

# Datum.

## Dairy Market Update



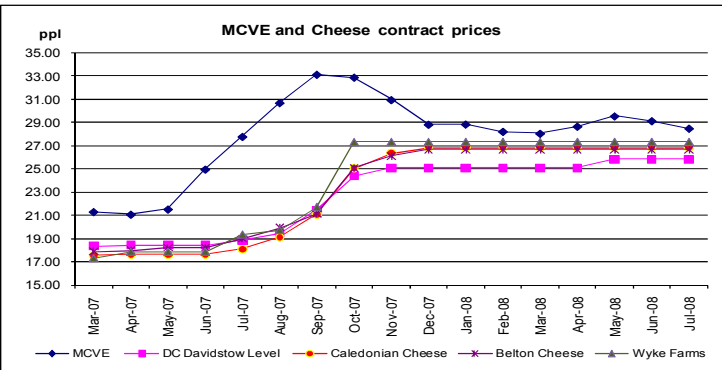
29 August 2008

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### Dairy Crest increases Davidstow contract price

From September Dairy Crest (DC) has announced a 1ppl increase in the price paid on its Davidstow contract - designed for the manufacture of mature and extra-mature cheddar. Based on the DairyCo standard litre, the annual average price will rise to 26.85ppl, which is now in line with similar cheese contracts on the market.

The latest Milk for Cheese Value Equivalent (MCVE), indicating the value returned by processing milk into mild cheddar and other by-products, stands at 28.45ppl. MCVE is the equivalent value of milk at the factory gate. It is therefore possible to compare MCVE with farmgate prices by deducting an assumed cost of 1 to 1.5ppl for transport to the factory. It therefore appears that the Davidstow milk price is coming in line with MCVE.



### In context

It will be interesting to see whether cheese processors continue to raise their contract prices in the coming months in order to compete for Britain's dwindling milk supplies. These processors receive a premium for their products when compared to the commodity mild cheddar price on which MCVE is based. The price DC will be able to pay depends largely on the processors' ability to add value by producing mature branded cheddar and negotiating adequate returns for this added value from the supermarkets.

### Half a ppl increase for the average farmgate price

Defra's latest average farmgate price for June shows a small increase of 2.1% - 0.51ppl to 24.96ppl when compared to the May price. Annual comparisons now show the average farmgate price stands at 38.1% - 6.88ppl above the level seen in June 2007. In addition, it is interesting to note the average farmgate price for June is 7.24ppl (40.9%) above the 10-year June average price of 17.72ppl.

### In context

Many industry experts have been suggesting that farmers should be receiving around 30ppl by October/November. However, if the small slowdown of the UK commodity mar-

-kets seen in August continues in the coming months, it will be interesting to see if this farmgate price is achieved.

### UDF auction prices and volumes down

At its August milk auction, United Dairy Farmers sold 30 million litres of milk for delivery in September at an average price of 25.53ppl. This was a fall of 25% in volumes (-9 million litres) and 3.7% in prices (-0.97ppl) compared to the July auction and 9.13ppl less than the average price achieved in August 2007 (for 27 million litres). Milk on one month contracts (3 million litres) averaged 26.44ppl compared to 25.52ppl last month, whereas milk on three month contracts (27 million litres) averaged 25.43ppl compared to 26.58ppl last month.

### In context

The decrease in UDF auction prices between July and August reflects some concerns about the market conditions in the near future. Some market commentators reported that the price for September delivered milk of 25.53ppl compared well to prices received so far this year. They suggest that confidence in the current level of milk price should remain positive bearing in mind the coming autumn trough which may imbalance the market with demand being greater than supply.

Other industry experts suggest the drop in UDF auction prices was expected because of world market prices falling for WMP following Fonterra's auction (-15% for October supply). However, NI has the flexibility to process more Cheddar cheese and less powder which may enable processors to secure higher returns.

### Commodity market roundup

In general, dairy commodity prices on the UK, EU and world markets have fallen in August but to different degrees. On the world stage, decreases of 11% to \$3,300/tonne (£1,737/tonne) for SMP and 10% to \$4,000/tonne (£2,105/tonne) for WMP were reported between July and August. This is the result of increasing global milk production mainly driven by the USA (producing SMP) and falling demand, overall leading to a price drop. Some recovery in Australian milk output and a predicted growth of 4 to 5% in milk production in New Zealand could put further downward pressure on dairy commodity prices in the coming months.

In the EU market, low export levels have led to high internal commodity supply resulting in high volumes of butter put into stores. As a consequence, prices for butter, SMP, WMP and

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block Gouda/Edam fell by 5 to 10% in August compared to the previous month.

Milk supply remaining tight and favourable exchange rates suggest the UK dairy market will be the most resilient. Alongside European prices, butter fell slightly by 2% to £2,300/tonne whereas SMP and mild cheddar remained unchanged at £2,120/tonne and £2,850/tonne respectively.

### In context

Several factors will determine the level of commodity prices over the next few months: the weather in Oceania which will affect the predicted growth in milk output, the pace of growth of US milk production - which is starting to slow due to high feed prices - and world demand for dairy products slowing against the backdrop of high prices and economic downturn. These commodity prices are worth monitoring considering UK commodity prices have historically provided the base for the UK farmgate price, not the retail price of milk.

### EU Commission prospects for dairy

The EU Commission's latest medium-term forecasts (April 2008) to 2014 predict that over the next decade, world milk production should increase by about 20%, mainly generated by enhanced yields per cow. Roughly 45% of the increase should occur in Asia, mainly in China and India (FAPRI, OECD-FAO outlooks). In terms of dairy commodities, FAO projects for 2017 a 16% increase for world butter and cheese production - an additional 2.3 million tonnes for butter and cheese compared to 2007 levels - whereas milk powder output should rise by around 20% (equivalent to 8 million tonnes).

As a result, although dairy commodity prices should remain 70 to 80% higher than those seen in the last decade, world prices, having peaked in 2007/08, are expected to fall in the coming years as production response rises. In 2008, WMP, SMP, butter and cheese prices are forecast to fall by 15%,

19%, 9% and 3% respectively compared to 2007. The downward trend is expected to last until 2013, with prices decreasing by 2% (cheese) to 4% (powders) per year.

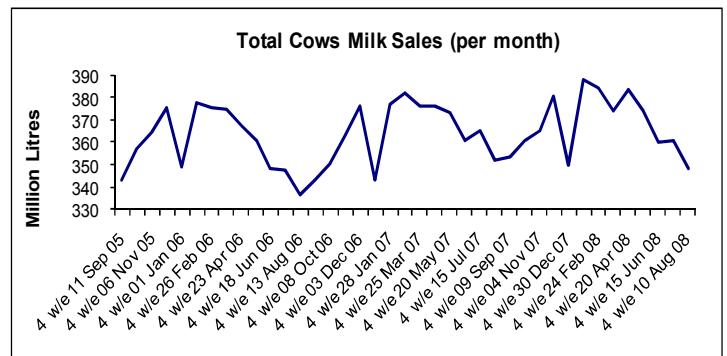
### In context

The Commission predicts that cheese and fresh dairy products production and consumption will keep growing with the EU continuing to be a major exporter. Predicted prices will remain at least 70% higher than those seen over the past 10 years suggesting a positive outlook for EU dairy producers if input prices allow competitive milk production.

### Credit crunch affecting milk sales

As the credit crunch in the UK continues to affect consumer spending, demand for cows milk seems to have fallen. TNS data shows that in the four weeks ending 10 August 2008 349 million litres of cows milk were purchased, this is a fall of 3.6% when compared to July. August sales are usually the lowest in the year due to the holiday season. However, sales decreased by 1.13% and 3.6% compared to August 07 and August 06 respectively.

The pressure on households to reduce food bills has led to consumers switching to discount retailers Aldi and Lidl, with their milk sales between July and August increasing 4.1% and 0.1% respectively.



Quota Prices (4.00%)	Clean	Lease	Exchange Rate €/£		Average Farmgate Milk Price: June				
			2008	2007	Butter (£/t)	SMP (£/t)	Mild Cheddar (£/t)	Bulk Cream (£/t)	
19/08/2008	0.50ppl	0.10ppl	0.79860		2008	24.96ppl	2007	18.08ppl	
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)	
					August 08	2300	2120	2850	1000
					July 08	2350	2120	2850	1010
					August 07	2900	2400	2800	1400
Retail Prices	Liquid Milk (retail) (ppl equivalent)		Doorstep (ppl equivalent)		Butter Branded (p/250g)		Mild Cheddar Non-branded (p/kg)		
	August 08		100		122		652		
% change vs August 07	+21.7%		+16.3%		+52.5%		+36.7%		

\*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.