



## Dairy Market Update

10 December 2009

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### New Dairy Crest 'milk and more' contract

Dairy Crest (DC) has announced the introduction of a new contract for supplying liquid milk into the DC 'milk&more' doorstep division. It will be available early in 2010 and open to all DC suppliers who are currently on non-aligned liquid contracts, on a first come, first served basis.

The doorstep division is estimated to represent around 20% of the total volume of milk DC purchases directly from farmers. In GB doorstep milk sales are declining, according to TNS data, with sales in the 52 weeks ending 1 November 2009 being 8.3% lower (in volume terms) than the previous year.

The base price for the contract will be set on the prevailing price at the time +0.25ppl. While this price will be fixed for two years, it will be tracked on a monthly basis against an agreed 'market price basket', composed of non-aligned DC, Arla and Robert Wiseman liquid milk prices. If the difference between the contract price and this basket price is greater than +/-2ppl, it will trigger an adjustment to the contract price.

The tracking component of the contract means that along with greater stability producers will benefit when there are significant increases in liquid milk prices in the market. Conversely, any price decreases which result in a greater than 2ppl difference between the contract price and the basket price will also be passed on.

#### In context:

With the EU dairy markets becoming more deregulated, milk prices will be increasingly affected by the volatility of world commodity markets. Dairy Crest is the first milk buyer to offer an innovative solution to some of its suppliers to help reduce this price volatility. As it is a domestic market the doorstep market, in common with other liquid milk markets, is partly insulated from commodity market volatility. However, it is still influenced by returns from bulk cream. The advantage of the new contract to farmers is greater stability in the milk price, making it easier to plan and budget. On the other hand, DC benefits from the fixed price contract by having a committed milk supply with a stable cost base for the 'milk&more' division. Whether farmers will take up this option will depend on how risk-averse they are and what their belief is surrounding the future movement of milk prices.

### UK milk deliveries at the same level as last year

Provisional figures for November show that UK milk deliveries totalled 986.4m litres, 0.4% (3.8m litres) above November 2008. Between October and November UK milk deliveries fell by 3.7% (37.9m litres) - this is a larger fall than in the last two milk years, and above the five year average which shows a fall of 3.3% between October and November.

Cumulative figures for the first eight months of the current milk year show UK milk deliveries at 8,634.2m litres, almost the same as this time last year which stood at 8,635.4m litres. In the same period GB milk deliveries were up 1.3% (93.6m litres) to 7,443.6m litres.

### New EU farm commissioner nominated

Dacian Ciolos has been nominated as the new EU Commissioner for Agriculture and Rural Development. He was nominated by the president of the European Commission; Manuel Barroso on 27 November. Mr Ciolos is from Romania, a new Member State (MS), where agriculture plays a major role in the country's economy and which, with more than 500,000 dairy farmers, has the largest number of dairy farmers in the EU. Before Mr Ciolos can take up

office early in 2010, the European Parliament will need to approve the nomination.

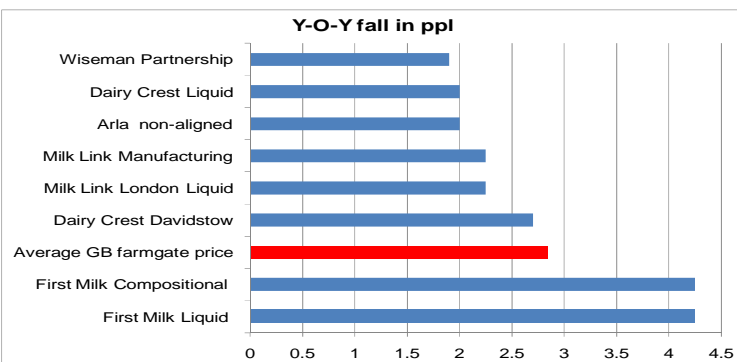
If his appointment is confirmed, he will have to handle two key issues over his five year term of office which will impact on the future of the EU agriculture: the WTO Doha Round negotiations and the reform of the CAP for the 2014-2020 period. A decision about this reform is required before the end of 2013.

#### In context:

The CAP budget is currently €55billion (£50billion), representing 45% of the EU's expenditure. The EU farm commissioner will play a key role in deciding what the future level of this budget will be, which will determine how much support EU dairy farmers will get. He will also have a major input in deciding how this support, including the single farm payment, will be distributed to farmers and between the different MS.

### Milk price variations

The average farmgate milk price paid in GB has fallen by 2.84ppl between September 08 and September 09. The price which is derived from Defra data has fallen from 27.41ppl to 24.57ppl. All milk buyers in GB have decreased prices during this period. However, the level of decrease varies between milk buyers with the lowest level of decrease seen on dedicated supply contracts.



As the graph above shows, most of the non-retailer aligned contracts offered by the main milk buyers had their price reduced by less than the GB farmgate price between September 08 and September 09 based on the DairyCo standard litre. First Milk is the exception with both its liquid and compositional contracts seeing their price lowered by 4.25ppl. The smallest decreases were experienced by the three main liquid contracts with Wiseman Partnership, Dairy Crest Liquid and Arla non-aligned having their price decreased by between 1.9ppl and 2ppl. Milk Link reduced its price on its Liquid and Manufacturing contracts by 2.25ppl, less than the 2.8ppl decrease applied on the Dairy Crest Davidstow contract.

#### In context:

Although all display a decrease in price in the 12 months to September 2009, most non-aligned contracts have seen an improvement in their relative position compared to the average GB farmgate price. For example, the annual average price of the Wiseman Partnership and the Milk Link London Liquid contracts were 1.33ppl and 1.91ppl

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respectively below the GB average price in September 08 compared to 0.39ppl and 1.32ppl in September 09. The main liquid contracts have shown less downward movement than the manufacturing contracts, reflecting the greater exposure of manufacturing contracts to the commodity market and competition from imports. Despite this, the co-operatives First Milk and Milk Link have respectively cut their prices on liquid and manufacturing contracts by the same amount suggesting that returns from these markets are pooled and redistributed equally between their members.

### World milk supply

Worldwide growth of milk production is predicted to slow in 2009, according to the Food and Agricultural Organization (FAO). For 2009, the total milk output of the five major exporters (United States, the EU, New Zealand, Australia and Argentina) is expected to reach 273m tonnes, the same level as 2008. Milk production is expected to recover in Oceania after a few years of poor production resulting from unfavourable weather conditions. However, production levels in North America and Europe are expected to fall. US production is predicted to decrease by 0.8% to 82.7 billion litres as a result of falling cow numbers while low milk prices and relatively high feed prices in much of Europe is expected to lead to a fall in production. Milk deliveries in the EU-27 in the first nine months of 2009 have fallen by 0.3% when compared to the same period the previous year.

Worldwide exports of key dairy products are forecast to decline to 39.4m tonnes in 2009, down by 0.3m tonnes (0.8%) from the estimate for 2008. While exports from Oceania are expected to increase, this will be more than offset by large reductions in exports from the United States and Europe.

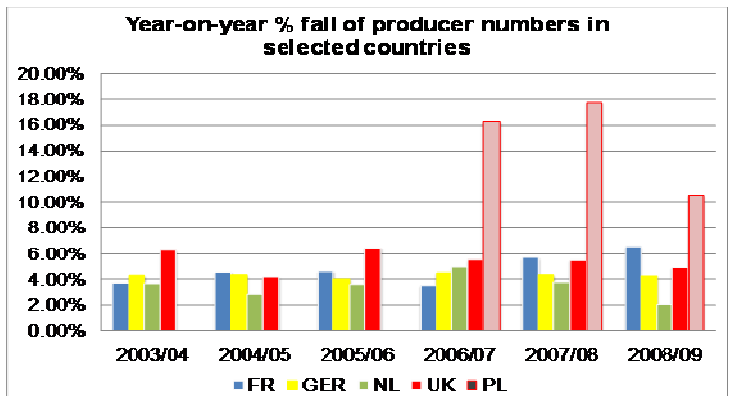
### In context:

It would be expected that the reduction in the world supply of milk and milk products would help to correct the over-supply situation which resulted from the dairy commodity price surge of 2007 and would therefore push prices up. However, a key factor impacting on international dairy markets is the economic situation in key importing regions. The largest importing markets for dairy products, including butter and powders are the Russian Federation and emerging Asian economies. The impact of rising prices on import demand by these countries will be dependent on how their economies have been affected by the global economic downturn. Latest

economic indicators from the Economist magazine forecast reduced GDP for 2009 in Russia and many Asian markets, with the exception of China and Indonesia.

### Producer numbers falling faster in EU-25 than in UK

Producer numbers in the EU are falling at a faster rate compared to the UK. During the 2008/09 year, the number of producers in the EU-25 fell by 7.6% to 728,760. In the six largest countries (in terms of milk production), the rate of decline stood on average at 7.4% and ranged between 2.1% in the Netherlands and 10.5% in Poland. Over the same period, the number of UK dairy producers fell by 5.0%, the lowest level of decline in four years. Despite the fall in EU producer numbers, milk production in the EU for the period fell by less than 0.2% compared with the previous year. This suggests that across the EU dairy producers expanding production is almost totally offsetting the fall in production associated with those who leave the industry.



### In context:

These figures show that there is no direct correlation between the evolution of producer numbers and milk production; producer numbers have fallen faster in the EU-25 in total than in the UK, yet milk production has fallen in the UK while it remained broadly static in the EU-25. It suggests that in total within the EU-25, dairy farmers may have expanded at a faster rate than in the UK in order to offset production lost by, on average, a larger proportion of farmers exiting the industry.

| Quota Prices (4.00%)                   | Clean                                 | Lease | Exchange Rate €/£                       |               | UK Average Farmgate Milk Price: October |           |                                 |                  |      |
|--|---------------------------------------|-------|---|---------------|---|-----------|---------------------------------|------------------|------|
|  | 10/12/09                              | 0.45  | 0.10                                    | 0.90420       | 2009                                    | 24.43     | 2008                            | 27.36            |      |
| Wholesale Prices and Market Indicators | IMPE                                  | AMPE  | MCVE (Milk for Cheese Value Equivalent) | Cream Income* | Butter (£/t)                            | SMP (£/t) | Mild Cheddar (£/t)              | Bulk Cream (£/t) |      |
|  | November 09                           | 19.2  | 27.6                                    | 28.21         | 8.43                                    | 3300      | 1700                            | 2600             | 1500 |
|  | October 09                            | 19.7  | 26.4                                    | 27.20         | 9.60                                    | 3250      | 1600                            | 2500             | 1700 |
|  | November 08                           | 17.9  | 21.0                                    | 27.04         | 4.42                                    | 1750      | 1800                            | 2750             | 780  |
| Retail Prices                          | Liquid Milk (retail) (ppl equivalent) |       | Doorstep (ppl equivalent)               |               | Butter Branded (p/250g)                 |           | Mild Cheddar Non-branded (p/kg) |                  |      |
| November 09                            | 66                                    |       | 100                                     |               | 100                                     |           | 618                             |                  |      |
| % change v November 08                 | -3.0%                                 |       | n/c                                     |               | -6.5%                                   |           | -12.7%                          |                  |      |

\*Cream income = The cream income to a liquid processor is based on the value of the excess cream created because the average level of fat on liquid milk sold through the retail market (supermarkets, local stores and doorstep) is less than the level of fat in the raw milk they receive. It assumes all the cream is sold in bulk form.

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