

# EU Dairy Markets, Situation and Outlook September-December 2009

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## Highlights:

- 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 Oceania
- No more sales to intervention likely until the end of 2009
- Retail prices not everywhere adjusted to lower market prices

## EU milk and dairy markets: modest recovery of prices in the next months

In September, the seasonal decline of milk deliveries and the measures of the EU to stabilize the milk and dairy markets showed effects: starting in the bulk milk and spot milk market prices recovered first, followed by the markets of cream and skim concentrates, bulk butter and milk powders. With rising prices of butter and powders, sales to intervention came to an end, although the EU Commission declared their willingness to extend buying over the deadlines of August 31.

The prices of consumer products which are distributed via the retail channels might follow, but it is not likely that this will happen everywhere in Europe, because the downturn of the prices in the commodity markets has not been reflected in all European countries in reduced consumer prices and so it cannot be expected that they will go up now, since it is not clear how long the present firm market situation will last.

Also the producer prices will follow with a time-lag to the firm situation in the commodity markets as usually, in particular also because many dairy companies



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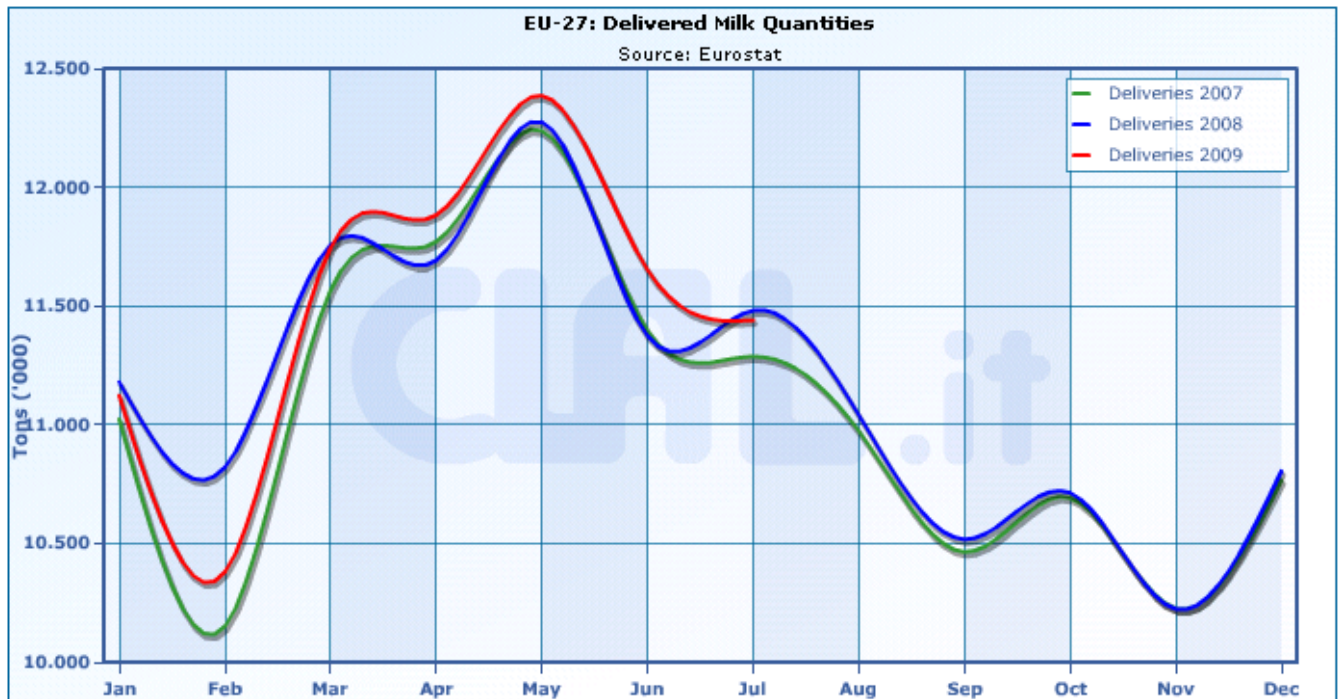
were under pressure from the farmers' side to pay higher prices than they could afford from market returns. Nevertheless, the producer prices are at low levels, and slight improvements which become possible in the present market situation will not be a signal to produce and sell more milk. The structural change in the farming industry will go on at a faster pace than it did in the years before with higher price levels. Farms with the intention to expand milk production will slow down and many farms with the intention to stop dairying, whatever the reason might be, will probably do it earlier than initially planned. This is not in contradiction to the fact that in spring and summer 2009 total milk supplies in Europe exceeded those of the year before.

It is partly due to the relatively favorable feed supplies of 2009 in the areas and farms where milk production in spring and summer is mainly based on grassland.

In the late summer and upcoming autumn the expansion rates in the EU declined, which confirms the view that in total milk production will react on low prices and seasonally rising producing costs. Compared to 2008 and 2007, many input costs of dairy farming are lower, but nevertheless the income situation of the farmers is significantly worse than in the years before and has created a lot of unrest.

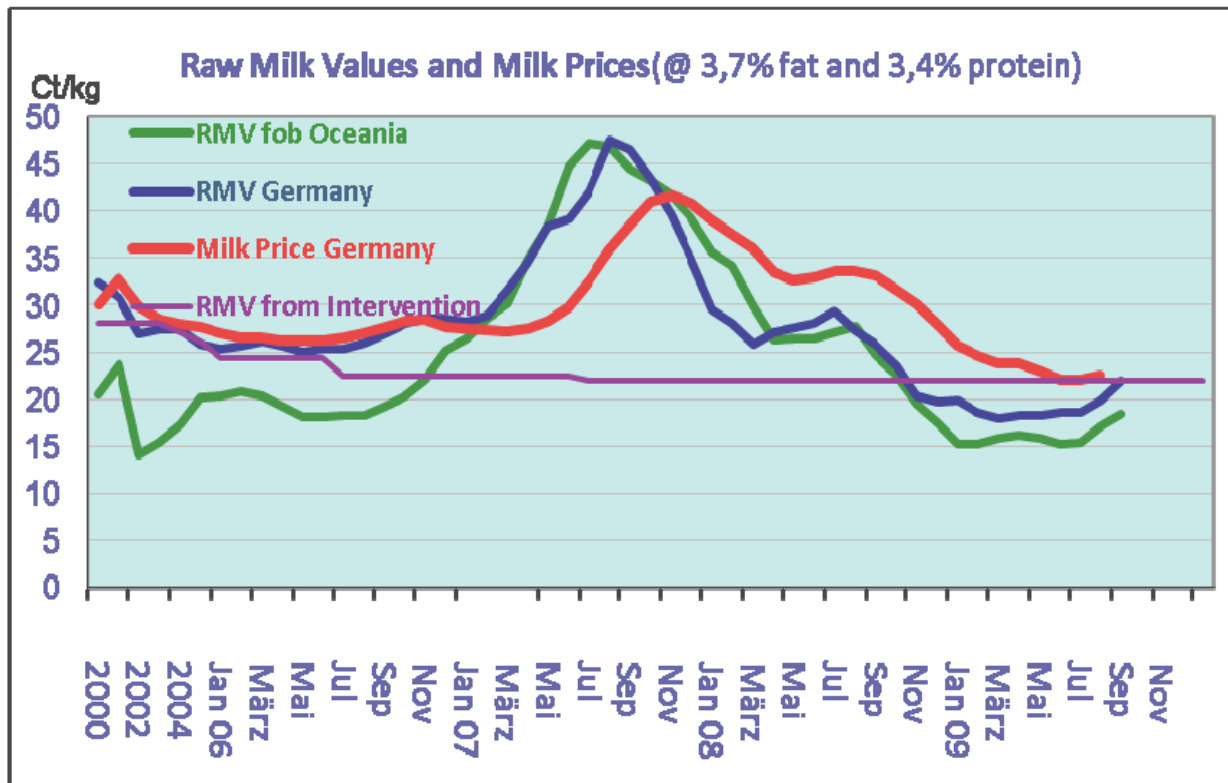
But the policy of the EU will not be changed in principal and it even seems to be unlikely that even modifications in the national quota rules with the aim to reduce supplies by quotas will have significant effects.

In this respect the policy of supply management, be it the scheduled quota increases or be it some restrictive measures on national patterns has lost its efficiency, which is evident by the fact that total milk deliveries trail behind the available quotas in the last years.



But policy is back in the market with the traditional measures of intervention and export refunds in an extent which would not have been expected a short time ago. In 2007 and 2008, the interlacement of the EU with the world market was the main reason for rising and falling prices: if the return from the world market exceeds the equivalent of the EU market support, the world price levels determine the domestic prices in the major milk producing countries and areas of the EU. If they are lower, the remaining market support which is left over after the reforms since 2004 which determines the price levels.

In September 2009, the Raw Milk Value of milk processed into butter and SMP, which is calculated by *ife*, has recovered to 22Ct (provisionally) from historical low levels of 18,1 Ct/kg for milk with 3,7% fat and 3,4% protein in March. This raw milk value represents the lowest valorization of milk under normal market conditions and is not the real milk price, but it gives the direction where prices move to. The prices which were paid out were still significantly higher. But for the German market the question is now whether the advantage of the other valorizations can be maintained, which requires higher prices for liquid products and cheese. Talks on new contracts are carried out but the outcome was not yet clear at the end of September.



## Stagnating Demand

Domestic and export markets are still depressed by the economic crisis. Markets in general had responded to the high prices already in late 2007 and 2008 by reduced demand, and supplies started partly to accelerate their growth. When prices came down demand did not recover as consequence of the upcoming economic crisis. For food and dairy markets also the fact might of relevance that many consumers had learned that products can still be used after the “best before” time had expired. Market research in several European countries shows clearly that in particular in the liquid and fresh sector household consumption has not come back to previous levels regardless of the reduced prices.

It is also clear that consumers in new EU member countries, which are more severely hit by the crisis, who have to spend higher shares of their lower incomes for food react more than in Western member countries on the crisis. Especially in the Western EU countries the impacts of the crisis do not yet have been realized by the consumers because employment has not yet shown the full

impacts of the crisis. Even if the economies start now to recover it is likely that more jobs will go lost than so far.

Under these conditions, reduced food prices are highly welcomed by consumers. It is interesting also to observe rising consumption of industrial cheeses. Although research panels do not reflect this in their figures, the question is how else than by rising total domestic demand the increasing production of hard and semi-hard industrial cheese, reduced exports and reduced stocks should be explained.

### **World Market Depressed**

EU exports to the world market are still at low levels and in some items they have still been reduced further in 2009, despite the support by refunds from the EU. Exports of whole milk powder, which increased the year before are now also down. Also other major players on the world market have lost market shares except Oceania, and the general volumes of the international trade are reduced.

And part of this picture of a break in the long term growth of dairy markets is also the stagnation of worldwide milk production, which was reported recently at the World Dairy Summit in Berlin.

### **Outlook**

Nevertheless, a recovery from this side can be expected earlier than in the European scene. Since the negative effects on employment and incomes came faster in the emerging market, also the positive effects of a better economy will probably be observed earlier than in the EU. But the relative strength of the EURO is a problem for competitiveness.

The question will be, however, whether export opportunities will already improve in 2010 and bring the EU in the position that no intervention measures will be necessary. At present, however, there is no scope yet that this will happen. But anyway the situation for the next months and early 2010 seems to

gradually improve, though not fundamentally better than a year ago, for following reasons:

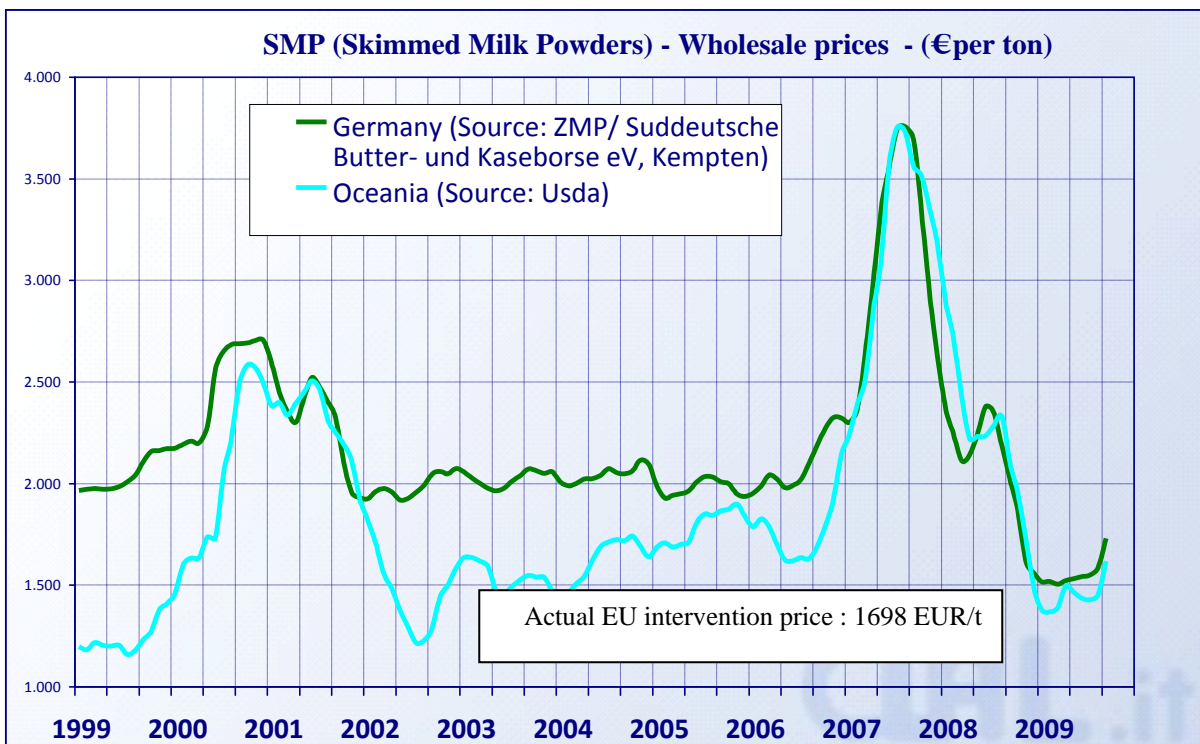
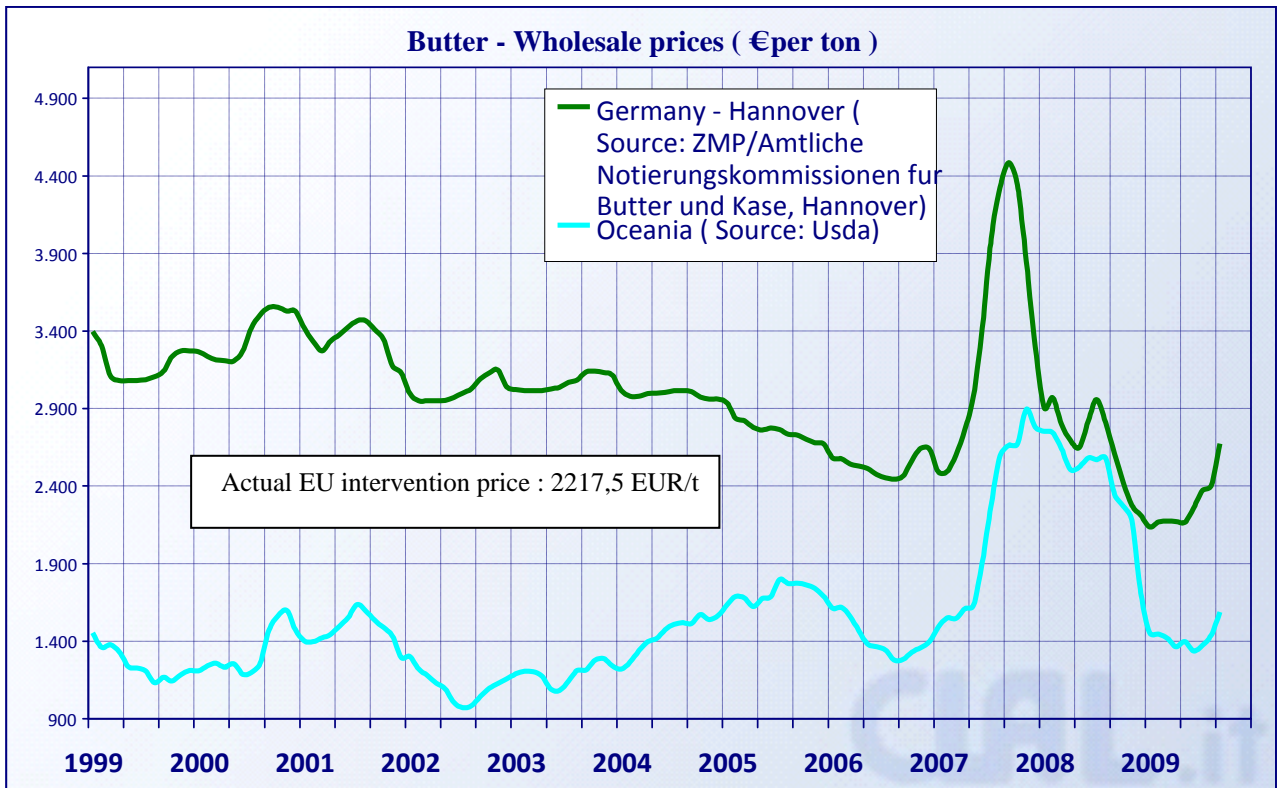
- The temporary surplus of the year 2009 is mainly cleared by intervention measures and will not be returned to the market unless prices go up.
- If the expectation that milk production will grow only slightly or even stagnate, the structural surplus which has to be cleared will be less compared to the situation in early 2009, because large private stocks of butter, powder and cheese were available at that time.
- In the industrial cheese sector several companies have already declared that they are willing to produce on normal levels over the year-end holiday period to replenish stocks back to normal levels. This means that less short term surpluses will have to be disposed of by producing butter and skim milk powder at the start of the year.
- If intervention is necessary everybody who is involved is well prepared after the 2009 experience.

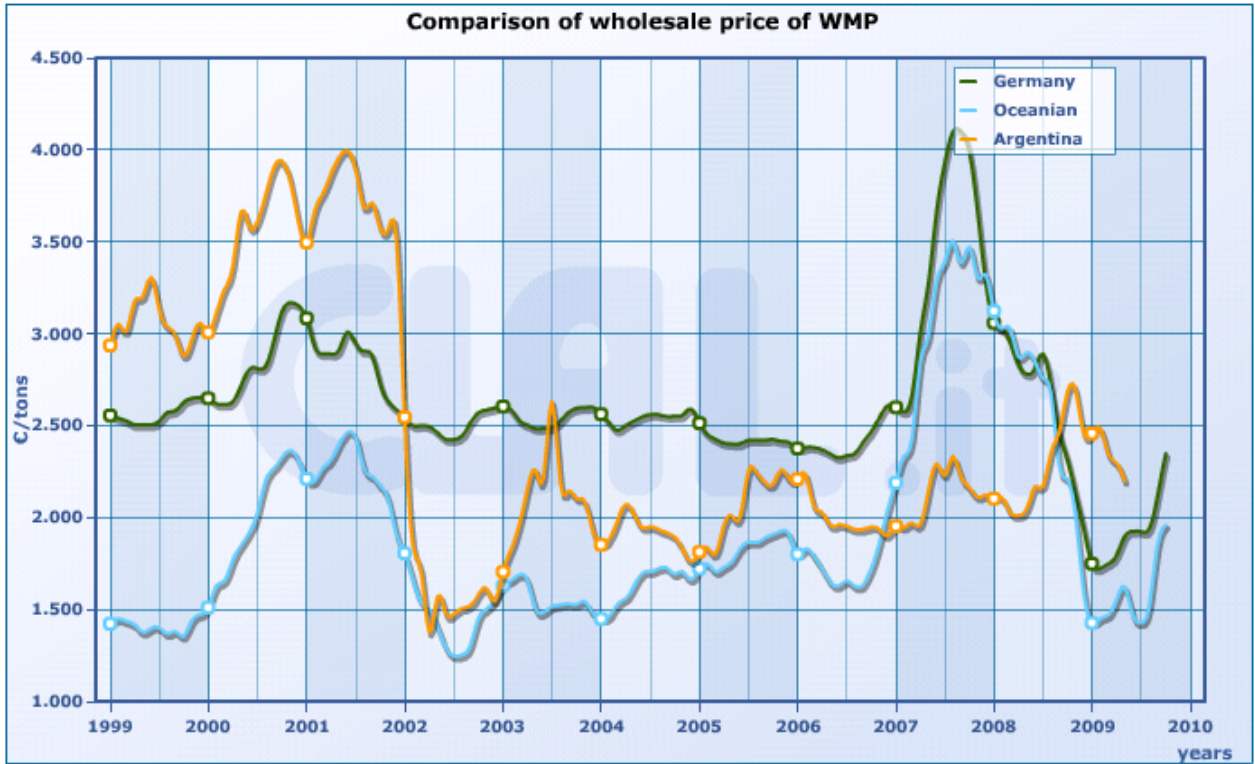
Nevertheless, the usual decline of prices by the end of 2009 seems to be likely, but more smoothly than the year before; it will also depend on the levels which will be reached in the next months until November. With the EU willing to continue the market support in a similar way as 2009 stability, however at low levels, can be expected. Also the large intervention stocks which already exist are a major factor of stability, because they will come back to the market when prices increase. The question, how they will be sold, is one of the secrets of the EU Commission.

### **Milk Processing: More Cheese, Butter and SMP almost unchanged**

So far the production of butter was increased only slightly in 2009, and the forecast is that it will not be changed significantly in 2010. Skim milk powder production grew very fast in 2009, which was mainly due to the reduced production of whole milk powder and casein. If these items are not subject to major changes, also SMP production will not be extended significantly. From domestic demand the main expectation of a change might be again a slight increase of cheese consumption, whereas most other items will probably unchanged.









## Annex

Table 1

### EU Dairy Market Summary including Forecast

in '000 t	2007	2008*	2009**	2010**
<b>Milk Deliveries to dairies</b>	133.767	134.300	134.500	135.000
<b>Consumed as fresh products<sup>1)</sup></b>	46.512	46.600	46.500	46.600
<b>Butter</b>				
Production	2.065	2.075	2.080	2.080
Consumption	1.966	1.940	1.940	1.950
<b>Cheese</b>				
Production <sup>2)</sup>	8.976	9.030	9.090	9.140
Consumption	8.721	8.804	8.900	8.950
<b>Skim Milk Powder</b>				
Production	1.090	1.040	1.120	1.130
Consumption	870	800	820	820
<b>Whole Milk Powder production</b>	775	850	800	800
<b>Population (million head)</b>	496	498	500	501
*) Provisional. **)Geschätzt. 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 2

<b>EU Butter Balance Sheet</b>				
'000 t	2007	2008	2009*	2010*
<b>Total production</b>	<b>2.065</b>	<b>2.075</b>	<b>2.080</b>	<b>2.080</b>
Imports	92	65	50	50
Exports	211	150	140	150
Final stocks	90	140	190	220
- in intervention	0	0	90	100
<b>Consumption</b>	<b>1.966</b>	<b>1.940</b>	<b>1.940</b>	<b>1.950</b>

Table 3

<b>EU Cheese Balance Sheet</b>				
' 000 t	2007	2008	2009*	2010*
<b>Production</b>	<b>8.976</b>	<b>9.030</b>	<b>9.090</b>	<b>9.140</b>
Imports	94	89	80	80
Processed cheese impact	265	260	250	250
Exports	594	555	520	520
Stock Change	20	20	0	0
<b>Consumption</b>	<b>8.721</b>	<b>8.804</b>	<b>8.900</b>	<b>8.950</b>
- per capita (kg)	17,6	17,7	17,8	17,8
*)Provisional/Forecast.		Updated September 2009		

Table 4

<b>EU SMP Balance Sheet</b>				
' 000 t	2007	2008	2009*	2010*
<b>Production</b>	<b>1.090</b>	<b>1.040</b>	<b>1.120</b>	<b>1.130</b>
Imports	10	8	5	10
Exports	196	177	165	170
Ending stocks	129	200	340	490
- in intervention	-	-	280	430
<b>Consumption</b>	<b>870</b>	<b>800</b>	<b>820</b>	<b>820</b>
*)Provisional/Forecast.		Updated September 2009		