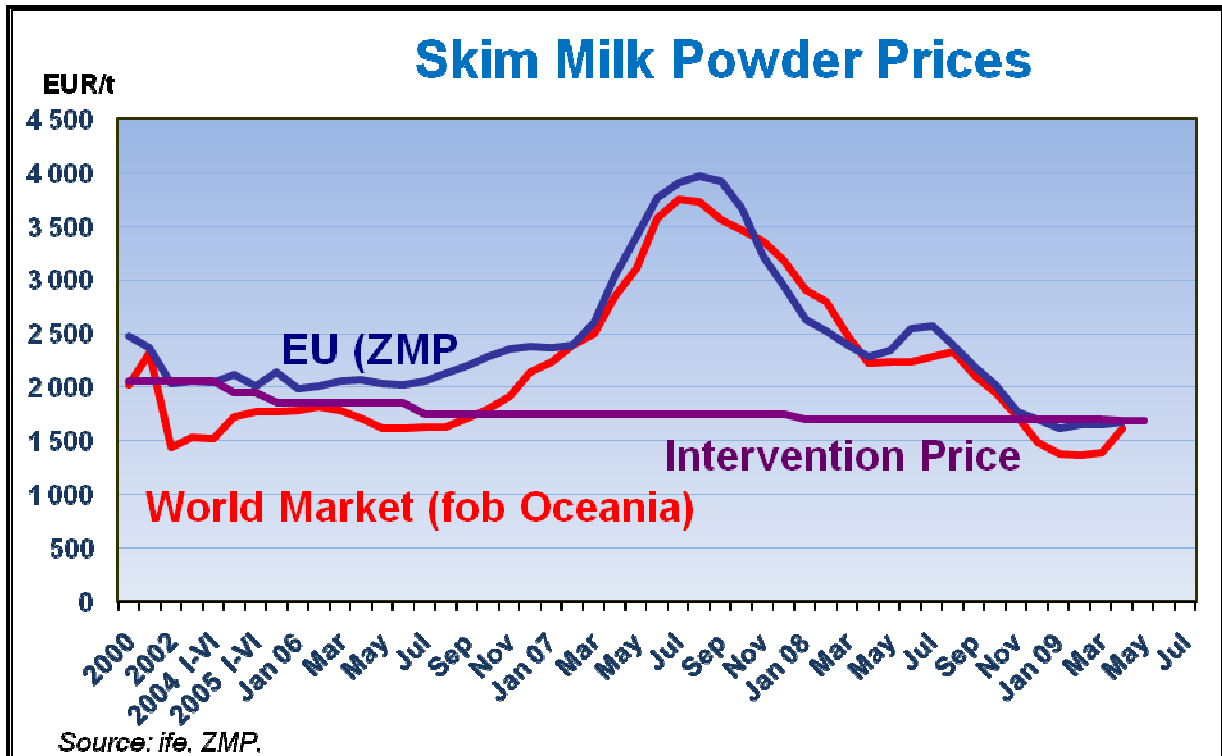
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follow the current tendency. [Whole milk powder production](#) has been increased in 2008 mainly as result of increased exports, and there is no evidence that this might change in 2009, if one takes into account the export figures which are available so far. For both the domestic and the foreign markets it might be attractive to incorporate whole milk powder in some applications instead of other milk powders because the price difference to skim milk powder is only low.

Compared to earlier forecasts most of the small additional milk volumes and the volumes which are not needed for cheese will be processed into butter and SMP. As result, the [butter](#) and [SMP](#) market will continuously need surplus clearance by intervention in the next months. The question is, whether this clearance , which will come to its end by August 31 will be sufficient to keep price levels stable or to allow a recovery in the time hereafter. In view of the seasonal decline of milk supplies it seems to be possible if sufficient volumes can be exported. But if the EU has to dispose of large volumes of butter and skim milk powder at the end of the intervention period, this will be an obstacle to significant price increases for probably one or more years. As long as stocks are being built up or are cleared the commodity prices will almost move in a narrow corridor between the market equivalent of buying in and selling out prices of intervention stocks.



After reaching the limits of 30.000 t of butter and 109.000 t of skim milk powder the EU has changed the buying in to the tendering procedure. In the first tenders the prices have been reduced only slightly against the fixed prices. It might depend on the further volumes if the tender prices will be reduced more. Anyway, the EU faces the risk of losses if the markets do not recover. On the short term, the budget is not formally charged as long as intervention stocks are not depreciated, which makes the difference to paying export refunds: The exported items subject to refund payment have created budget costs, but have the advantage of having disappeared from the domestic market, whereas the stock initially does not create costs. But once it is be returned to the market place it will increase the supplies and can hinder a quick price recovery.





## Conclusion

Despite the fact that all experts agree in predicting stronger price volatility in dairy markets it can be assessed that for a longer period until and possibly beyond 2010 prices will move at reduced levels, but certainly not all the time as low as at present.

For the commodities like butter, bulk cheeses and milk powders the lowest level might be reached, although further reductions cannot be ruled out but do not seem to be very likely.

Consumer dairy products are still under pressure. Should the commodity market gains more stability later in the year, they can also return to a more stable situation.

Farm milk prices will be further reduced where they are not yet on a level which is close to that of the market returns from the commodities.

The structural change in dairy farming and dairy processing will be accelerated.

## Annex

EU Dairy Market 2007 - 2009			
in '000 t	2007	2008*	2009**
<b>Milk Deliveries</b> to dairies	133.480	134.680	135.000
<b>Consumed as fresh products</b> <sup>1)</sup>	46.512	46.600	46.600
<b>Butter</b>			
Production	2.065	2.075	2.100
Consumption	1.960	1.920	1.920
<b>Cheese</b>			
Production <sup>2)</sup>	8.976	8.990	8.950
Consumption	8.721	8.765	8.760
<b>Skim Milk Powder</b>			
Production	1.090	1.050	1.080
Consumption	870	850	850
<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 milk, excluding processed cheese.  
Sources: Ife, Kiel; partly based on data from ZMP, Bonn.

Table 1





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<b>EU Butter Balance Sheet</b>			
'000 t	2007	2008*	2009*
Total production	<b>2.065</b>	<b>2.075</b>	<b>2.100</b>
Imports	85	65	50
Exports	210	150	140
Final stocks	80	150	240
- in intervention	0	0	100
Disappearance	<b>1.960</b>	<b>1.920</b>	<b>1.920</b>
*) <i>Provisional/Forecast.</i>		<i>Updated May 2009</i>	

Table 2

<b>EU Cheese Balance Sheet</b>			
' 000 t	2007	2008*	2009*
<b>Production</b>	<b>8.976</b>	<b>8.990</b>	<b>8.950</b>
Imports	94	90	60
Processed cheese impact	265	260	250
Exports	594	555	520
Stock Change	+20	+20	-20
<b>Consumption</b>	<b>8.721</b>	<b>8.765</b>	<b>8.760</b>
- <i>per capita (kg)</i>	17,6	17,6	17,6
*) <i>Provisional/Forecast.</i>		<i>Updated May 2009</i>	

Table 3

<b>EU SMP Balance Sheet</b>			
'000 t	2007	2008*	2009*
Production	1.090	1.050	1.080
Imports	10	5	0
Consumption	870	850	850
Exports	196	160	160
Ending stocks	129	175	230
- in intervention	-	-	100
*) <i>Provisional/Forecast.</i>		<i>Updated May 2009</i>	

Table 4