

# EU Dairy Markets, Situation and Outlook September - December 2011

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*Special report produced for CLAL*

## Highlights:

- Milk and dairy markets are still characterized by prices at high levels and growing production.
- EU milk supplies will go down seasonally until the end of November. But growth above 2010 levels has slowed down and will be more modest than in the first half of 2011.
- Outside EU milk production is increasing in many parts of the world, but obviously not fast enough to cover additional demand.
- Most of all additional milk supplies in the EU will be used for cheese production.
- Commodity prices of nonfat dairy products, mainly skim milk powder on the international market and in the EU are very close to each other.
- Butter and milk fat supplies are tight in relation to demand, and with modest stocks prices of butter and other milk products with high fat contents will continue to stay at high levels for most of the year 2011.
- Butter and whole milk powder export opportunities are poor as domestic EU prices cannot compete on the international market.
- The fluctuating relation of the Euro to the US-Dollar and the not yet foreseeable impacts of the financial crisis create uncertainty.
- Whether the tight supply situation might be eased soon by Oceanian suppliers is not clear yet. If it happens, the impacts on the EU situation will at first appear in the sector of industrial dairy products and later in the market of products designed for the final consumer.

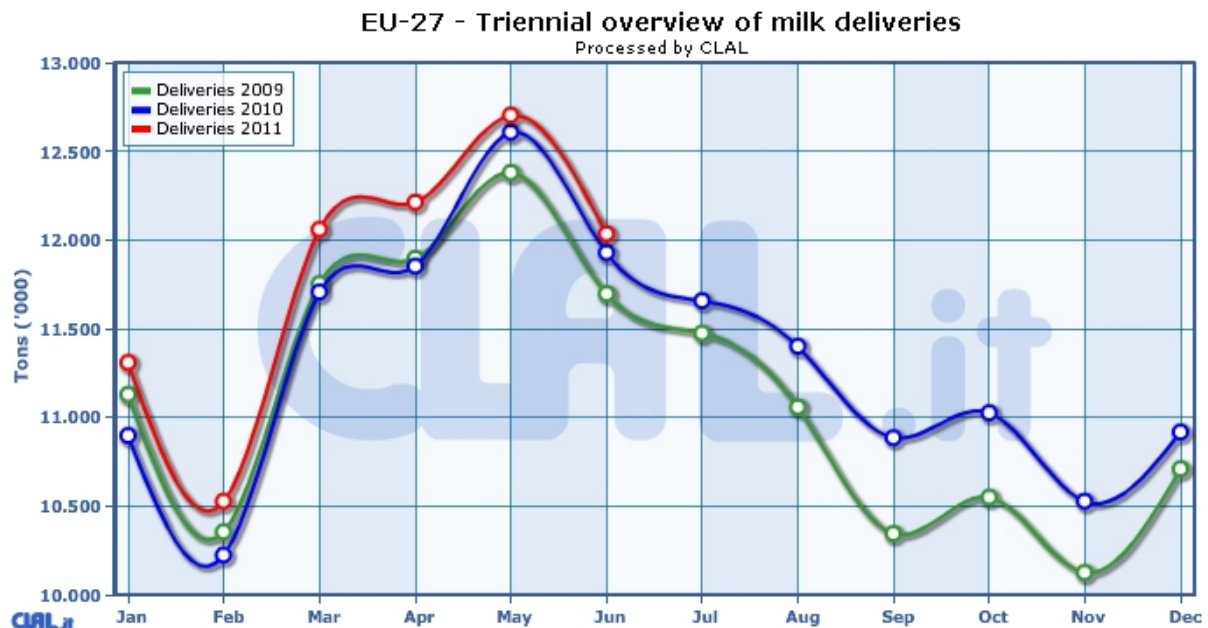
## Milk production slowing down

[EU milk supplies](#) are still characterized by more modest growth since May, 2011. According to a first estimate the rate is down to an average of 1,6% of the four months ended August after having grown by 3,4 m.t or 2,5% in the 12 months period from May 2010 through April 2011.

Also a smaller growth has to be expected for the rest of the calendar year, prospectively ending up with milk deliveries of 139,2 m. t, 2,5 m. t or 1,8% more than in 2010. The strongest increase could be observed in the first semester in Ireland with 11%, followed by France with 5%, Austria and the Baltics a bit below 4%, the U.K., Poland and Germany with 3% and a bit below and Spain below 2%. In absolute terms, the strongest increases occurred in France, Germany, Ireland, U.K. and Poland, which counted together for additional 1,54 m. t. Less milk was delivered to processors in Romania, Bulgaria, Greece, Denmark and Finland.

With respect to available quotas more countries can expect super levy charges at the end of the period from April 2011 through March 2012 than in the previous one, unless farmers do not reduce milk deliveries in the second half of the current period and in particular in the first trimester of 2012. This might lead to a slowing down or even reductions in Germany, Belgium and Ireland.

Higher milk prices than the year before have been paid to farmers so far this year and are still expected to exceed last year's levels in the second half of 2011. But the incentives to increase milk production seem to be weaker in view of growing prices for feed components. This is partly the result of a poorer grain harvest in North Western Europe. Also the price of soybean crushing, a major component of milk feed concentrates has recovered recently after a short period of weakness. More cows have been slaughtered in the first half of 2012 in the EU.



### Stronger growth of demand from domestic European than from foreign markets

At first sight it appears to be surprising that the prices of milk and dairy products stay at relatively high levels in the EU, despite the outstanding speed of milk production growth since more than one year. It also seems that it has not mainly attributed to the growing domestic demand than to the also rising export opportunities. Substantially more skim milk powder and whey products were exported in the first half of this year.

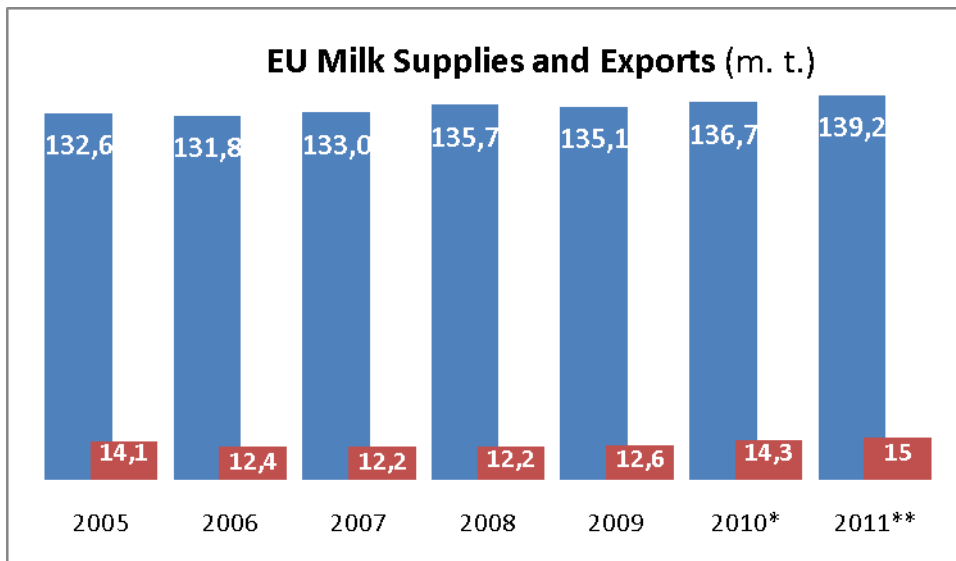
Also cheese exports grew by comparatively modest 3,5 %. But it seems that not enough SMP supplies will be available in the second half to continue with similar export growth rates. So altogether the EU dairy export in milk equivalent terms will be 15 m. t, less than expected earlier. Taking this into account the increase of milk supplies by 2,5 m. t, the overall consumption within the EU can be estimated at 124,2m. t, which is 2,0 m. t more than 2010. This can be compared to the “conservative” estimate only 0,9m. t in the CLAL outlook of May, 2011.

Although the export demand initially was the driving force of firm market prices, it is clear now that most of the additional milk supplies are absorbed by the internal demand. The question is, how this conclusion can convince in view of figures on (mainly stagnating) demand from private households. It can be explained by more consumption away from home and increasing volumes of dairy ingredients being incorporated into other food items, which both gain continuously higher shares in total dairy consumption.

Also more other food than just dairy products are exported, and many products which are not regarded as genuine dairy products contain dairy ingredients. All this, the outlets beyond private households and the hidden content of dairy in other food are difficult to express in solid statistical figures. But where

else should all this milk and dairy products be consumed if we know that it is not consumed by private households?

At present the economic prospects for the EU and the impacts on food consumption and expenditures are very unclear. Much depend on how policies are going to address the debt crisis which has turned itself into a crisis of the Euro club, how financial markets react and whether all might end up in a new economic crisis. Anyway, for some countries severe cuts in disposable incomes are inevitable.



\*)Provisional. \*\*)Forecast

### **World: Milk production has difficulties to follow demand growth**

In other parts of the [world milk production](#) is mainly expanding: for the U.S. an increase of 1 m. t is expected for 2011, in Oceania of 1 up to 2m. t in the current season, in India and China the “usual” increases of combined 5 to 6m. t. Less milk is produced in Russia and the Ukraine. Taking into account all available figures and short term production prospects from the different sources, the conclusion is that world milk production will grow in 2011 in the size of probably not more than 12 m. t, which would be the fastest growth since 2007.

But the potential of medium and long term demand growth has been estimated by different projections to range between 12 and 14 m. t per annum. According to figures released by FAO, the worldwide milk production grew by 132 m. t in the years from 1999 to 2007, on average 16,5 m. t per year. Taking into account an estimate of 711 m. t in 2010 and 723 m. t in 2011, the growth from 2007 to 2011 is 42 m. t or 10,5 m. t on average per year. Large stocks have been cleared in the mean time, also those which were allocated in the “crisis” year 2009.

The conclusion is that world milk consumption has reduced its growth significantly, since it is clear that it cannot exceed production on the long term.

### **Dairy product prices staying at high levels**

Both, the above mentioned projections and the retrospective consideration of production confirm the view that much more milk would be demanded if it would be available anyway. Also the additional volume of 12 m. t is not enough to change the market feature from a sellers to a buyers market and

thus put pressure on prices, since no substantial stocks are available to fill the gap between supply and potential demand. And it explains why prices are still relatively high despite production gains in many parts of the world since 2009, also because of the good economic development so far this year in many countries, notably in emerging markets.

Also in spring and summer with large seasonal milk production on the Northern hemisphere prices became weaker only for a short time. On the world market it is not yet clear what can be expected from Oceania. Despite optimistic reports about the start of the season reportedly much of the current production is already sold.

The other major sources are the EU and the U.S., with EU at present in a competitive position regarding SMP because of a favorable currency rate against the US-Dollar. This might change because not only the Euro zone, but both monetary systems have severe problems to be solved. But as long as major importing countries are not affected by an economic crisis, the export demand will be strong enough to keep the dairy product prices oscillating modestly around present levels at least until the end of 2012.

The prices of many products which are mainly intended for sale on the EU domestic market have been adjusted to this situation now and will not be revised on the short term, should markets of milk powders and butter weaken significantly after the turn of the year, which, however, still remains to be seen.

Although milk supplies in the EU and many countries beyond developed both seasonal and cyclical growth in recent months, prices reacted only shortly by a certain weakness and remained relatively high. The dependency on currency rates with temporary strength of the Euro led within the EU to a certain weakness of milk powder and butter prices - though at elevated levels. But this was only for a short period, and the recovery started already before the seasonal peak of West European milk production in May.

### **Stable butter market**

Despite slight weaknesses in the summer months, the European butter market has developed in a remarkable stability this year on a historical high level. In the period from January to mid-September, the average for bulk butter in Hannover was 4,47€/kg, which had been exceeded only for a few weeks in the summer 2007.

Prices are also higher than on the international market which explains that exports so far were reduced to an also historically low volume. Therefore the EU is practically decoupled from the world market for exports, unless older contracts from earlier this year have to be settled or there are special qualities required which cannot be supplied from elsewhere. The price gap to the international market is not so large that it would attract significant imports because of the prohibitive regular tariff rate.

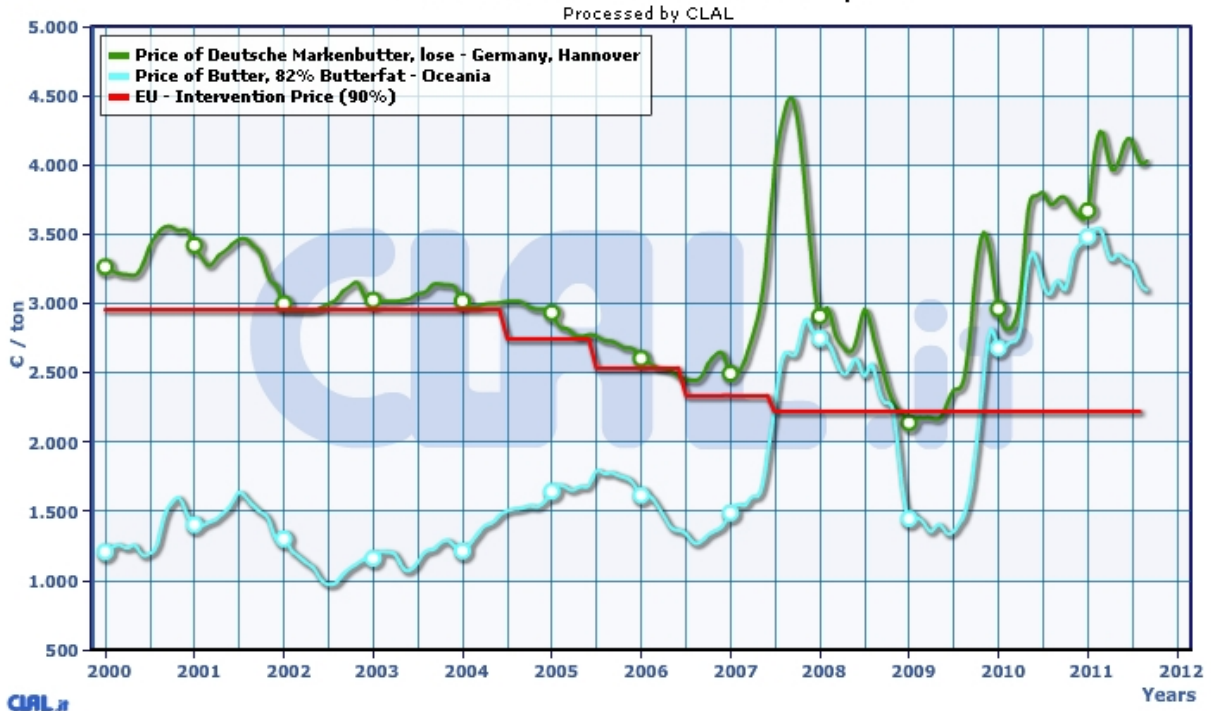
Imports which are only charged with the special tariff under the WTO market minimum access scheme can be easier now but probably are not significantly more attractive than selling butter to other international destinations. So the butter market seems to be well in balance for the next months.

Supplies from private stocks which are intended to cover the demand which is exceeding the seasonally low production are regarded as normal. If the butter market should come under pressure, which cannot be ruled out for the time around the end of 2011, prices will find a bottom line at the world market level, which also is still elevated compared to many years ago.

The international butter market is still short in supplies, but the situation has eased since the mid of this year, when also historically high prices of 5.000 US-\$/t were quoted in Oceania. Since then they

have fallen by around 725 to 4.300 US-\$/t. That is transformed into Euro 3.113€/t , only 380€ less which is due to the stronger Dollar. But so far the international trade in butter has not been expanded this year in volumes, only in values.

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



### After a weaker evolution in summer firmer SMP prices again

SMP prices will continue to stay at high levels at least until December. Unlike the situation with butter, SMP prices are highly dependent on the international market as large volumes have to be exported to balance the market.

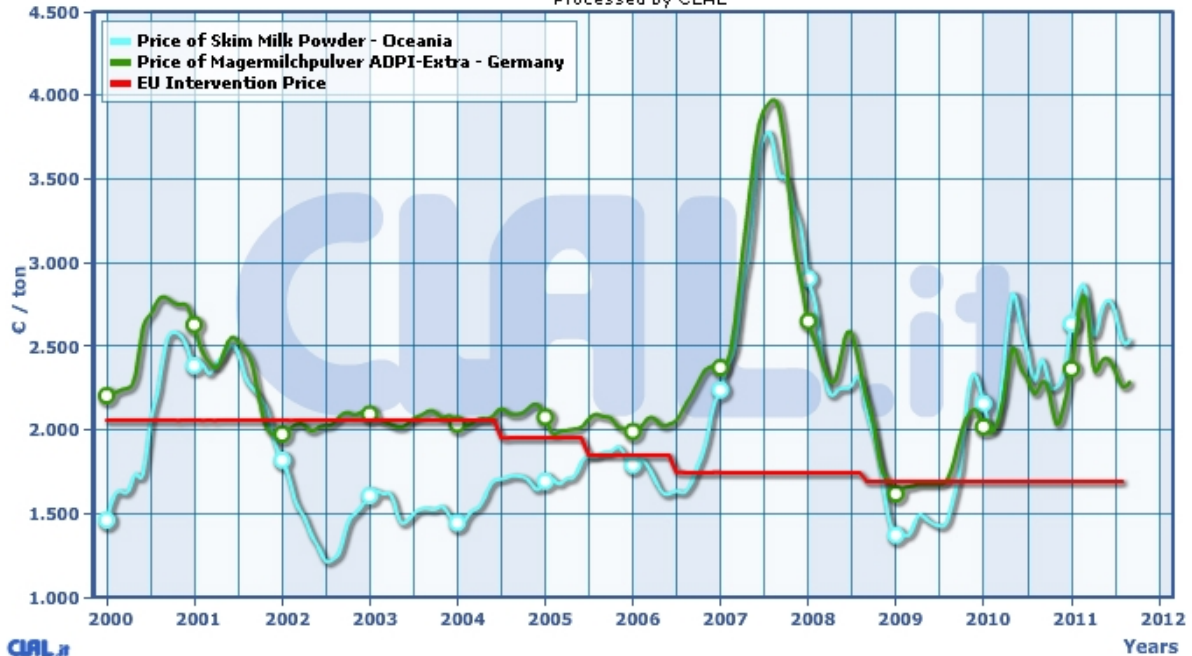
So far this year exports were the main driving force of the stronger demand. In the first half year, world trade grew by around 170.000 t to more than 0,8 m. t, with the EU sharing a significant part of 244.00 t which were 62.000 over the already strong exports of the first half of 2010. But it seems to be unlikely that similar volumes can be exported in the second half, because production is falling seasonally since June.

Most of the intervention stocks is reserved for domestic food aid products, only limited volumes will be available for covering other demand sectors. The domestic demand is expected to be stable or even stronger, as substitution of SMP by actually very expensive whey derivatives is not attractive.

In this market environment it can be expected that EU price levels are rather guiding international price levels than vice versa. Nevertheless strong currency fluctuations will also transform themselves into this market, as it already happened in recent months when situations of weak Euro rates opened the window to more new export contracts.

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

Processed by CLAL



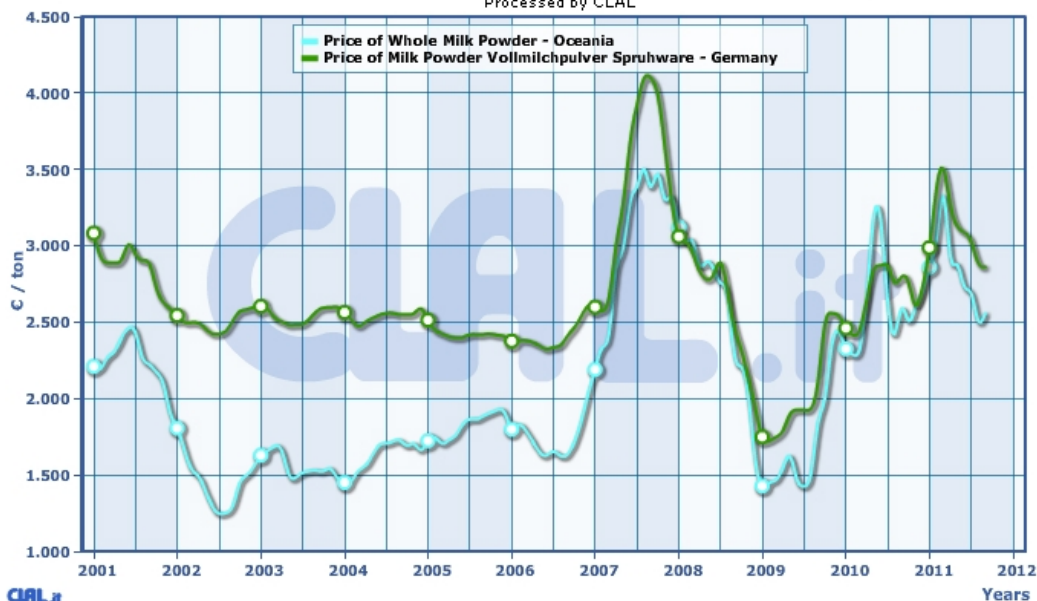
The EU has not taken advantage of the growing international demand for whole milk powder, because the domestically quoted prices were not and are still not competitive. This has to do with the higher internal value of milk fat, deducted from butter market prices.

In the first half of 2011, the world trade has been increased by more than 120.000 t to 1,07 m. t according ZMB, but the EU has lost market shares. The winners are New Zealand and Argentina. Therefore the EU production will be reduced further in line mainly with reduced exports and with regard to the stagnation or even reduction of domestic consumption.

Prices have been reduced in the recent months but will probably stay unchanged in the next months until December in line with butter and SMP prices.

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

Processed by CLAL



## Other sectors

As prices of industrial dairy commodities stayed high for a longer period than initially expected the price evolution of consumer ready dairy products have slowly been adjusted but still do not yet reflect the true relation of overall supply and demand in the milk market. 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, so far the prices of liquid milk products and cheese could not be adjusted to the full extent to returns from bulk butter and milk powders.

The returns for the milk which is needed for cheesemaking have been supported partly by higher prices of whey products. Cheese prices are also moving above 2010 levels, but have been reduced in the summer and are expected now to remain stable over the next months. Cheese production had been increased in the first months of 2011 in particular in the major countries exporting to the international markets but later with reduced rates. Later followed expansion in those countries focussing more to the domestic European market, i.e. France. Exports to destinations outside the EU are expected to increase again later in the year.

Table 1

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

in 1.000 t	2007	2008	2009	2010*	2011**
<b>Milk deliveries</b>	134.018	135.698	135.081	136.700	139.200
<b>Liquid Products</b>	44.850	44.818	44.820	45.000	45.100
<b>Butter</b>					
Production	2.110	2.100	2.050	2.010	2.050
Consumption	1.994	1.968	1.977	1.960	1.950
<b>Cheese</b>					
Production	9.248	9.305	9.298	9.450	9.530
Consumption	8.728	8.829	8.826	8.866	8.950
<b>Skim Milk Powder</b>					
Production	1.090	1.040	1.100	1.020	1.100
Consumption	870	770	780	770	770
<b>Whole Milk Powder</b>					
<b>Production</b>	773	840	759	761	730
<b>Population m. head</b>	496	498	500	502	503
*) Provisional. **) Forecast.					Updated Sept. 2011

Source: ife, Kiel; ZMB, Berlin.

Table 2

**EU Butter Balance Sheet**

1.000 t	2007	2008	2009	2010*	2011*
Total production	2.110	2.100	2.050	2.010	2.050
Imports	85	65	62	40	40
Exports	211	147	150	155	130
Final stocks	100	150	135	70	80
- in intervention	0	0	80	2	0
<b>Consumption</b>	1.994	1.968	1.977	1.960	1.950

\*) *Estimated. Sep 11*

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	9.200	9.280
Imports	94	89	84	82	80
Processed cheese impact	265	255	250	250	250
Exports	594	555	576	676	680
Stock change	+20	+10	-20	-10	+0
Consumption	8.728	8.829	8.826	8.866	8.930
-per capita (kg)	17,6	17,7	17,6	17,7	17,8

\*) *Estimated. Sep 11*

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

Table 4

**EU WMP Balance Sheet**

1.000 t	2007	2008	2009	2010*	2011*
Production	773	840	759	761	730
Imports	2	2	2	2	0
Exports	366	481	451	444	410
Stock change	20	0	-30	-15	0
Consumption	389	361	340	333	320

\*) *Estimated. Sep 11*

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	<i>1.020</i>	<i>1.100</i>
Imports	10	8	6	<i>4</i>	<i>0</i>
Consumption	870	770	780	770	770
- as feed	245	150	160	160	160
Exports	201	179	230	378	440
Ending stocks	124	222	318	194	84
- in intervention	-	-	260	190	50

*\*) Estimated. ife September 2011*

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