

EU Dairy Markets, Situation and Outlook, May 2014

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Highlights:

- Milk production in the EU and worldwide is coming back to former growth after few years of reduced rates or temporary stagnation.
- This will bring supplies in a better balance to demand and will allow to build up stocks which will reduce volatility.
- Finally this will lead back the dairy commodities to the path of moderate price evolution where other major commodities have reverted earlier.
- In general, prices of dairy commodities in the EU will move below the high levels of the period from May 2013 through January 2014.
- EU-Butter prices will be closer to the international level.
- The EU is in the position to regain shares in the international trade.

Forecast conditions

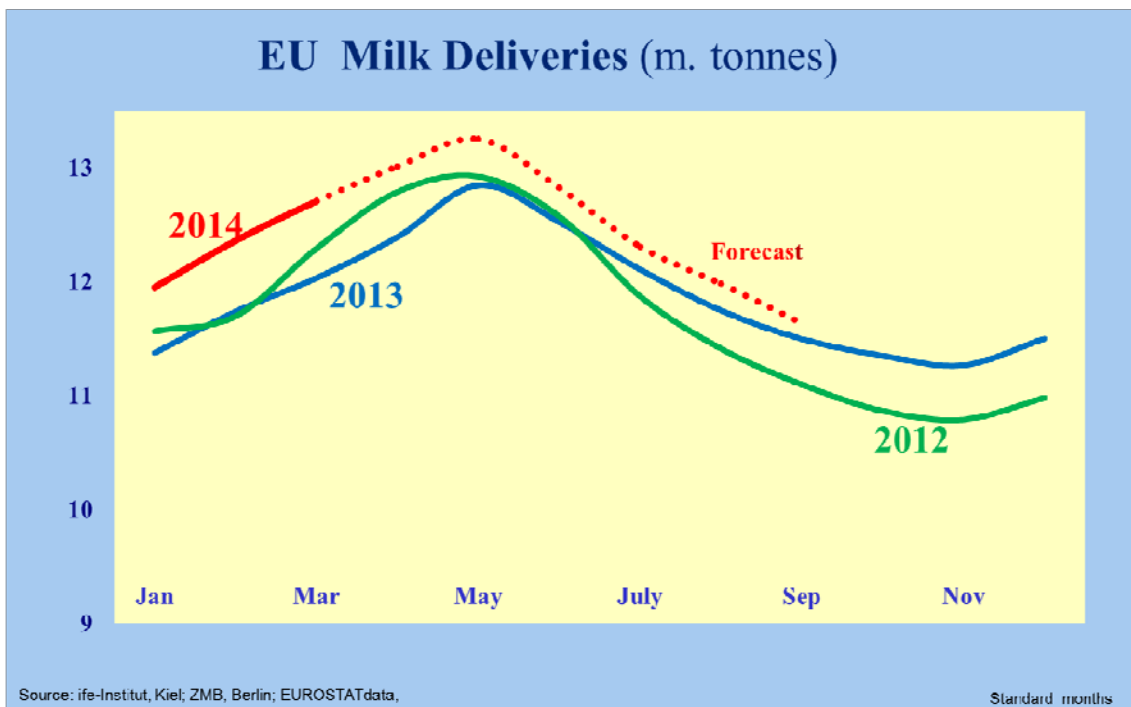
This assessment is valid under the following conditions:

1. An average development of climatic conditions over the whole year in all areas of the world.
2. An ongoing growth of demand in major areas of the world, which is supported by the expectation of ongoing economic growth in major world areas and a stabilization of economic and financial conditions in the Euro-Zone countries.
3. No soaring of present political conflicts.

Ongoing expansion of EU milk production

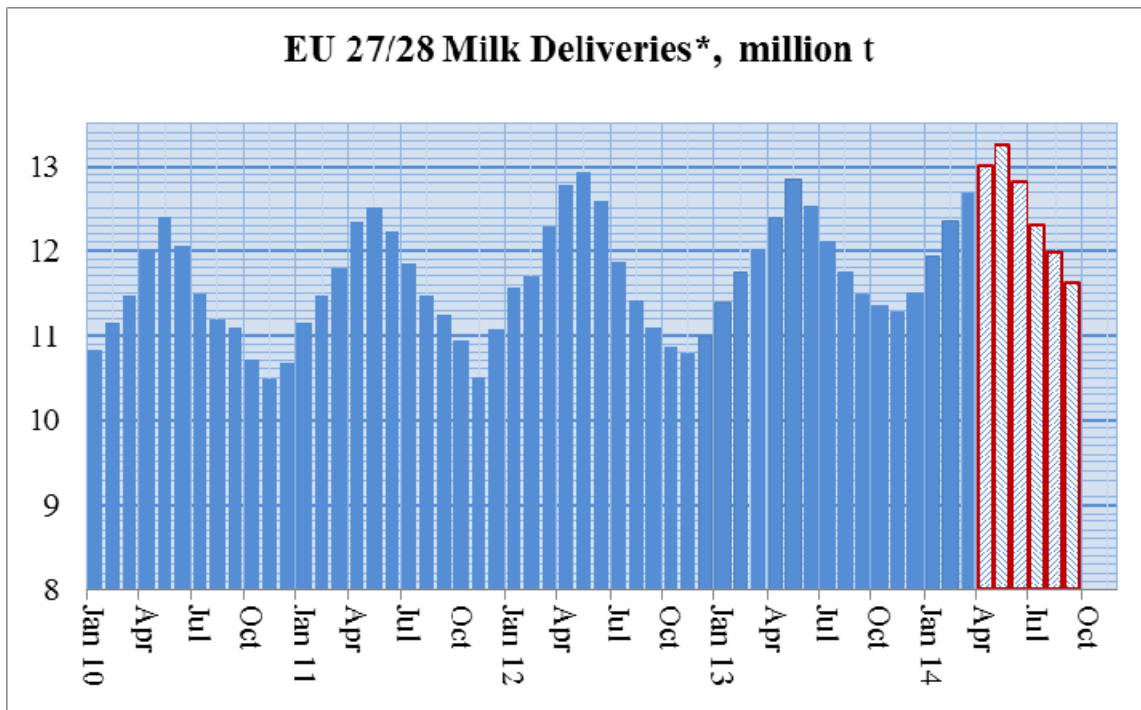
In the period from November, 2013 through April, 2014, EU milk production is characterized by seasonal and cyclical expansion at the same time. According a first estimate, 70,4 mio. tons were delivered to dairies. Compared to the corresponding six months period of 2012/2013, the increase is 3,4 mio. tons or 5% on average. But it seems to be unlikely that this recently observed growth between in relation to the year before can hold on in late spring and summer. The real potential will be half of these rates. An increase of 4 million t (3%) for the whole calendar year seems to be realistic.

Triennial overview of EU milk deliveries (mio. t)



More butter, cheese and milk powders

Most of these additional volumes of milk have been and will be used to produce more cheese, butter and milk powders. Only a small part might be used for liquid products, because also here more exports are going on. But it is of minor importance in relation to the total of milk processing. In particular the EU domestic cheese market is still good for modest growth. But already now, parts of the larger productions have been disposed of to replenish stocks which were short in all categories until early 2014. Also more products are needed just to bring pipeline stocks to levels which are regarded as normal. If the international market continues to demand more and more dairy products, the EU will be in a good position to export most of the extra production of butter and milk powders.



*)January 2010/April 214 and estimate May2014/ Sept. 2014, adjusted for average length of months.

Therefore it can be concluded that the present downward corrections of dairy commodity prices both in European and international markets will hardly lead to a situation which is similar to that of 2009. It has to be taken into account that commodity stocks had been run down to very low volumes until early 2014. The expanding production will enable food and dairy industries to bring them back to volumes which can be regarded as normal, and cheese stocks might even be more than normal. Another major difference to 2009 is the prospect of recovering economies which were in crisis. However, since no aids are given for private stocks of butter and skim milk powder and no intervention measures were necessary since 2009 and will not become necessary this year, no statistics on inventories are available anymore in the EU.

Anyway “normal” inventories of products lead to a temporary reduction of the volatility. Thus the situation is quite different to that of last year. Once in the EU and North America the spring flush of milk supplies is over, which will happen towards the end of May, prices might stabilize but stay at reduced levels, compared to the second half of 2013. Therefore it remains to be seen, whether the expectations of falling prices will keep demand reluctant for long term contracts. In the last years waiting too long did not pay for the buyers.

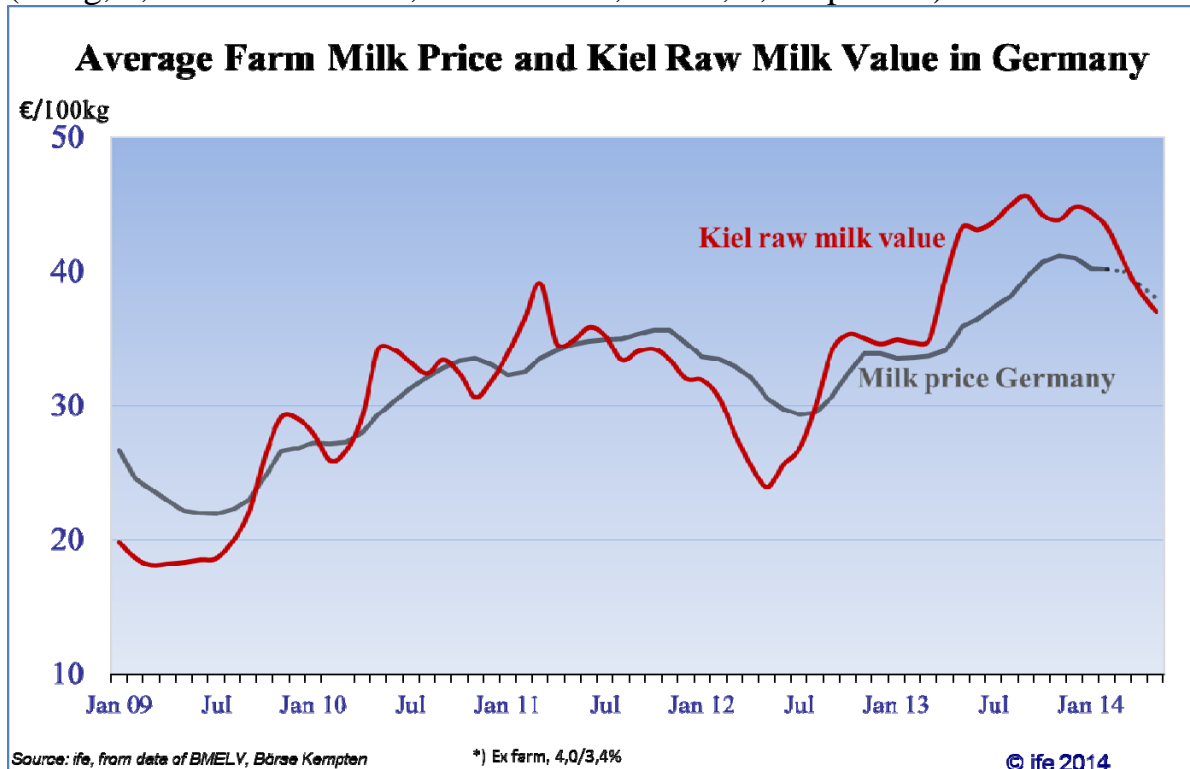
Farm milk prices down on record year 2013

The payout strategies of most dairies are characterized by a certain time lag in which farm milk prices trail behind the market returns, regardless whether they go up or down. At present large volumes of milk products bring high returns because of large forward trading until recently. Even now when product prices

go down further farmers can expect favourable prices for most of this year, though not at the levels of November 2013 through March 2014.

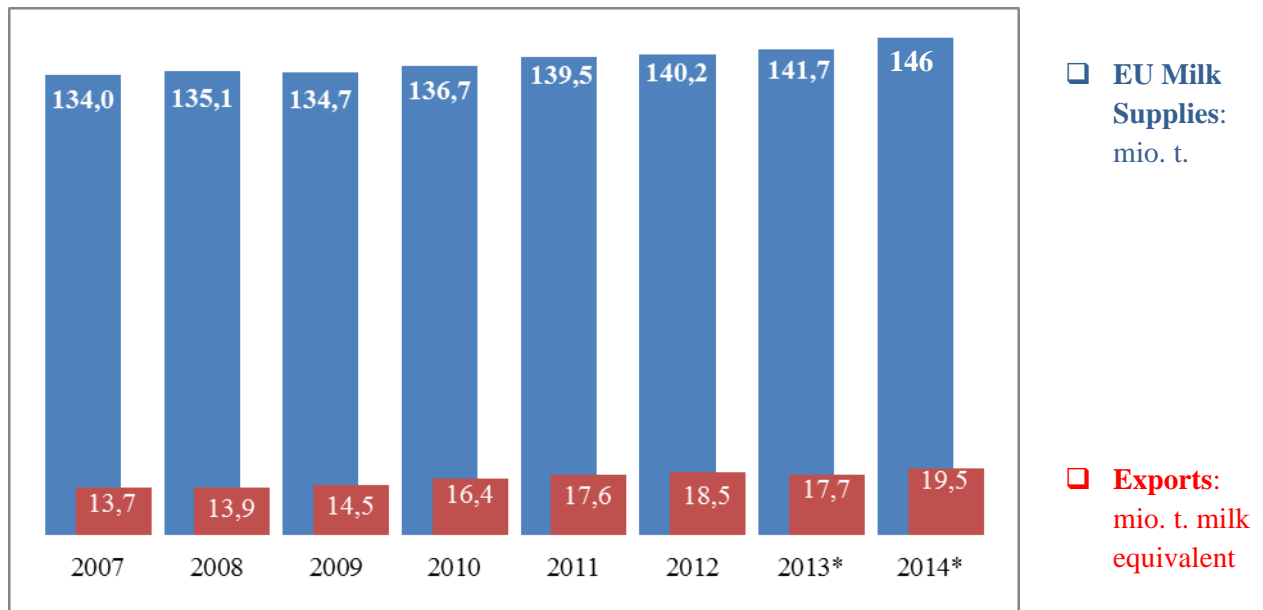
Market return from butter and skim milk powder in Germany

(Ct/kg, 3,7% fat until 2009, afterwards 4,0% fat, 3,4% protein)



This expectation of a relatively stable situation at still high levels is nurtured mainly by the strong impacts of world market developments on the EU market. World market prices have declined but are still above levels of 2010/11 for powders and cheese and on similar levels for butter and whey products. Moreover, the prospects for some EU countries have improved and an easing of the crisis affecting consumer incomes is forecast by many observers. In the first months of 2014, EU exports continued to grow substantially as already had happened in the last months of 2013. To maintain this growth of exports an increase of milk supplies by much more than the estimated 4 million t would be required, which does not seem to be realistic. Anyway, the combined exports, (expressed in milk equivalents based on the solids content of the dairy products) are likely to reach a new historical high, in particular for milk powders and whey products. Also more butter has been exported in the first months, and more exports are necessary in 2014 to keep the market in balance.

EU milk supplies and dairy exports



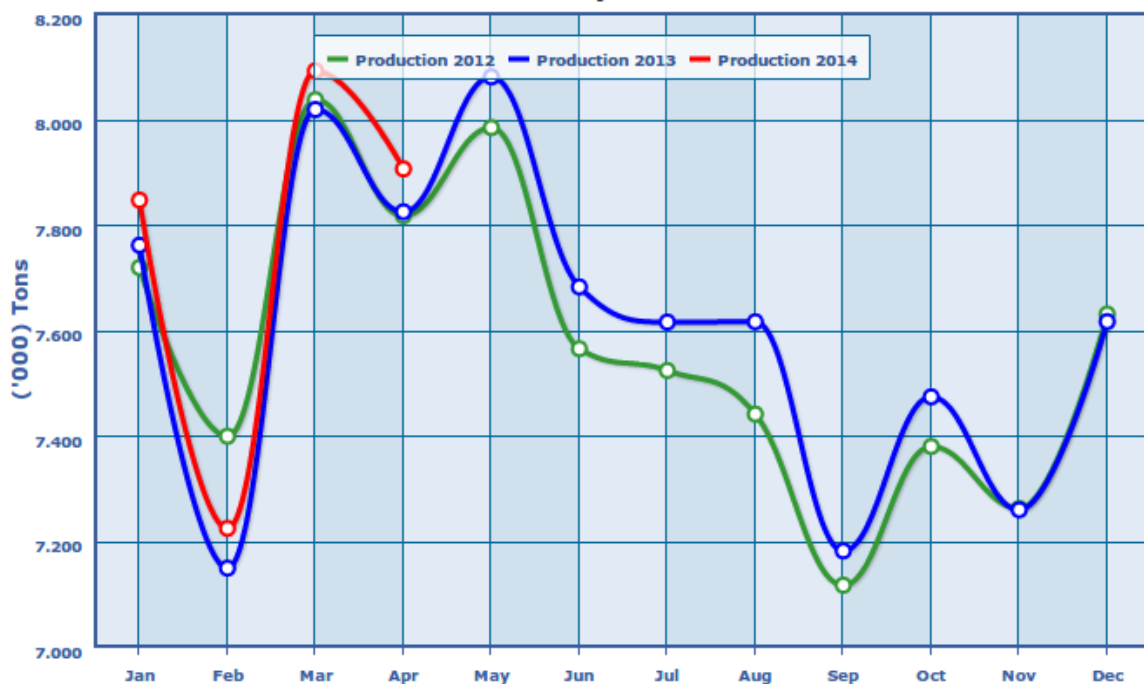
Moderate expansion in other parts of the world

Also in other major areas of the world milk production continues to grow.

The combined production of major exporting areas might increase within a range from 7 to 8.5 million t to a total between 288 and 292 million t (**EU** 146, +4; **USA** 93 +2; **NZ** 22 +2; **Australia** 9.3, +0; **Argentina** 11,8, + 0.0; **Belarus** 6.3, +0.2; **Uruguay** 2.2, +0.1). In percent this combined growth will be around 3%.

USA: Monthly cow's Milk production

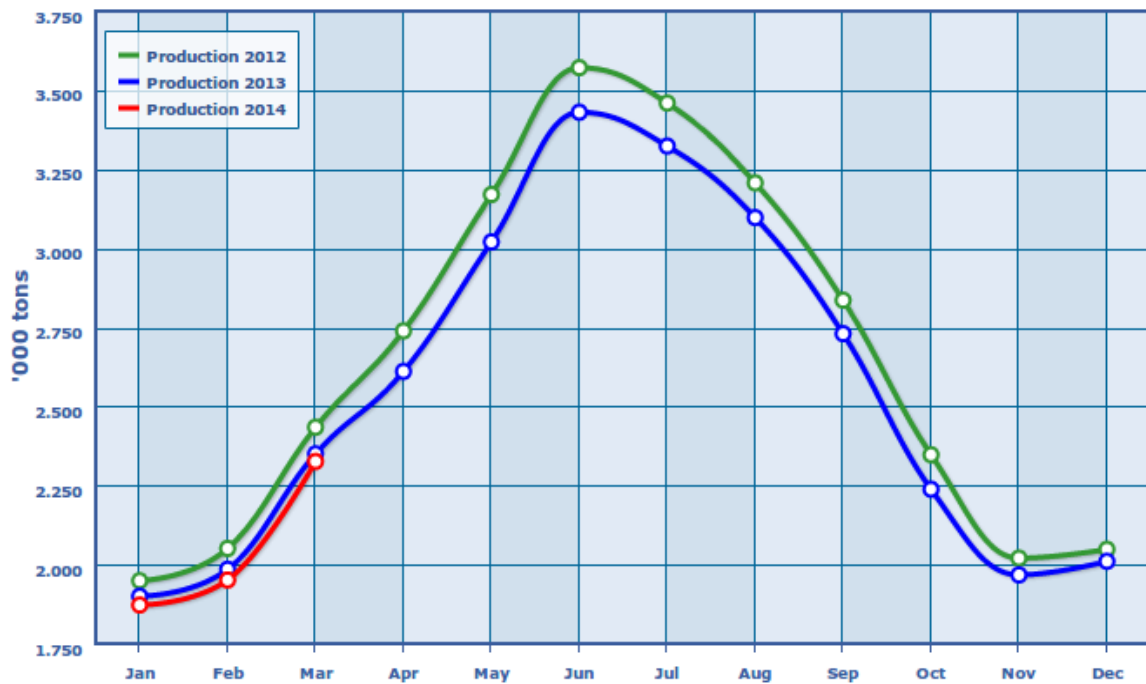
Source: National Agricultural Statistics Service



Production in other markets is expected to go up in the size between 8 and 10 million t (**India** 134, +4; **Russia** 30, +0); **Brazil** 33, +1; **Turkey** 8.5, + 0.5; all other 150, +3). No actual figures are available yet from China.

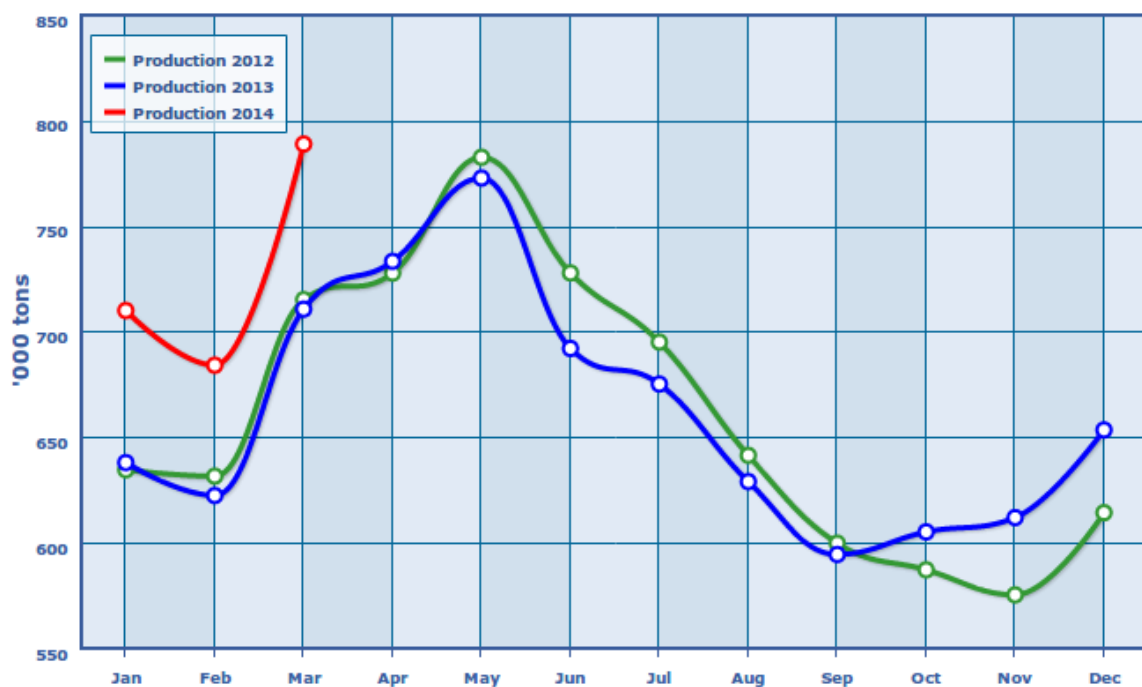
Russia - Monthly cow's Milk deliveries

Source: FSSS

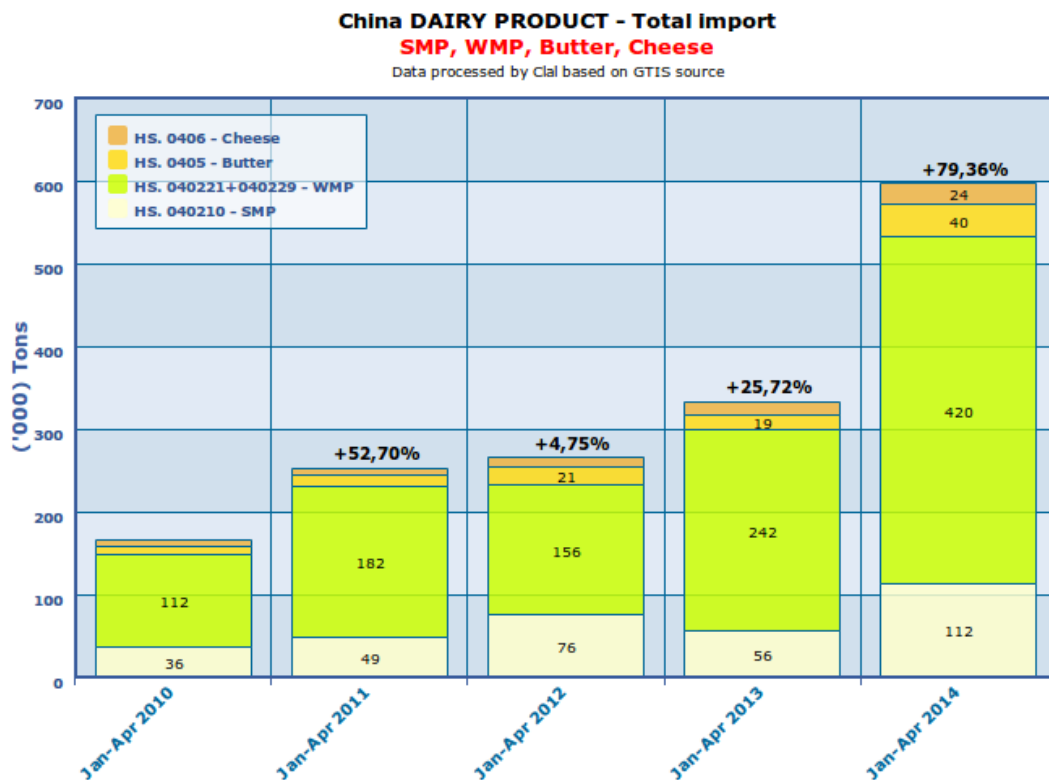


Turkey - Monthly cow's Milk Production

Source: Turkstat



China has boosted imports of milk powders and other dairy products in the first months of 2014, but has recently withdrawn from the market. Nevertheless existing contracts have to be served. With China's geographic position in the Northern hemisphere, this withdrawal is probably only temporary. It remains to be seen what happens when in China the spring peak of milk production is over.



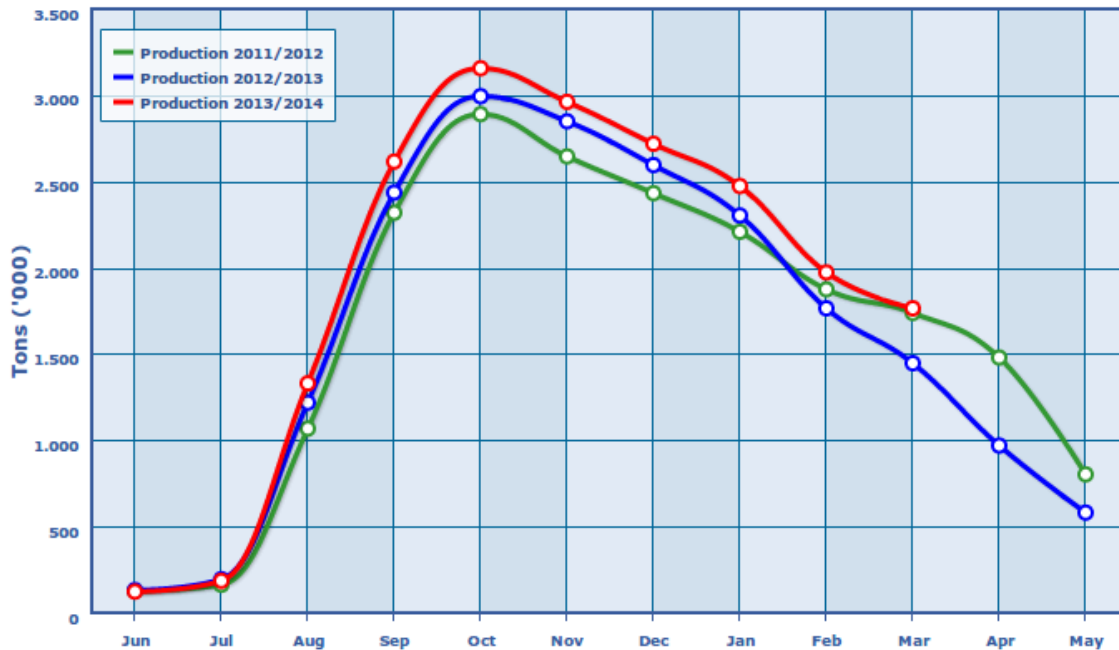
Thus the total of **World** milk production would go up to 778 million t, which is an increase of 18 m or 2,4%. According to different projections the annual growth of World consumption of milk products, expressed in milk terms, is growing on average between 12 million (conservative forecast) and 18million t (optimistic version). According FAO the growth of milk production was 60 million t in the five year from 2008 to 2013, on average 12 million per annum.

Evidence that this growth has trailed behind the growth of the potential demand are the significant price increases in that specific period. It can be concluded that even an increase of 18 million t will not be sufficient to bring prices down to the low levels which were observed in 2008 and 2009.

Similarly to the EU the growth rates of milk supplies in **New Zealand** in the year to year comparison must be seen before the background of a weak production in the dairy year 2012/13. Also here halving of growth in the next season is realistic.

New Zealand - Triennial overview of Milk production

Source: DCANZ

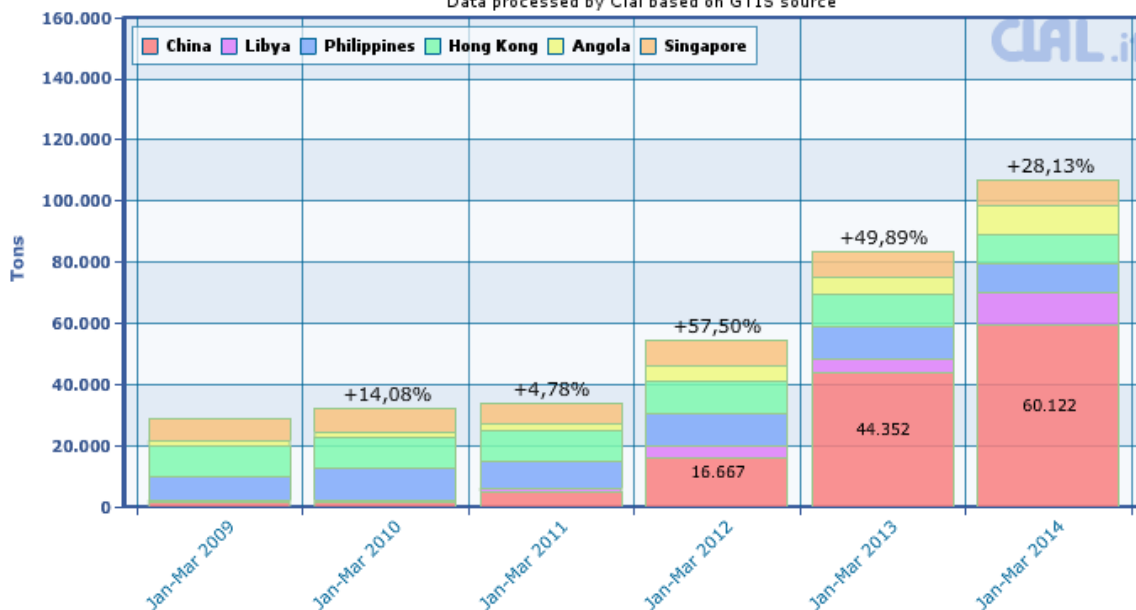


More milk powders, butter and cheese

Expanding milk supplies in the EU are mainly used to produce more butter, cheese and milk powders. The market of liquid milk and other fresh products can only absorb a small share of the additional milk supplies. **But more UHT products are exported to China and other destinations.**

Bulk and pack. milk (HS. 040110+040120): Main Purchasing Countries (Exporters: EU-28, AU, CN, NZ)

Data processed by Clal based on GTIS source



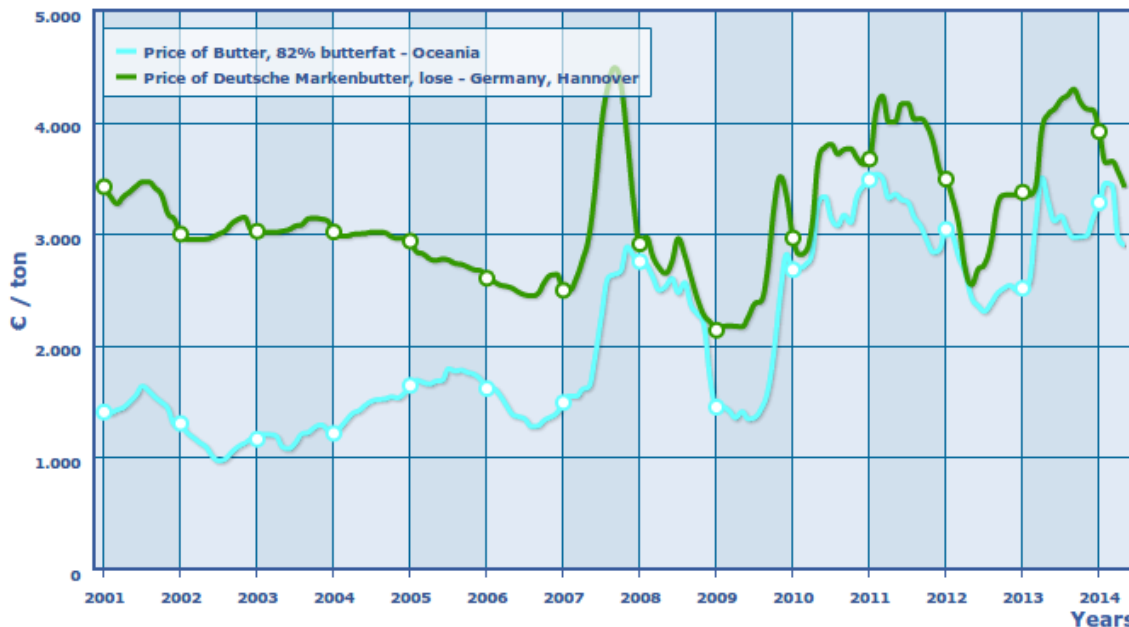
In the seasonal milk flush from March to May, the cheese production has been extended beyond the needs of domestic and export markets, because capacities for processing to butter and milk powders were short in relation to the milk volumes.

EU butter prices down and closer to World market levels

In the EU, all major butter price quotations have been reduced in recent months as result of increased supplies and despite higher exports. No subsidies for private storage are available from the EU; this is the first time since decades.

Comparative historical overview between Butter prices in Oceania and Germany

Processed by CLAL



Formation of stocks has to be financed now only by price differentials over the storing time, of course with greater risks. Therefore sellers were willing to accept price concessions at first for bulk butter which was followed by prices of packaged butter for the retail sector. Only temporarily bulk butter firmed up in April, but further price reduction followed early May. Since significantly more EU-butter has to be sold beyond the EU borders, prices have to move themselves much more in line with world market levels than in recent years.

Reduced cheese prices

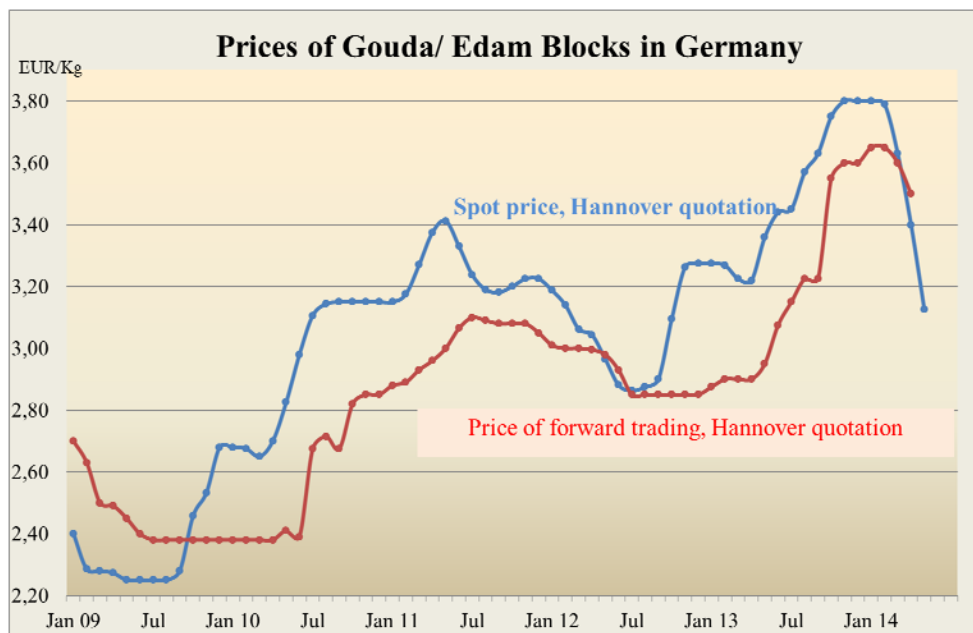
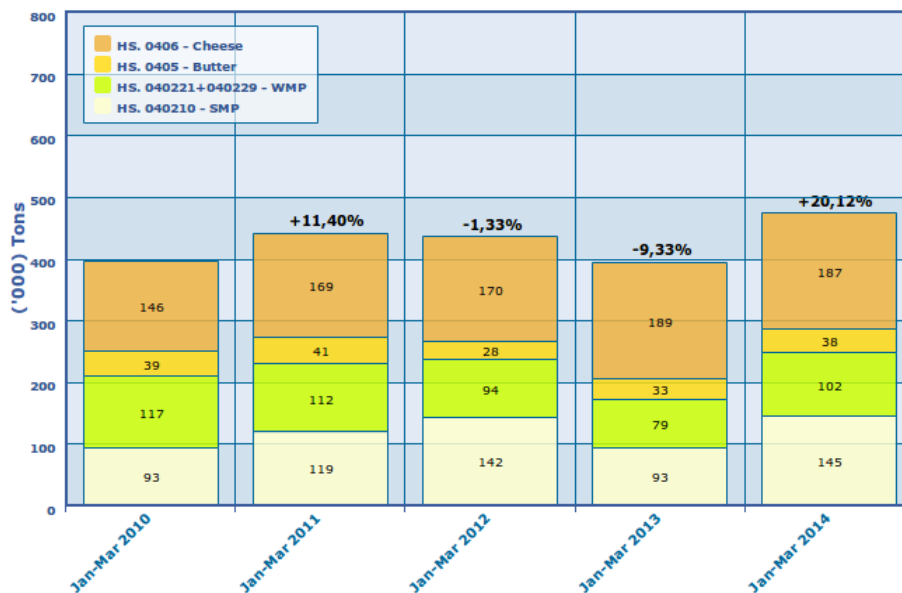
Also cheese prices have fallen since March. Production has been expanded in several member states and in particular in those, which are major exporters, as result of increased milk supplies and the lack of sufficient alternatives for milk processing in the peak season.

As cheese exports could not be expanded, more semi-hard and hard cheeses had to be taken into stores. Within short time thus the low inventories in ripening

stores developed to more than what is regarded as normal. For the next months a reduction of hard and semi-hard cheese production is likely, when the seasonal milk flush is over, which might stabilize prices at reduced levels.

This year no further expansion of EU exports is in sight. It is even difficult to find other destinations for the volumes which cannot be exported to **Russia** as result of the bans imposed on many cheese factories in the EU and Ukraine. Cheese prices in Russia had gone up significantly not only according to the high EU prices, also as result of the weakening Rouble. No recovery is in sight for the Rouble – political troubles might even weaken it further. Therefore a recovery of Russian imports and an easing of import bans do not seem to be likely.

EU-28 DAIRY PRODUCT - Total export
SMP, WMP, Butter, Cheese
Data processed by Clal based on GTIS source



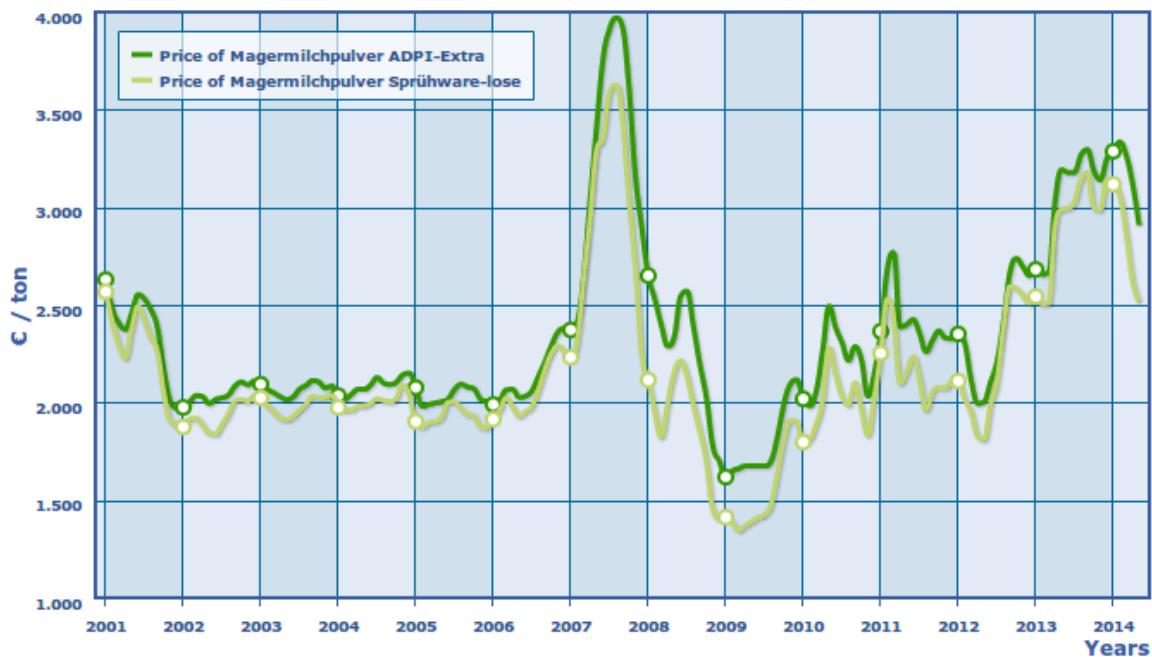
More milk powders

Already in the first months of 2014 EU milk powder production has been extended significantly, since exports have been boosted. And in the following months this expansion will continue, also with new capacities coming in operation. When the seasonal flush of milk supplies is over, milk drying will be more concentrated on those operations which are in the position to produce the high qualities and specifications which are required for exports.

Thus productions of poorer qualities which are acceptable for animal feed purposes will decline, which **might reduce the price gap between food and feed qualities**.

Germany - Historical comparative overview between SMP prices

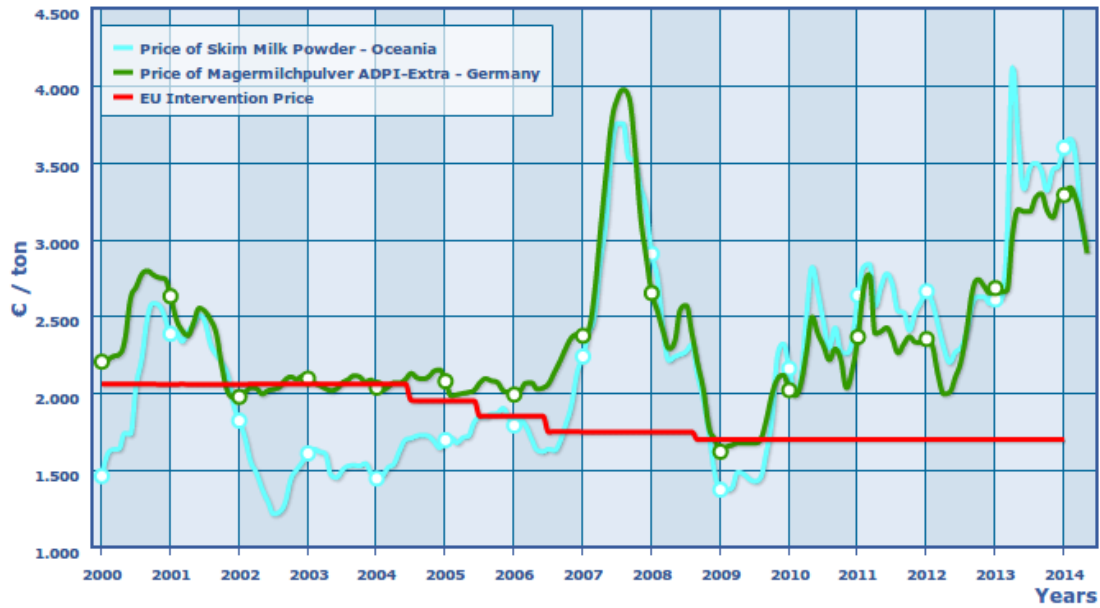
Source: ZMP; since May 6, 2009 Süddeutsche Butter - und Käsebörsen eV, Kempten



Since several years EU skim milk powder prices have been very much in line with the international prices. The same will happen in the whole milk powder sector now, because more will be available for exports and because of the closer evolution of EU and international butter prices.

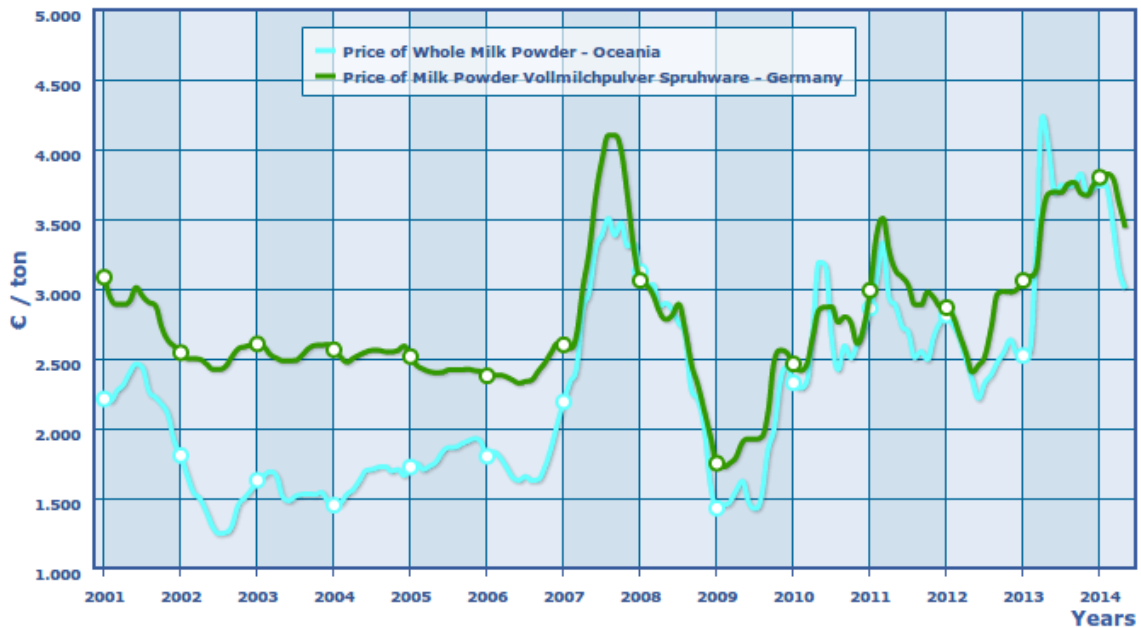
Comparative historical overview between SMP market prices in Germany and Oceania and EU intervention price

Processed by CLAL



Comparative historical overview between WMP prices in Germany and Oceania

Processed by CLAL



Annex

Table 1

EU- Dairy Market 2009 - 2013 and Forecast 2014

1.000 t	2009	2010	2011	2012	2013*	2013**	2014**
	EU 27	EU 27	EU 27	EU 27	EU 27	EU 28	EU 28
Milk deliveries	134.702	136.666	139.526	140.234	141.200	141.701	146.000
Liquid Products	44.157	44.440	44.555	44.850	44.780	45.080	45.200
Butter							
Production	2.050	2.010	2.080	2.105	2.111	2.115	2240
Consumption	1.984	1.974	1.966	2.013	2.021	2.027	2045
Cheese							
Production	9.333	9.497	9.611	9.700	9.810	9.840	9890
Consumption	8.840	8.908	8.993	9.007	9.101	9.135	9165
Skim Milk Powder							
Production	1.160	1.080	1.220	1.230	1.200	1.200	1.400
Consumption	800	805	810	810	797	800	825
WMP Production	735	760	750	715	730	730	780
Population m. head	500	501	502	504	505	510	511
*) Provisional. **) Forecast.						<i>ife May 2014</i>	

Sources: ife, Kiel; ZMB, Berlin.

Table 2

EU Butter Balance Sheet

1.000 t	2009	2010	2011	2012	2013*	2013*	2014**
	EU 27	EU 27	EU 27	EU 27	EU 27	EU 28	EU 28
Production	2.050	2.010	2.080	2.105	2.111	2.115	2.240
Imports	62	40	47	56	45	45	45
Exports	143	161	132	128	135	133	160
Final stocks	135	50	80	100	100	100	180
- in intervention	79	2	0	0	0	0	0
Consumption	1.984	1.974	1.966	2.013	2.021	2.027	2.045
*)Provisional. **)Estimated						<i>ife May 2014</i>	

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

Table 3

EU Cheese Balance Sheet

1.000 t	2009	2010	2011	2012	2013*	2013*	2014**
	EU 27	EU 27	EU 27	EU 27	EU 27	EU 28	EU 28
Production	9.083	9.237	9.366	9.465	9.570	9.600	9.650
Imports	85	82	74	78	76	78	80
Proc. cheese impact	250	260	245	235	240	240	240
Exports	578	676	682	776	790	788	800
Stock change	+0	-5	+10	-5	-5	-5	5
Consumption	8.840	8.908	8.993	9.007	9.101	9.135	9.165
<i>-per capita (kg)</i>	<i>17,7</i>	<i>17,8</i>	<i>17,9</i>	<i>17,9</i>	<i>18,0</i>	<i>17,9</i>	<i>17,9</i>
*)Provisional. **)Estimated						<i>ife May 2014</i>	

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

Table 4

EU SMP Balance Sheet

1.000 t	2009	2010	2011	2012	2013*	2013*	2014**
	EU 27	EU 27	EU 27	EU 27	EU 27	EU 28	EU 28
Production	1.160	1.080	1.220	1.230	1.200	1.200	1.400
Imports	6	4	0	2	5	5	5
Exports	227	378	518	523	413	410	530
Final stocks	359	260	152	50	45	45	95
- in intervention	260	195	54	0	0	0	0
Consumption	800	805	810	810	797	800	825
<i>- as Feed</i>	<i>160</i>	<i>165</i>	<i>175</i>	<i>160</i>	<i>120</i>	<i>120</i>	<i>140</i>
*)Provisional. **)Estimated						<i>ife May 2014</i>	

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

Table 5

EU WMP Balance Sheet

1.000 t	2009	2010	2011	2012	2013*	2013*	2014**
	EU 27	EU 27	EU 27	EU 27	EU 27	EU 28	EU 28
Production	735	760	750	715	730	730	780
Imports	2	2	2	2	3	3	3
Exports	463	447	390	396	394	394	440
Stock change	-55	-20	10	0	0	0	0
Consumption	329	335	352	321	339	339	343
*)Provisional. **)Estimated						<i>ife May 2014</i>	

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