

EU Dairy Markets, Situation and Outlook September-December 2010

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

Special report produced for CLAL

Highlights:

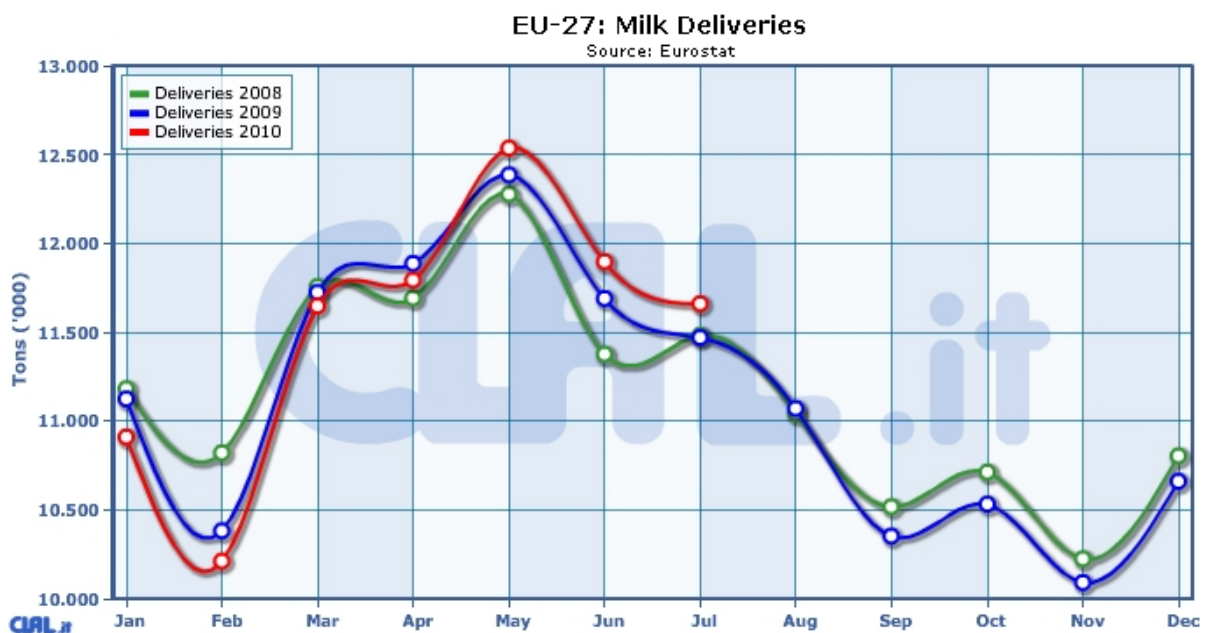
- Milk supplies declining until December, but since May ahead of 2009.
- Higher farm milk prices and quota increases create incentives and give space to produce more milk.
- Outside EU milk production increasing in many parts of the world.
- Cheese production will absorb almost all additional milk supplies, therefore no significant increase of butter and skim milk powder production is likely.
- Growth of demand for dairy products is back in many areas.
- Dairy commodity prices on the international market and in the EU are in full convergence.
- Relative stability is expected for skim milk powder and skim milk as component of many dairy products, because EU intervention stocks can be used to fill uncovered demand from current production in the low season.
- Butter and milkfat supplies are tight in relation to demand, because no butter stocks are available, and therefore prices of butter, bulk cream and other milk products with high fat contents might soar in the last trimester.
- For the European scene much is depending on the Euro exchange rate.
- Easing of the tight supply situation is possible in early 2011

Milk Production

The evolution of milk supplies in the EU changed fundamentally in May: For the period May through September, an estimated volume of 58 million tonnes was delivered to EU dairies, 1,0 million or 1,8% more than in the same period of 2009. In the period from January to April 44,8 million tonnes had been delivered, which were 0,45 million tonnes or 1% less. The increase in the summer was mainly due to favorable conditions in major parts of the EU, though not everywhere, and reflects a certain response of dairy farmers to higher farm milk prices and better prospects in general and the reaction to increased

quotas and easier rules of the system, in particular the reduced fat adjustment. Heat and drought had only temporarily adverse effects in July in some member countries. Relative strong increase rates of milk production could be observed in Germany, the Netherlands, Denmark, France, Austria, Ireland and the United Kingdom, whereas production in other areas and in particular in the Eastern member states and in Italy stagnated or trailed behind last year's volumes.

For the upcoming winter months, however, it seems to be likely that the growth trend will slacken because of late effects of the summer draught mentioned above. In many regions the feed crop yields (silage, hay and other) are poor, and prices for components of supplementary feed concentrates went up significantly, which might have even stronger effects where farmers are committed to refrain from soybean feeding .



In other parts of the world milk production is on the rise, but with the exception of Russia and Ukraine. Also the flood disaster in Pakistan is likely to have strong negative effects on the country's milk production. Recent information from Oceania indicates that milk production could develop below earlier expectations because of unusually cold weather in New Zealand in the early months of the new season 2010/11.

Demand for dairy back on the road of growth

Many signs in the markets give scope for ongoing growth of demand, which is more slow in countries and markets with already high consumption but strong in emerging markets. In absolute terms, however, also slow rates in well developed markets absorb substantial volumes. In the EU, the economic recovery has taken different pace in individual countries but it has already created better consumer confidence which also has led to a modest growth of demand for dairy products. In the U.S. the situation is more unclear, but here the constant growth of population is still a constantly driving force of dairy consumption. In emerging markets both population and economic growth are the the driving forces, and here the recovery after the crisis has been the fastest and has led to a quick return to earlier trends. Despite the fact that most of the dairy products in emerging markets are required from local or area production, increasing volumes are also supplied by the international trade which has increased again since 2009. After stocks have been run down in Oceania and the U.S., the EU gained back its role as a major supplier of the world market, second to New Zealand.

Despite higher production: Not the right time yet for price reductions

When milk production started to expand on year to year basis the first in the United States in March, followed by the EU in May the expectation of an easing of commodity prices was expected by many observers. However, also with the increases in summer which are mentioned above this was not the right time for price reductions. In June, milk production of the Northern Hemisphere entered into the phase of its seasonal decline, which by far cannot be compensated by the adverse seasonality in Oceania and Southern Latin America. Since supplies of Oceania from the season 2009/10 were almost sold out, prices on the world market, in Europe and North America weakened only for a very short period. For a certain time EU suppliers lost competitiveness as result of the strength of the Euro as they do now again, but buyers had to come back to EU origin supplies because of the limited availability from other sources and it is likely that they will come back again very soon. Therefore it can be expected that markets will be dominated by stability or firmness of present price levels until the end of the year. It cannot be ruled out that prices go down in early 2011, but

whether this will be only a short term seasonal or a longer lasting cyclical phenomenon remains to be seen. It would be premature to give a clear indication already now. Much will depend on the evolution of milk supplies.

Not yet clear are the impacts of the Pakistan flood and the drought in Russia. Will they lead to additional demand for imports, be they commercial or for the purpose of food aid? In the diet of Pakistani people dairy products play a relatively important role and reportedly many dairy animals were lost in the flood.

Interaction of EU and World markets of dairy commodities

EU exported substantially more cheese and SMP in the first seven months of 2010 than the year before, whereas whole milk powder and butter exports were slightly reduced. Price levels of commodities in EU and in the international markets were close to each other. The recent strength of the Euro created again a gap between domestic prices and world market prices and the question is whether EU-prices will have to adjust to international prices or vice versa. As for butter and AMF, it seems to be likely that world prices will have to accept EU levels for some time. There is no scope for re-introduction of export refunds.

Reduced EU production of butter and skim milk powder

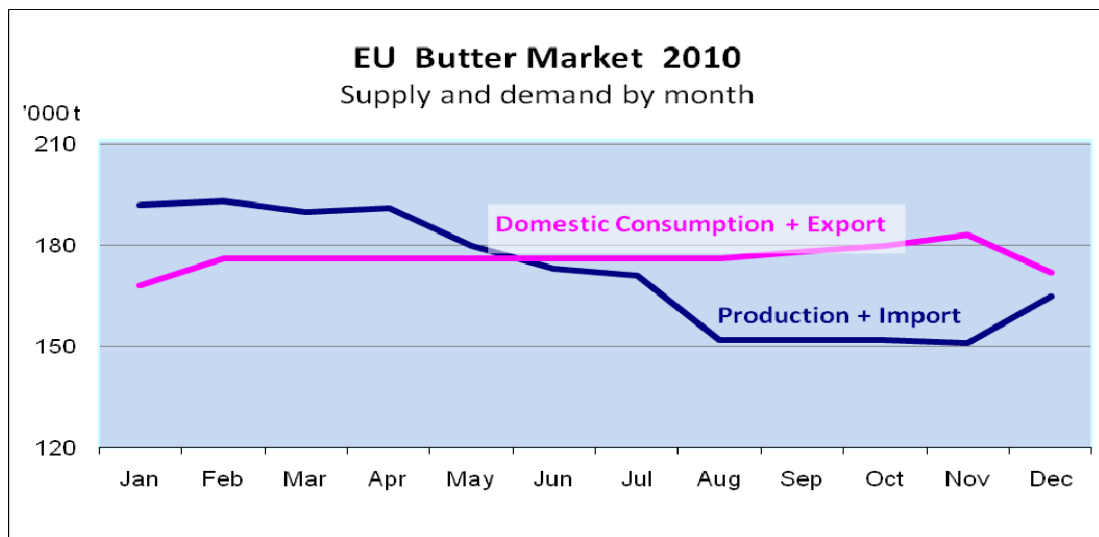
As EU cheese production is boosted both by domestic and export demand almost all of the additional milk supplies will be absorbed for cheese. Therefore no increase of butter and SMP output over last year is likely and production of both products is declining until December according to the usual seasonal pattern anyway. So far less WMP was produced in the EU, but in line with increasing export opportunities production in the second half of the year might exceed previous year's quantities.

Firm Butter Market

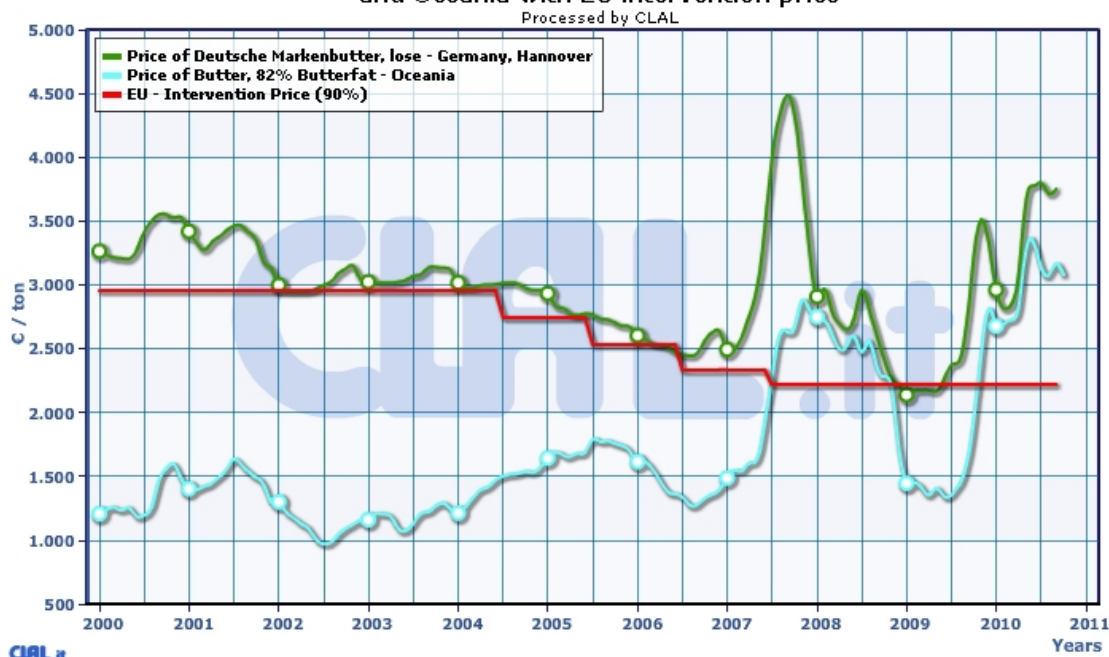
With a declining butter production, a slightly reduced domestic consumption in the EU and growing exports the butter stocks of the EU have already been reduced. Parts of the stocks in intervention are cleared by the scheme of butter donations. Inventories in private stocks which are needed to fill supply gaps

later in the year are significantly lower than last year, and with only 1.545 tonnes of not committed stocks (as of September 23, 2010) in intervention, the

market will be short even if there is no additional demand from the international market. This prices have increased if quoted in US-Dollar, but converted in Euro become a little weaker. But in view of short butter and milkfat supplies prices are expected to adjust to European levels. If more butter is contracted for exports even here prices could continue to rise over the next months with seasonal strong demand from the domestic retail sector. Also if intervention butter designed for social programs appears in the commercial channels the situation will not be different. An easing of the situation might happen at the end of 2010.

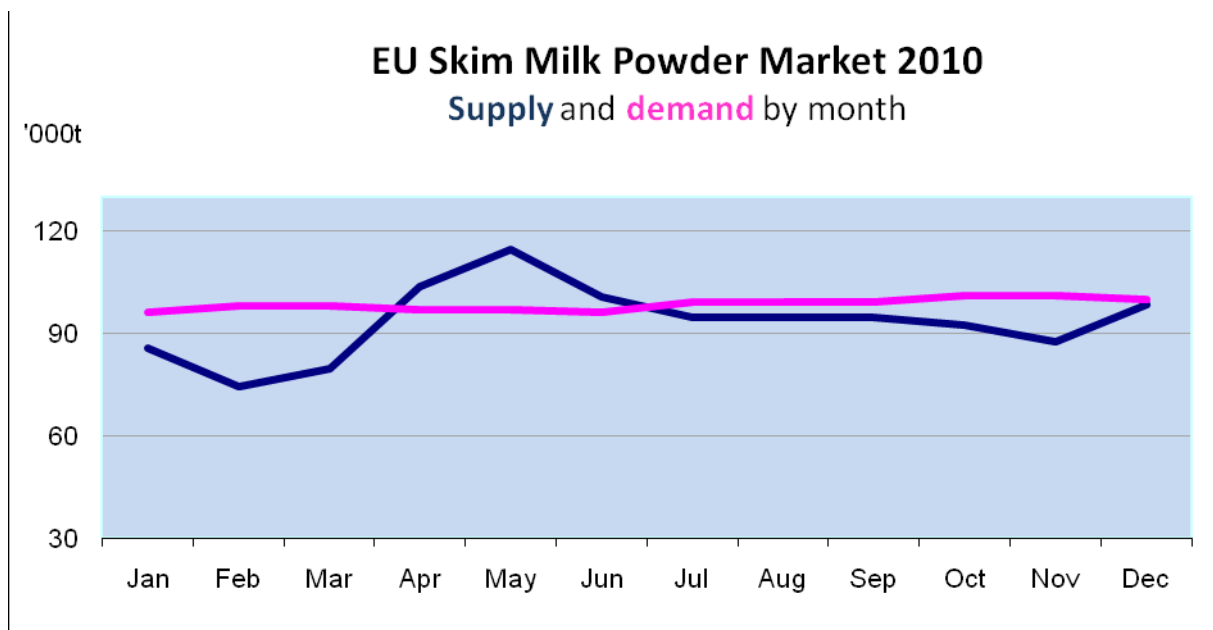


Historical comparative overview between Butter prices in Germany and Oceania with EU intervention price



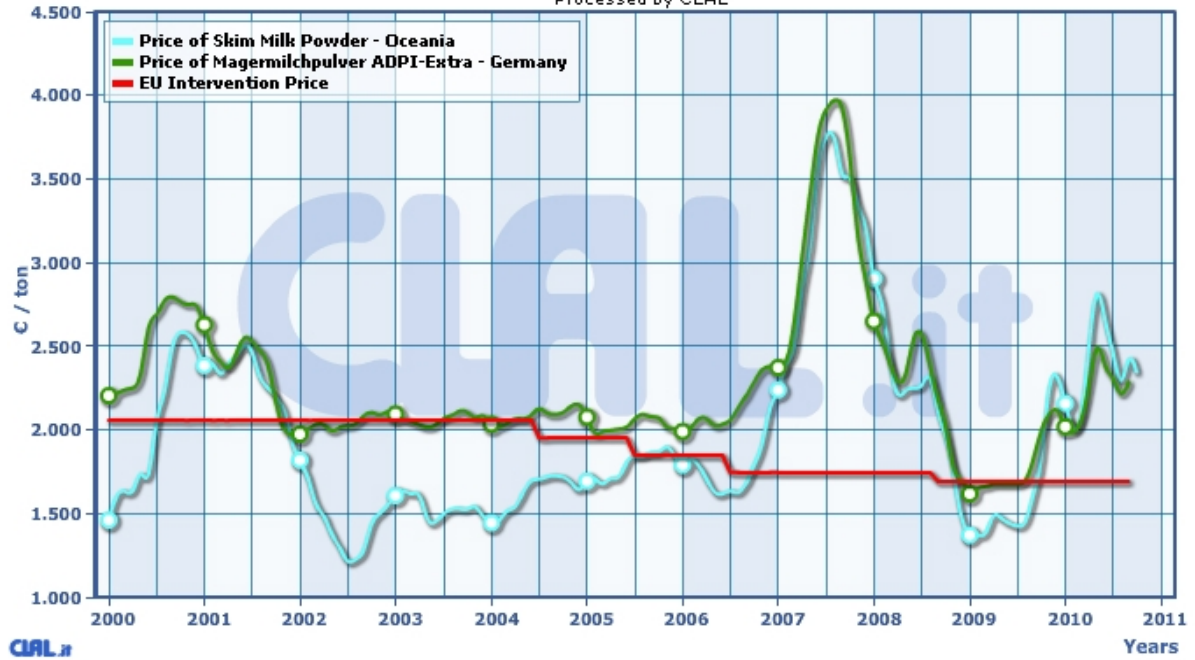
Stability in the market of skim milk powder

A more stable situation is expected for skim milk powder in the next months, and the slight price reductions at the end of September are a first indication. Against the expectations expressed in the CLAL May 2010 forecast the sale out of EU intervention stocks is going on only slowly because the additional milk supplies since May led to more SMP being produced than expected (but not significantly more than the year ago). In the last months of 2010, production will be reduced not only seasonally, but also fall back behind 2009 figures. The strong demand from the EU food industries, the calf-feed producers for exports will exceed production anyway, but the gaps can be filled by intervention stocks. According to the European Commission, 190.193 tonnes were available as of September 23, which is a quantity which is sufficient to balance the market at present price levels. It can be assumed that the market is preferring SMP which is available in bulk or bigbags, whereas intervention stocks are filled in 25kg bags. Therefore the market prices will move above the selling prices of the intervention agencies which are fixed by tenders. In the last selling round the minimum price was fixed at 2,14€/kg. If sales continue at this level, market prices can be expected in a range between 2,25 to 2,35/kg.



Historical comparative overview between SMP market prices in Germany and Oceania and EU intervention price

Processed by CLAL



Annex

Table 1

EU Dairy Market: Overview 2007 - 2009 and Forecast 2010

1.000 t	2007	2008	2009	2010 F-cast
Milk Deliveries	133.767	135.508	135.225	136.800
Liquid Products	46.370	46.600	46.600	46.800
Butter				
Production	2.065	2.075	2.040	2.000
Consumption	1.966	1.933	1.960	1.950
Cheese				
Production ¹⁾	8.976	9.030	9.030	9.200
Consumption	8.721	8.809	8.834	8.870
Skim Milk Powder				
Production	1.090	1.040	1.100	1.080
Consumption	870	770	785	800
Whole Milk Powder				
Production	775	875	768	800
Consumption	415	396	370	380
Population (m. head)	496	498	500	502
<i>1) Including processed cheese impact.</i>				<i>ife Oct. 2010</i>

Source: ife Kiel, according figures collected from ZMB and EU Commission publications.

Table 2

EU Butter Balance Sheet

1.000 t	2007	2008	2009	2010*
Total production	2.065	2.075	2.040	2.000
Imports	92	65	62	50
Exports	211	147	143	160
Final stocks	90	150	150	90
- in intervention	0	0	80	10
Consumption	1.966	1.933	1.960	1.950
<i>*) Estimated.</i>				<i>ife Oct. 2010</i>

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

Table 3

EU Cheese Balance Sheet

1.000 t	2007	2008	2009	2010*
Production	8.976	9.030	9.030	9.200
Imports	94	89	84	90
Processed cheese				
import	265	255	250	250
Exports	594	555	570	660
Stock change	+20	+10	-40	+10
Consumption	8.721	8.809	8.834	8.870
<i>-per capita (kg)</i>	<i>17,6</i>	<i>17,7</i>	<i>17,7</i>	<i>17,7</i>
*) <i>Estimated.</i>			<i>ife Oct. 2010</i>	

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

Table 4

EU WMP Balance Sheet

'000 t	2007	2008	2009	2010*
Production	775	875	768	800
Imports	2	2	1	0
Exports	362	481	420	420
Change in stocks	0	0	-20	0
Consumption	415	396	370	380
*) <i>Estimated.</i>			<i>ife Oct. 2010</i>	

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

Table 6

EU SMP Balance Sheet

1.000 t	2007	2008	2009	2010
Production	1.090	1.040	1.100	1.065
Imports	10	8	6	5
Consumption	870	770	785	800
Exports	201	179	227	360
Ending stocks	124	223	317	227
- in intervention	-	-	260	170
*) <i>Estimated.</i>			<i>ife Oct. 2010</i>	

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