# mdc Dairy Market Update



**This week's update takes a looks at what might happen across parts of the supply chain in 2006. There is some good news with consumer demand increasing for premium dairy products, the potential for improvements in cull cow and calf returns, and retail price increases in the liquid market. There is some concern over commodity and possibly cheese markets, but as always, milk supply (UK, EU and world) will impact on the overall prospects for 2006.**

## Milk production continues to fall

With production running an estimated 389 million litres below profile (non butterfat adjusted volume, week ending 13 January), it now looks impossible that quota will be met. This would put the UK under quota for five of the last six years. Unlike last year, when production returned to more normal levels in the autumn after a poor spring and summer, this year's output has remained consistently below profile.

The initial explanation for low production has been low milk prices. However, the potential to produce marginal litres is better now than 10 years ago, when the milk price was 24-25ppl – but quota was in excess of 10ppl to lease. Production is being limited by other factors; such as increasing costs, apathy, lack of space to expand without investment and reduced availability of farm labour. In addition, there is an increased awareness that quota does not represent the market demand for milk. Production in the latter part of 2006 will depend on weather (particulary in spring), milk prices, and farmer confidence. This does not suggest a strong increase in production in 2006.

**In context:**
Milk supply will have an impact on prices, with high supply leading to a strong link between commodity prices and all farmgate prices. Low milk supply probably helps to weaken the link between commodity prices and some farmgate prices.

## Returns set to be better for cull cows?

It is possible that returns from cull cows and calves might improve in 2006. Prices for liveweight culled dairy cows on the market are currently around 6.5 pence/kg more than the OTM compensation rate. Many farmers are hoping that as the OTM ends (20 January) prices for culled cows will improve. However, these higher prices are for good quality cows. In future cow beef is likely to displace imports so it will be important that these imports find another market otherwise prices could be under pressure.

The opening of the export market for cows and calves, possibly by the end of March, might help prices. However, industry commentators predict there will only be demand for high quality animals. In addition, SAC says it expects renewed interest in dairy/beef cross calves, as these cattle are able to produce quality beef at a competitive cost.

## Will the commodity markets stay firm?

Many industry commentators expect commodity prices to decrease during 2006 and as a result some farmgate prices may be affected.

| Ppl | IMPE | AMPE | Farmgate Price | Diff AMPE v IMPE |
|---|---|---|---|---|
| 2003/4* | 18.7 | 18.8 | 18.6 | 1% |
| 2004/5* | 17.4 | 18.6 | 18.4 | 7% |
| 2005/6** | 16.1 | 18.2 | 18.5*** | 13% |

Period Jul-Jun **Jul-Dec ***12 month rolling to Nov 2005

A gap between IMPE (intervention prices) and AMPE (actual market prices) has grown over the past two years as intervention prices have been cut. This is because market prices have been maintained by low supply and high demand for commodity products. The concern is that this gap will not continue in 2006, and prices will fall further when the next intervention cut is made in July.

The reason for the concern is that the butter market has weakened due to extra availability over recent months. The EU Commission has recently increased export refunds slightly for butter, possibly due to concerns that intervention might be used heavily if exports do not increase. This means butter prices might fall quickly when intervention prices are cut in July.

**In the long term:** The intervention cut in July is the last of the large intervention price cuts. These new lower intervention prices mean that supply and demand (AMPE) will play a more significant role in the future than IMPE, as has been seen in the past two years.

## Cheese in balance for now

The cheese market has performed better than expected over the past year resulting in farmgate prices of milk for cheese remaining firm. However there is concern that

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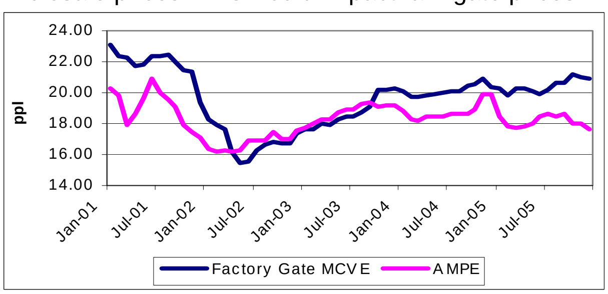
on any of these items please go to
**www.mdcdatum.org.uk**


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

imports and increasing UK production could put pressure on prices during 2006.

Whey powder prices increased by 38% during 2005, and wholesale cheese prices remained stable. This was despite cheese production growing by 10% (12 months rolling figures to November 2005). The market was kept in balance partly because some of the extra Cheddar was manufactured as 'young curd' (i.e. before maturing) and sold into food processing. In addition, there was growth in the consumption of Cheddar and other cheeses.

Although the cheese market is currently in balance, there may be increased pressure at the lower end of the market (i.e. mild cheddar) from imports during 2006. Importers may try to benefit from the current good margins in cheddar (MCVE) compared to commodities (AMPE) by producing more cheddar rather than butter and SMP. If any increase in supply were not matched by increased demand (as it was in 2005) this would lead to lower wholesale prices. This would impact farmgate prices.




## Liquid farmgate prices firm in short term?

Liquid milk farmgate prices are currently similar to last year, but what will happen in 2006? In the coming year farmgate prices will depend on: how intense competition is for retail and middle ground contracts, commodity prices if milk supply is adequate, and marginal price movements if cream prices fall due to intervention cuts.

On the competition point, the industry could benefit from the recent closure of a number of plants (e.g. Arla's Shefield Park site) and further mergers and acquisitions. Over capacity has played a prominent role in the aggressive competition of recent years as processors push for full utilisation of plants to reduce costs. It is possible there will be further closures, acquisitions and mergers during 2006. These may help to reduce pressure on farmgate prices

On a positive note, processors are attempting to recover more out of the market place. Tesco has just increased its retail price by around 2ppl with other retailers expected to follow. There have also been some price increases in the middle-ground. This should help improve processor margins and reduce the pressure to cut farmgate prices.

## Good demand for liquid milk

Good news for the industry as growth in demand for liquid milk is expected to continue in 2006. This is primarily being driven by both organic and branded milk. According to figures from TNS an extra 47 million litres were bought from retailers in 2005. The majority of this increase is due to a 60% growth in demand for organic milk which accounts for 2.7% of the retail market. Sales of branded milk have also increased and more recent launches means this trend looks set to continue in 2006.

## Consumers want premium cheese

Industry commentators are suggesting that growth in the cheese market will continue in 2006, albeit at a lower rate than 2005. There has been significant growth in sales of mature cheddar compared to a decrease in mild cheddar sales. There has also been good demand for some territorial and continental cheeses. Increases in sales of premium products can only be good news for the industry.

| Quota Prices (4.00%) | Clean | | | Leased | | | Average Farmgate Milk Price: November | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Day End 19/1/06 | 4.22ppl | | | 0.19ppl | | | 2005 | 19.69ppl | | 2004 | 19.51ppl | |
| Wholesale Dairy Prices | Butter (unsalted) | | | Skimmed Milk Powder | | | Mild Cheddar | | | Bulk Cream | | |
| 19/1/06 £=1.762$<br>19/1/06 €=0.688£ | Dec 05 | Nov 05 | Dec 04 | Dec 05 | Nov 05 | Dec 04 | Dec 05 | Nov 05 | Dec 04 | Dec 05 | Nov 05 | Dec 04 |
| UK £/tonne | 1,800 | 1,820 | 1,990 | 1,390 | 1,420 | 1,550 | 2,100 | 2,100 | 2,100 | 830 | 840 | 920 |
| World £/tonne | 1,146 | 1,183 | 1,203 | 1,260 | 1,298 | 1,375 | 1,633 | 1,659 | 1,604 | 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) | | |
| Dec 05 | 52.2 | | | 82.2 | | | 82 | | | 485 | | |
| % Change vs Dec 04 | +7.4 | | | +3.9 | | | N/C | | | +8.3 | | |


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