

EU Dairy Markets, Situation and Outlook, June 2017

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Special report produced for CLAL

Highlights:

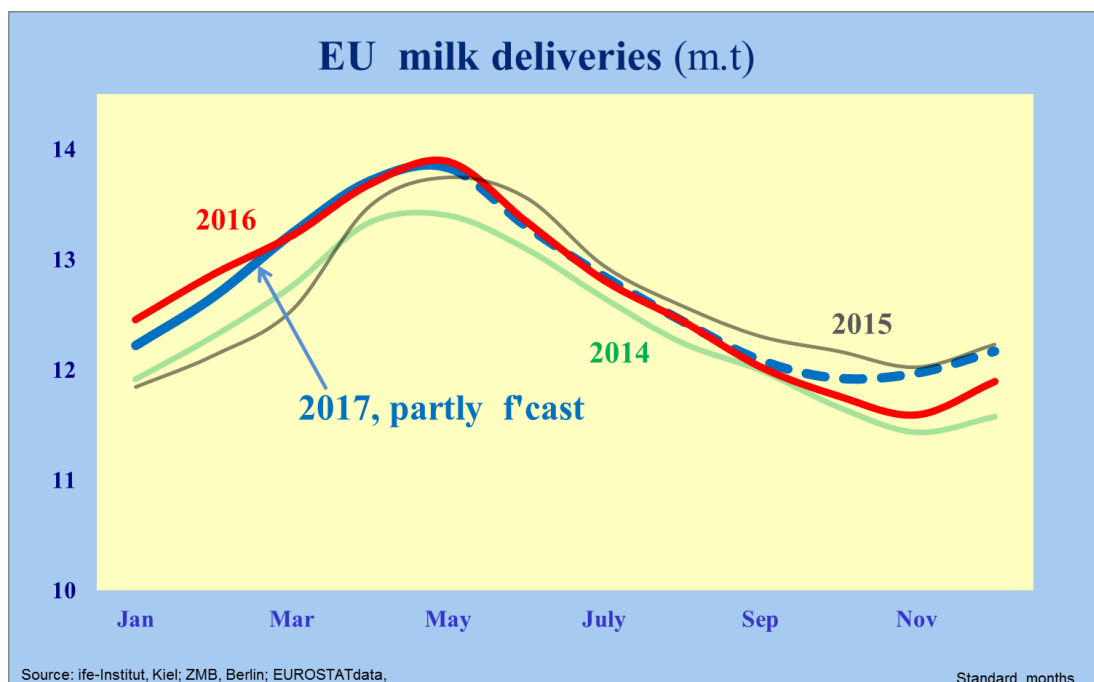
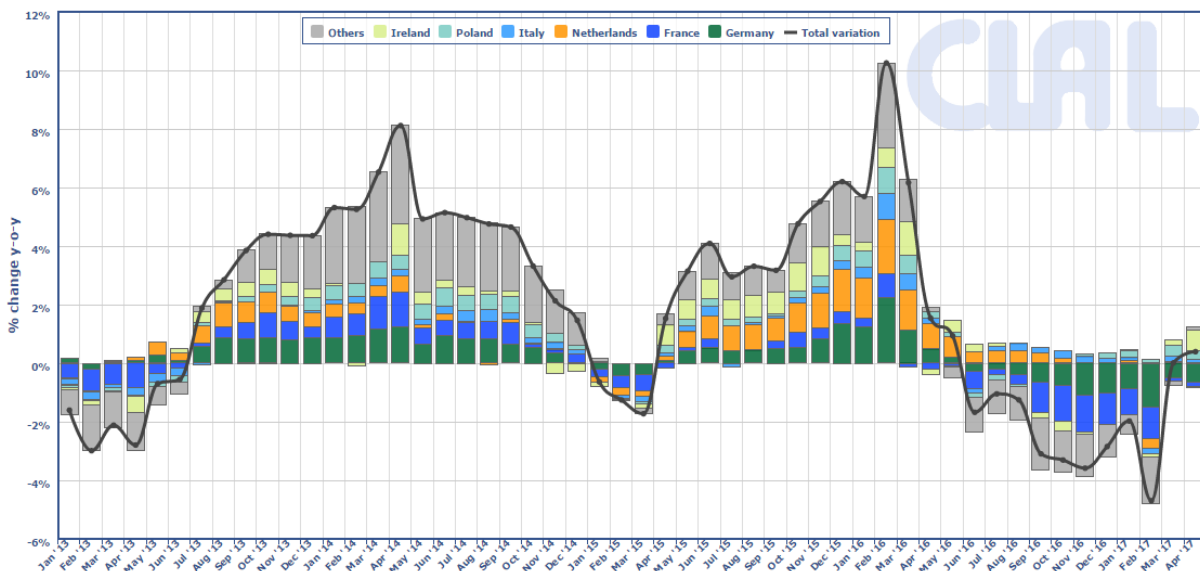
- EU milk production will decline seasonally until November, but exceed the volumes of the second half year of 2016 by 1 million metric tons.
- The total production of major exporting countries is expected to decline seasonally by 1,7 million tons less than in the first half year, but 2,4 million tons up on second half of 2016.
- In the domestic market of the EU a modest growth of dairy consumption can be expected, mainly in the cheese sector.
- The demand of importing countries for dairy produced in the EU will continue to grow.
- Prices of butter are moving at historical high and significantly above the EU support level, and further increases seem possible.
- The space for rising prices of skim milk powder prices will be limited, since large stocks in intervention are available.
- Again contract cheese prices have to catch up to returns of the cash market prices and to returns of other dairy sectors.
- Producer milk prices are expected to grow further, which is mainly driven by high prices of milk fat and butter.

EU-milk supplies: Reduced seasonality, turn to cyclical growth in mid-2017, but decline in the second half of the year.

In June 2017, the seasonal decline of EU milk deliveries started jointly with a cyclical expansion over 2016 volumes. Just one year ago, the seasonal decline had started in combination with the cyclical decline. Looking back what had happened since then it can be stated that the response of European dairy farming in terms of milk volumes to the low price situation of 2015 and 2016 was relatively modest. Already in March and April, 2017, milk deliveries were almost back to 2016 quantities. But the evolution was different in individual member states. In **Germany** and **France**, spring milk deliveries were reduced when compared to the same months in 2016. In the **UK** and the **Netherlands** April production was close to last year figures, despite the Dutch measures to reduce the livestock phosphate emissions which resulted in strong increases of cow culling. Mainly the constant expansion of **Polish** and **Irish** milk production compensated for the reductions in Germany and France. One reason might be that the price crisis had forced farms in particular in Germany and France with traditional feeding systems which is based on fresh grown grass in spring and summer

to leave the industry, which explains that the seasonal peak was significantly weaker than in earlier years. But obviously that has not been the case in Ireland and Poland. Also weather conditions were not favourable in spring in many areas. According to figures available until April the Dutch milk production has not been reduced despite the programme to reduce livestock emissions of phosphates. But this is likely to come now, since cow culling has been increased dramatically in the Netherlands, which is unlikely to be compensated by higher yields of the remaining cows. In other member countries, an earlier return to further expansion of milk supplies seems to be possible. Because of the progress in dairy animal breeding strong culling of cows leads to a stronger selection to higher performant cows. Thus the total EU milk production will start a modest cyclical growth, and the recovery will be supported by the prospects of rising milk prices. But this is a consideration on the year to year basis, anyway milk supplies will go down seasonally until November, and prospectively the present market trends will prevail at least until early December.

EU-28 - Milk Deliveries in the key producer countries
% change y-o-y subdivided by the contribution of each Player
Sources: Eurostat, AGEA and CLAL estimations - Processed by CLAL



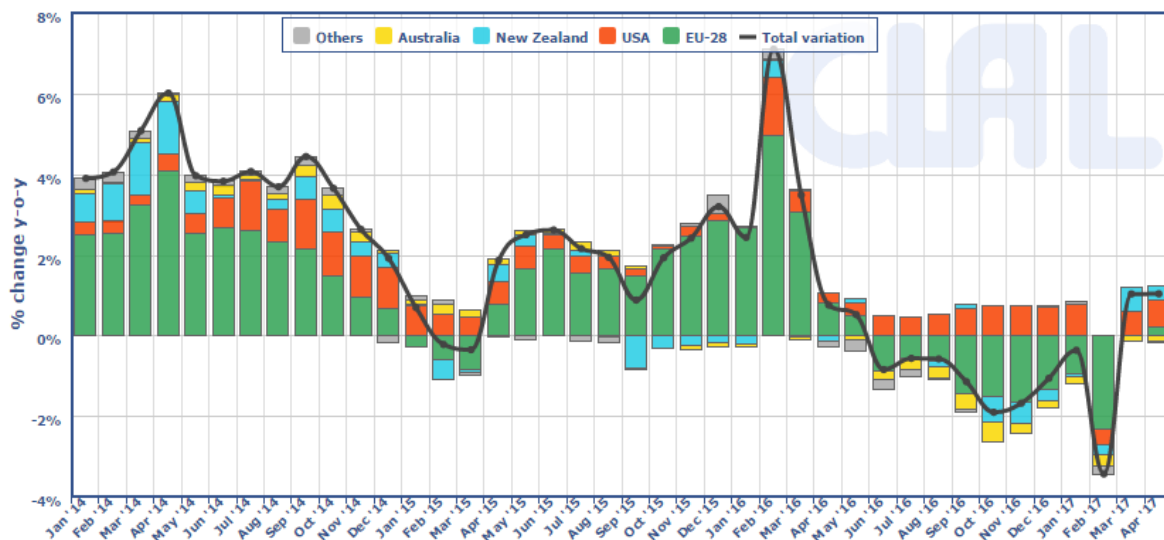
Favourable market situation

Compared to the previous CLAL Outlook which was published in January two major features of the market can be stated:

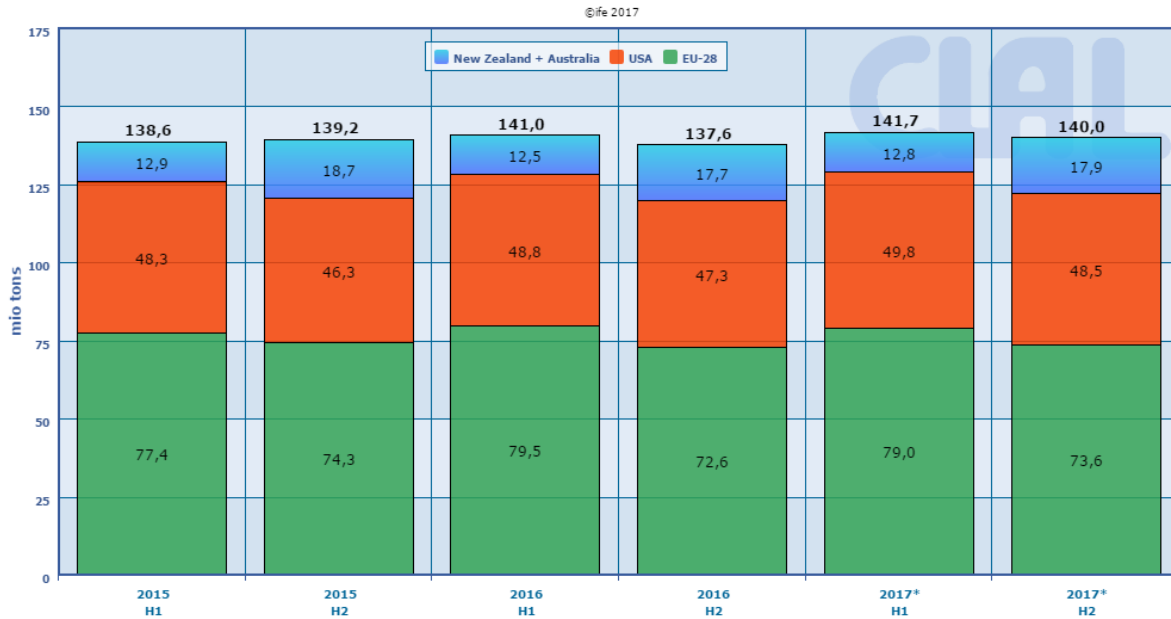
- The decline of milk production had been overestimated.
- The recovery of prices has taken faster momentum than has been expected, regardless of the temporary weakness in February and March.
- Hence the dynamic of the demand for dairy in domestic and international markets has been underestimated.

Reasons are the modest growth of domestic demand in the EU in particular in the cheese sector, the growing demand for dairy fats and improved export opportunities since the demand from international markets, which cannot be met to the full extent by exports from other origins. International demand is expected to continue its growth though at a moderate speed, which, however might still be stronger than the prospective recovery of milk production in the main areas which cover the world's import demand. Similarly, to the EU also less milk had been produced in the second half of 2016 in Oceania and South America. The recovery started in New Zealand in recent months, just in the late phase of the dairy year ending May, 31st, and prospects for the new campaign are assessed as good. In Australia the return to a modest growth for the new campaign 2017/18 is expected and stronger productions are likely in South America as well. The U.S. milk production is characterized by a constant growth on year to year basis. But since productions in North America and Europe are declining seasonally since June, the overall supply of the major exporting areas will be reduced when compared to the first half of 2017.

World - Global Supply Variation in the Key Exporters of Dairy Products
% change y-o-y subdivided by the contribution of each Player
Players considered: EU-28, USA, New Zealand, Australia, Others: Ukraine, Belarus, Chile, Uruguay, Turkey
Processed by CLAL



Milk Supplies of EU, USA, New Zealand and Australia by Semesters

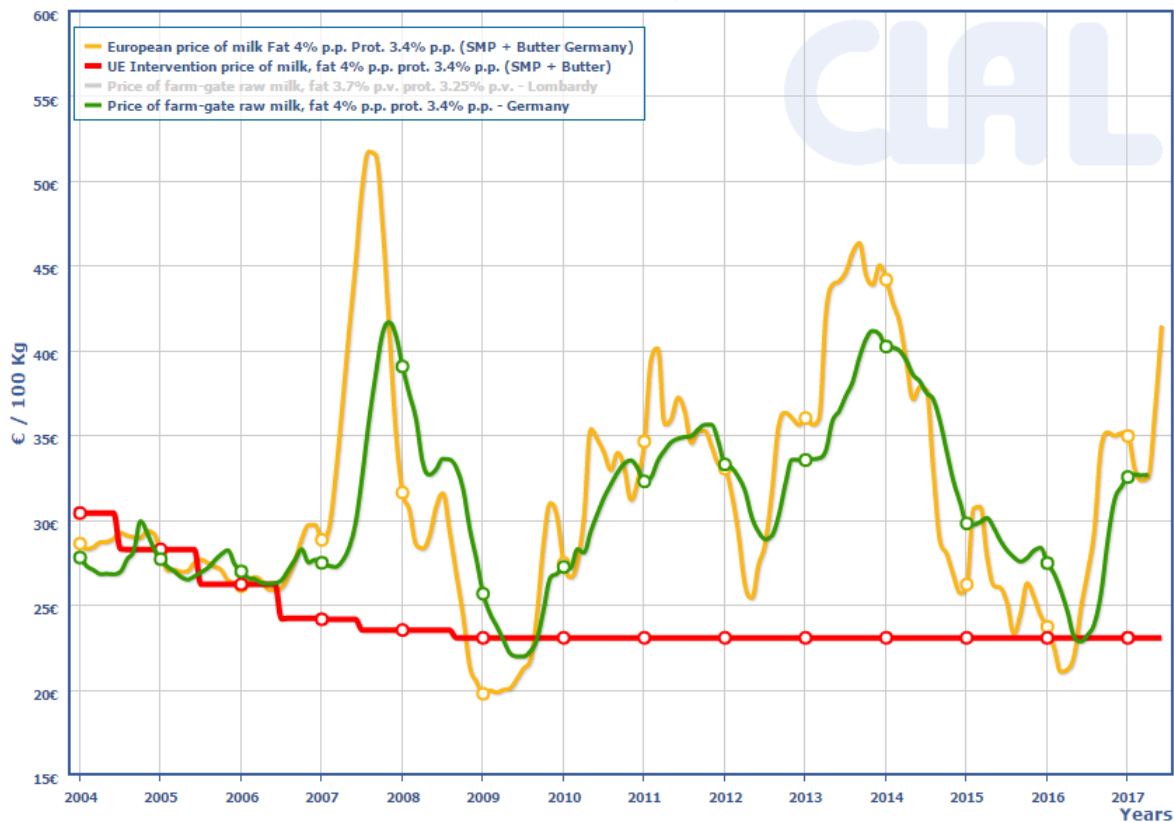


Milk and dairy product prices: Stability on elevated level.

Because no significant change of the supply/demand relation is in sight for the second half of 2017, prices are expected to stay at the levels they have reached recently. This is also well evident from the prices of butter and skim milk powder futures, which, when transferred into values of liquid milk as raw material are fluctuating around the levels which have been quoted in June in the cash markets. The high values of the milk are mainly driven by the markets of butter and bulk cream which also have stimulated high prices in particular for other dairy products with high fat contents, and in this sector even higher prices cannot be ruled out. On the non-fat further upward movements are unlikely, as plenty of intervention stocks are available.

EU-28: Farm-gate milk price competitiveness

Source: Processed by CLAL



EU: More cheese but less butter and milk powder

Although milk deliveries will exceed last year's volumes modestly in the EU in the second half of 2017, only cheese production is likely to be expanded. This expansion will require more than the additional milk quantities and less will be available for the production of butter and milk powders. The demand of liquid markets is expected to be relatively constant: Domestic needs are stagnating or slightly declining. So far this year exports of liquid milk, mainly with destination China, have been reduced. But the fluctuations in this market are not so important that they have strong effects into the other sectors.

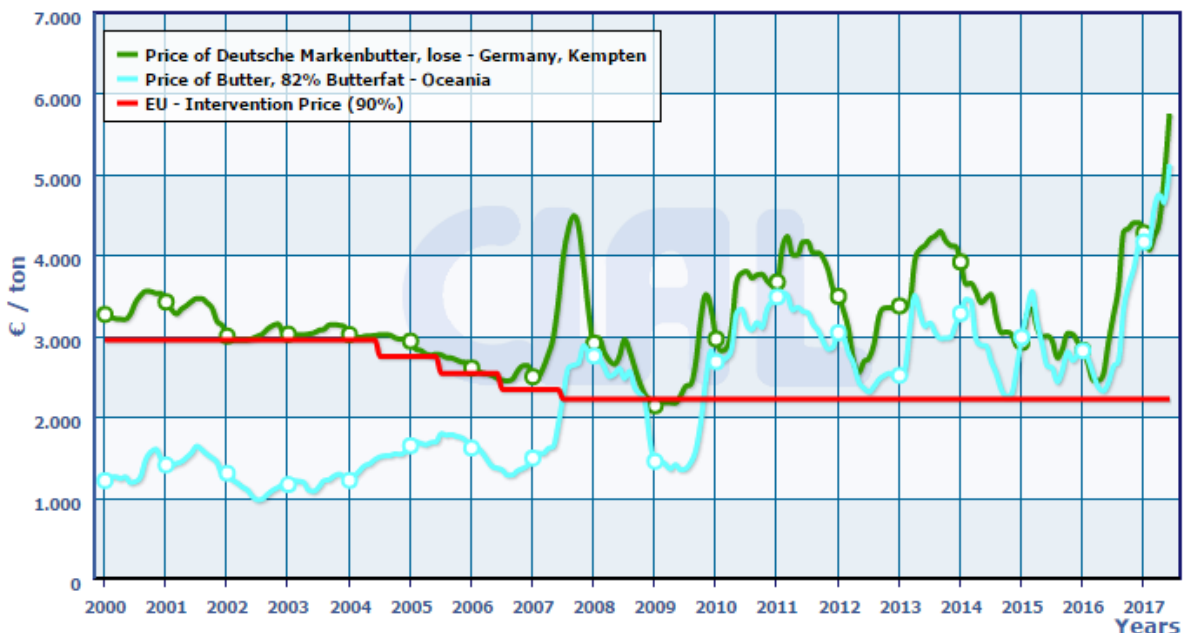
In theory, another scenario could happen: If the record level of butter prices is strong enough as incentive to focus milk processing extremely to butter manufacturing, the by-product will be more skim milk which has to be processed to skim milk powder, of which, however, plenty of supplies are held in intervention stocks; and no additional production is required by the market. In this scenario skim milk powder prices would be endangered to fall back to the intervention level. But the majority of the processors have to safeguard a certain loyalty to their costumers for cheese and liquid milk products, and it is also a question of capacities. But the option is a good argument in price negotiations.

Butter prices at historical high

The prices of butter have reached historical high in the EU and in the international market as well. The temporary weakness, though at a high level, did not fit into the general shape of that market, but can be explained by the behaviour that the major players have difficulties to accept as reality what has never happened before in this extreme manner. It is only partly the butter market itself which is characterized by growing demand, also since health concerns against it seem to be out of date. The increasing cheese production and market of bulk cream which is used as raw material in other food industries has reduced the availability for butter manufacturing and will continue to do so. Temporarily also a slight reduction of fat content in the milk collection was observed recently, which, however, will not last for longer but has soared the shortage. To some extent, fat contents of raw milk can be influenced by feeding, but the main determinant of milkfat availability will be the overall milk supply. Therefore, no significant easing of the situation is in sight for the next half year. Also the currency fluctuations, in particular an ongoing strengthening of the Euro rate will not have immediately a major impact because production in the EU is behind the market needs and domestic prices are not necessarily linked to the international level unless the market has to be balanced by large exports. No figures about stocks are available, since no subsidies have been spent by the EU for private storages. It has to be supposed that significantly less butter is available in stocks for the seasonal balancing of the market, which also means that supplies are supposed to be short of demand. The question, however, is what will be the reaction of demand to the high prices resulting from this unprecedented market situation.

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

Processed by CLAL

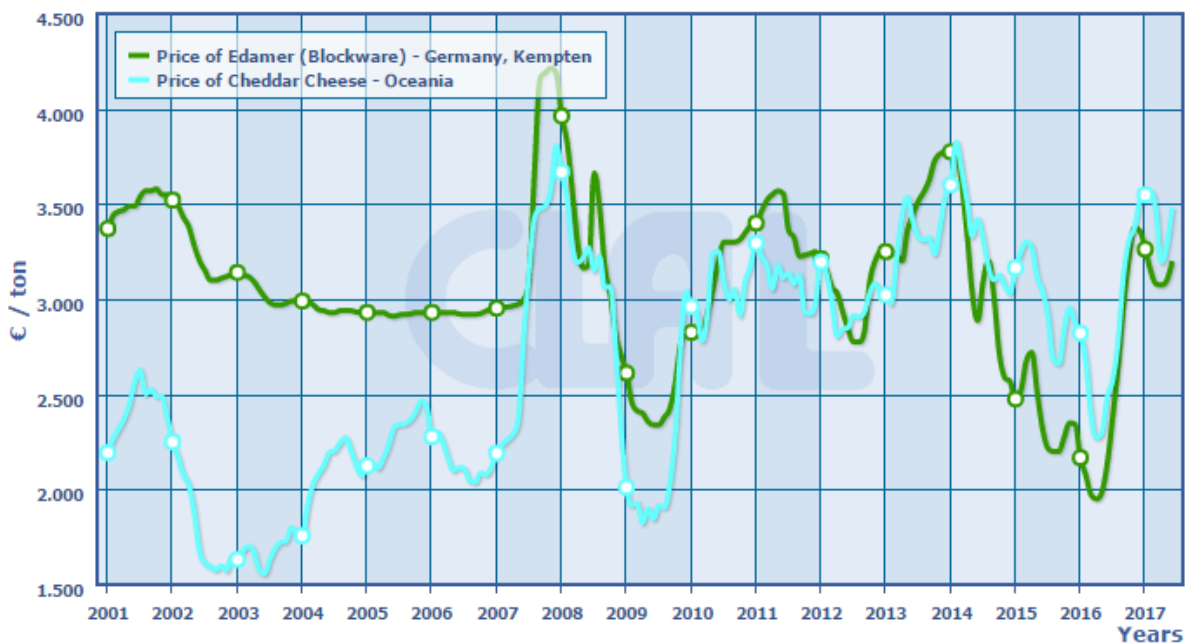


Cheese market: Ongoing growth

After a weak period in spring commodity cheese prices have firmed up later, and it is very likely that they have not yet reached their peak if cheese production has to be competitive with other milk utilizations in the allocation of the raw milk which is available from collection. New contract prices have to catch up with the ones quoted in the short-term business, but it might take some time until earlier contracts expire. Also in the international market prices have overcome the weakness of recent months and are coming closer to the former record peaks of 2014. The international trade is expanding again, despite the continuous absence of Russian buyers in major exporting countries. Asian markets are growing and supplied not only from the EU, the United States and Australia, but also from other countries gaining market shares like Turkey and Iran.

Historical comparative overview of prices of Edamer(Germany) and Cheddar Cheese (Oceania)

Source: ZMP; since 6 May 2009: Sddeutsche Butter - und Kasebörse eV, Kempten



Further growth of cheese production, consumption and exports is expected in the EU, if they follow the evolution which could be observed in the first months of 2017. Production expanded differently among the member states: So far available figures for the first three months show that growth was concentrated in Germany, Denmark, Poland, the UK and Spain, whereas less cheese than was produced in France and the Netherlands. In absolute terms production grew faster than exports; combined with the information that stocks in ripening facilities are relatively short it can be concluded that domestic consumption is rising further. If that continues over the year again significantly larger volumes of milk are being used for cheese manufacturing.

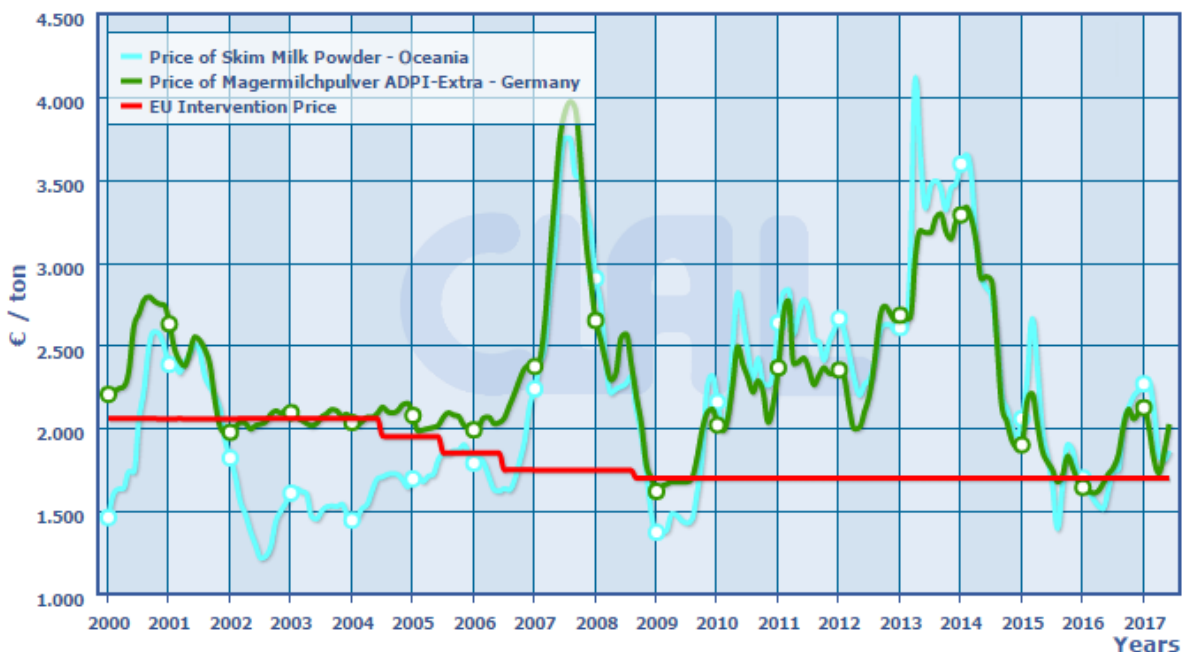
Reduced milk powder production

Under the conditions described above – reduced milk supplies, more milk used for cheese – the production of milk powders will go down when compared to the first half year and also below quantities produced in the second half of 2016. Prices of skim milk powder are still at low levels,

but above the purchase price for intervention. The possibility that stocks from intervention can appear on the market will form a ceiling for market prices. The fundamental difference to earlier bullish market situations is that now that they cannot catch up with the price increases in the markets of butter and cream. Price increases since spring took only a modest upward direction and will not have negative effects for domestic consumption. The competitiveness in the growing international market is mainly a question of the currency rate and the international price. A strong rate will be an obstacle to clear intervention stocks, a weak rate makes it easier. Anyway, the clearing of the stocks cannot be achieved within a short time. Hence these stocks create a certain stability in the market at low price levels, which can only fluctuate in a corridor which is limited by the intervention purchasing price of 1.690€/t and the selling out price which might be around 2.000€/t.

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

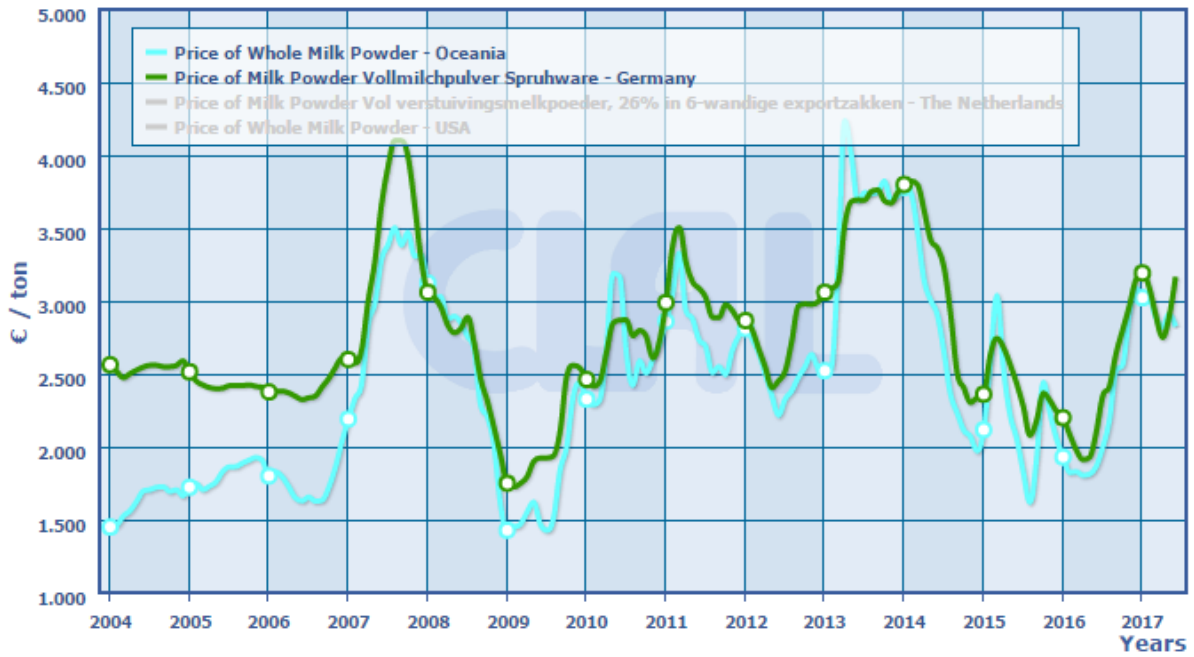
Processed by CLAL



The relative shortage in milkfat and the possibility that milkfat values are above the international level are limiting the competitiveness in the international market of whole milk powders. Therefore it seems to be doubtful whether the EU can continue in producing and exporting bigger volumes for export markets than in 2016, though it happened in the first months of 2017. The prices will be formed by the mix of the very firm situation of the butter market and the stability of the skim milk powder market.

Comparative historical overview between WMP prices in Germany, Oceania and The Netherlands

Processed by CLAL



Annex

Table 1

EU 28: Dairy Markets 2016 - 2016 and Forecast 2017

1.000 t	2012	2013	2014	2015	2016*	2017**
Milk deliveries	141.085	141.887	148.787	151.602	152.413	152.400
Liquid products						
Production	46.706	46.761	46.467	46.920	47.080	47.000
Consumption	46.195	46.159	45.713	46.024	45.974	46.010
Butter						
Production	2.167	2.127	2.237	2.341	2.390	2.340
Consumption	1.938	2.042	2.106	2.168	2.230	2.240
Cheese						
Production	9.493	9.529	9.683	9.955	9.969	10.160
Consumption	9.043	9.062	9.199	9.477	9.510	9.580
Skim Milk Powder						
Production	1.225	1.220	1.550	1.670	1.675	1.500
Consumption	805	805	805	805	805	805
Whole Milk Powder						
Production	659	732	766	735	730	720
Consumption	298	351	359	349	355	335
Resident Population,						
Jan 1 st , m. head	504	505	506	508	510	513
*)Provisional. **) Forecast					ife, June 2017	

Sources: ife, Kiel, according to ZMB, Berlin, Milk Market Observatory, Brussels, own calculations.

Table 2

EU 28: Balance Sheet of Liquid Dairy Products

1.000 t	2012	2013	2014	2015	2016*	2017**
Production	46.706	46.761	46.467	46.920	47.080	47.000
Imports	63	33	19	12	14	10
Exports	574	635	773	908	1.120	1.000
Consumption	46.195	46.159	45.713	46.024	45.974	46.010
- per capita (kg)	91,6	91,4	90,3	90,6	90,1	89,7
*)Provisional. **) Forecast					ife, June 2017	

Sources: ife, Kiel, according to ZMB, Berlin, Milk Market Observatory, Brussels, own calculations.

Table 3

EU28: Butter Balance Sheet

1.000 t	2012	2013	2014	2015	2016*	2017**
Production	2.167	2.127	2.237	2.341	2.390	2.340
Imports	29	45	53	27	23	10
Exports	128	130	154	180	208	165
Final stocks	100	100	130	150	125	70
Consumption	1.938	2.042	2.106	2.168	2.230	2.240
- per capita (kg)	3,8	4,0	4,2	4,3	4,4	4,4

*)Provisional. **) Forecast

ife, June 2017

Sources: ife, Kiel, according to ZMB, Berlin, Milk Market Observatoy, Brussels, own calculations.

Table 4

EU 28: Cheese Balance Sheet

1.000 t	2012	2013	2014	2015	2016*	2017**
Production	9.493	9.529	9.683	9.955	9.969	10.160
Processed cheese						
impact	235	240	210	210	210	210
Imports	78	75	77	61	71	70
Exports	768	787	721	719	800	860
Stock change	-5	-5	50	30	-60	0
Consumption	9.043	9.062	9.199	9.477	9.510	9.580
- per capita (kg)	17,9	17,9	18,2	18,7	18,6	18,7

*)Provisional. **) Forecast

ife, June 2017

Sources: ife, Kiel, according to ZMB, Berlin, Milk Market Observatoy, Brussels, own calculations.

Table 5

EU SMP Balance Sheet

1.000 t	2012	2013	2014	2015	2016*	2017**
Production	1.225	1.220	1.550	1.670	1.675	1.500
Imports	2	5	2	5	4	0
Exports	520	407	648	691	574	700
Final stocks	65	77	153	282	540	470
- in intervention	0	0	0	29	353	300
Consumption	794	806	828	855	847	870
- as Feed	160	120	130	140	150	150

*)Provisional. **) Forecast

ife, June 2017

Sources: ife, Kiel, according to ZMB, Berlin, Milk Market Observatoy, Brussels, own calculations.

Table 6

EU WMP Balance Sheet

1.000 t	2012	2013	2014	2015	2016*	2017**
Production	659	732	766	735	730	720
Imports	2	3	1	4	5	5
Exports	388	374	389	400	390	390
Stock change	-25	10	20	-10	-10	0
Consumption	298	351	359	349	355	335
*)Provisional. **) Forecast					ife, June 2017	