Dairy Market Update

Asda slash supermarket prices and increase farmgate prices

Last week supermarket chain Asda announced it was to slash retail prices of liquid milk by around 7ppl. As a result Sainsbury and Tesco have followed suit with a similar 7ppl cut.

However, Asda also announced it would increase the premium it pays its producers by 0.5ppl to 1ppl. Asda's announcement is part of a campaign to highlight its dedication to direct supply groups. The campaign also lists milk prices (using MDC figures) for a selection of contracts and shows the Asda contract paying the highest amount. However, there is no mention of prices for other supermarkets such as Waitrose and M&S which have dedicated supply groups and are currently paying more than Asda.

The three main supermarkets have now reduced their margins on liquid milk by approximately £130 million. However, Asda states funding for lower supermarket prices should come from supermarkets' own margins, not those of producers.

In context

The promotion of dedicated supply groups is of particular interest. With consumers becoming more interested in where their food comes from, it may be of benefit for retailers to have dedicated supply chains. This could also benefit producers, with supermarkets wanting to guarantee supply and hence offer better prices. However, for this to succeed these deals need to be long term and bring price stability.

OFT to investigate grocery market

The OFT has announced plans to ask the Competition Commission to re-investigate the grocery market. The enquiry will concentrate on how increased buying power can affect consumer welfare. Therefore the review, as with previous reviews, will concentrate on the consumer and not the supplier.

The review is to investigate whether supermarket consolidation, and the movement of supermarkets into the convenience store sector, has distorted competition.

The OFT has identified there is increasingly limited choice of outlets in some locations. Also within the convenience store sector there is a decline in independents and choice of store. Areas of particular concern are:

1) The barriers to entry of new stores created by the planning system
2) Increasing buying power of supermarkets
3) Pricing behaviour - below cost selling and price flexing (changing prices on a regular basis)
4) Reduced choice of stores from the entry of supermarkets into the convenience store sector.

In context:

There is concern that in the long term supermarket buying power will affect consumer welfare, despite lowering prices in the short term. This can be through reduction in choice of location to shop and also in range of products. If buying power reduces processors' margins, it can reduce the incentive to invest and develop new products. This could be seen as harming consumers.

EU lifts export ban on UK cattle

Farmers can expect increased returns from the cow and calf market once the export ban is lifted. Last week (8 March) EU veterinary experts voted unanimously to lift the export ban on UK cattle born on or after 1 August 1996, in addition to beef and beef products from cattle slaughtered after 15 June 2005. It is expected that trade will re-commence by the end of April.

The end to the export ban could have a major impact on the UK. In 1995, beef and cattle exports from the UK were estimated at approximately £675 million. A comparison with prices from Ireland show that UK cull cow prices are currently 25-30% lower, with an even greater differential in dairy bull calf prices. As a result this could boost farm income by around 0.5ppl although this is very dependant on what happens to prices and the quality of the animals.

Farmgate price remains firm

The Defra provisional farmgate milk price for January was 18.71ppl. This is 0.18ppl higher than January 2005. Prices continued to remain firm for January although this is likely to change in February following a number of price cuts.

For more information
on any of these items please go to
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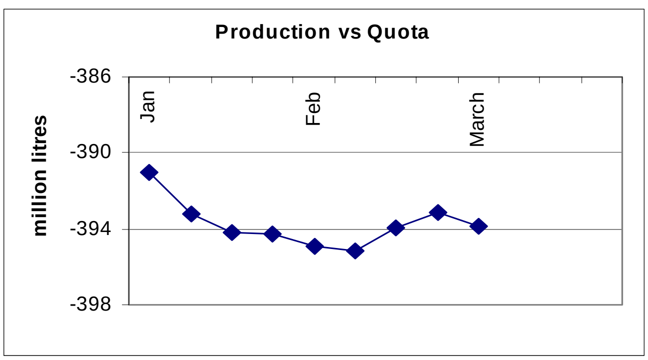
Sources: Agri Fax, Agra CEAS, De Nederlandsche Bank, DIN Consultancy, DEFRA, Eurostat, FT, MDC, RPA, TNS, Kingshay Farming Trust

Relatively stable prices and a decrease in commodity production have meant that average farmgate prices have remained firm. The reduction in commodity processing is due to a decrease in milk production over the past year and increase in cheese production.

Monthly production flattens

February production was 1,045 million litres, the lowest February figure in 10 years. In addition, daily milk production has remained flat at approximately 37 million litres. Normally production increases from January through into February. Production is now 395 million litres under quota.

There are several possible factors contributing to production remaining relatively flat in February. This includes: weather, cows not milking as well, changing calving patterns to benefit level supply contracts, yields not compensating for the decrease in cow numbers and producers unwilling to push for marginal litres, despite relatively good returns. It is hoped the MDC's annual intention survey, which is being carried out this month, will give us a clearer picture.



Milk Link reduce capital levy

Milk Link is to reduce the levy paid by its members from 1ppl to 0.5ppl from 1 April 2006. This will improve farm cash flow but will mean it will take longer to reduce Milk Link's debts.

Milk Link is also to introduce a new system (providing members approve) to reward its members who have invested financially over the years. Member Qualifying Certificates (MQC) will be linked to its existing qualifying loans on a one for one basis (ie, £1 equals £1 worth of MQC). Future profits will be distributed to members on the basis of MQC.

A Milk Link member now has three options when he retires. They can either leave their money in and get an ongoing return from the investment, be paid the full amount invested over a 3, 4 and 5 year period or trade certificates to another co-op member. In the case of someone leaving Milk Link, the member must trade their certificates to another member within one year or get their money paid out fully after 5 years.

Wiseman invest further in the South West

Wiseman has acquired the trading rights and certain assets of the fresh liquid milk business Definitely Devon, which deals with an annual supply of around 20 million litres. This further consolidates Wiseman's position in the South West following the announcement of their proposed 200 million litre plant in Taunton.

This new business will allow Wiseman to move into the regional branded milk market through the Definitely Devon brand and also allow it to process clotted cream (a small but growing market). The opportunity to move into more branded and value added products should be good news for its producers in the longer term. Wiseman currently sells a significant amount of cream as bulk cream onto the commodity market.

Quota Prices (4.00%)	Clean			Leased			Average Farmgate Milk Price: January					
Day End 16/03/06	4.02ppl			0.1ppl			2006	18.71ppl		2005	18.92ppl	
Wholesale Dairy Prices	Butter (unsalted)			Skimmed Milk Powder			Mild Cheddar			Bulk Cream		
16/03/06 £=$1.755 16/03/06 €=£0.693	Feb 06	Jan 06	Feb 05	Feb 06	Jan 06	Feb 05	Feb 06	Jan 06	Feb 05	Feb 06	Jan 06	Feb 05
UK £/tonne	1,740	1,780	1,920	1,390	1,360	1,360	2,100	2,100	2,075	760	790	890
World £/tonne	1,059	1,104	1,088	1,202	1,202	1,202	1,546	1,546	1,603	N/A	N/A	N/A
Retail Prices	Liquid Milk (retail) 4 pint poly bottle (ppl equivalent)			Liquid Milk (doorstep) (ppl equivalent)			Butter Branded (p/250g)			Mild Cheddar Non-branded (p/kg)		
Feb 06	53.1			82.7			81			485		
% Change vs Feb 05	+9.0			+4.7			-2.4			+8.3		

Sources: Agri Fax, Agra CEAS, De Nederlandsche Bank, DIN Consultancy, DEFRA, Eurostat, FT, MDC, RPA, TNS, Kingshay Farming Trust