

## Retail price increases by 2.2 pence per litre

All the major supermarkets have increased the price of milk in their stores by the equivalent of 2.2 pence per litre. The price of a four pint-poly bottle has increased by five pence, to £1.16 in the majority of stores. This follows concerted pressure by liquid milk processors on retailers for wholesale price increases. Liquid processors have experienced oil-related inflationary costs (affecting energy and packaging costs) in recent months.

Retail liquid milk prices have now increased by 10% since last January. It is not currently known how much costs have gone up by at retail and processing level.

## SPS payments confirmed

Defra has confirmed that farmers in England will start receiving full Single Payment Scheme payments at the end of February. Farmers in Scotland, Wales and Northern Ireland began receiving interim payments in December. Full payments could not be made until entitlements were definitively established within the whole of the UK. The RPA is aiming to complete establishing entitlements by the 14 February. Farmers will be informed of their individual entitlements by the end of February.

## Arla cuts milk price

Arla has cut its milk price for its farmers by 0.9ppl for February and March; although 0.6ppl will be restored in April. It has also confirmed that its farmgate price in future will be a formula based on returns from individual markets.

The cut of 0.3ppl will take effect from February onwards to compensate for current and expected future low commodity returns. The extra 0.6ppl will only cover February and March to compensate for falling commodity prices (primarily cream) over the past four months. Arla has stated categorically the 0.6ppl will be restored in April.

Cream prices have fallen £50/t since October (equivalent to around 0.3ppl for a liquid milk processor). In addition, any milk a liquid processor is putting into commodities (e.g. weekly balancing milk) will also be returning less than in recent months (see AMPE story). However, whether these falling returns add up to 0.6ppl for two months is only known by Arla, because it will depend on exactly how much milk it is putting into commodities.

However, it is worth noting that other liquid milk processors have been subject to the same pressures in the cream and commodity market. Dairy Crest and Wiseman have yet to cut and are holding in February. They may of course do so shortly.

However, the good news is Arla has put forward a more market-related milk pricing system. As a result, milk prices will be determined by returns from four categories:

- 1) Branded added value milks;
- 2) Fresh milk and cream sales;
- 3) Butter, export and SMP, and;
- 4) The impact of balancing seasonal variations.

The expectation is that the new system will be implemented from April.

### In context:

Despite the price cut, there are potential future gains for farmers if the new pricing system works. The benefit for farmers is that it should allow prices to be dictated by what the market they are supplying is paying; and not a competitor. This may have the effect of reducing some of the tit-for-tat price cuts by processors in recent years, although the market is likely to remain very competitive. A lot will depend on how the new system actually operates, but hopefully pricing will be more transparent.

## Wiseman and DFB hold their price

Wiseman and Dairy Farmers of Britain (DFB) have announced they are to hold their milk price for February; DFB also announced it is holding its price for March. Wiseman has warned that bulk cream prices are under pressure and it does not expect prices to improve. Wiseman has said that it benefited from some of the recent 2.2ppl retail price rise being passed back to cover rising costs.

DFB has also come under pressure from increased cost pressures and competitive trading; especially in liquid milk. However, it has been successful in gaining price increases from some customers and gaining some cost savings. This has allowed it to return a stable milk price until the end of March. DFB's London liquid premium price will temporarily be slightly higher than Arla's milk price for February and March.

## Variable farm costs set to remain firm

Farm variable costs have been under pressure from

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significant increases in oil (37%), gas and fertiliser prices over the past year. Going forward, prices are set to remain firm due to good world demand and shortage of supply for oil/gas. As a result, AN prices have risen by 13% over the past year and are currently trading at over £170/tonne.

**In context:**

At farmer level, cost increases are not being passed through to consumers. Raw milk prices continue to be driven by dairy commodity prices regardless of cost changes. In the future, it is possible that as CAP Reform takes effect across the EU, milk supply will react more than in the past to changes in prices. If it does it is possible that farm cost increases will be passed through.

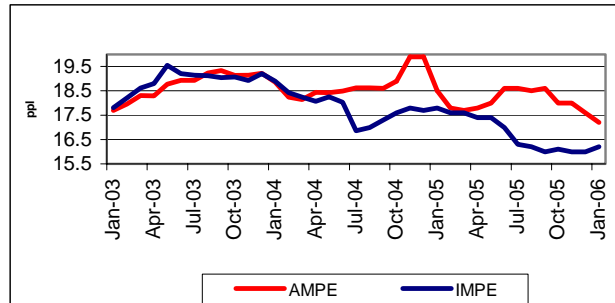
**Organic milk market growth increases**

Recent consumer and farm data shows that demand for organic milk continues to grow, with suggestions that demand could outstrip supply. As a result there has been an increase of almost 3ppl paid to farmers over the last twelve months. A recent OMSCo report estimates that the demand for raw organic milk will continue to increase by 25% per year for the foreseeable future. Of interest is the growth between different markets. Although organic accounts for 3.1% of total liquid milk sales (all retail outlets and doorstep), recent figures show that organic has exceeded 5% of total supermarket liquid sales.

To combat the effects of increased demand, several short-term measures might have to be taken. These include: expansion by existing farms; encouraging the return of 'in-conversion' producers, flattening production profiles and, partial imports of organic milk in powder form. However the report is keen to point out that meeting future demand should be done in a controlled manner. It estimates that the market can only absorb approximately 60 million litres over the next two years and anymore than this could lead to past trends of over-supply and hence falling returns.

**AMPE starts to decrease**

The market price for butter (and cream) and SMP (AMPE) has decreased by 0.4ppl over the past month. AMPE is now only 1ppl higher than intervention prices for butter and SMP at 17.2ppl. Some analysts are concerned that butter prices could continue to decrease. The EU commission recently increased export refunds for butter slightly - the first increase since Jan 2004.



**In context:**

A decrease in commodity prices will be of most concern to producers supplying the commodity market as it is likely to reduce their price. However, it will also be important for most other producers as at present the commodity market plays a pivotal role in balancing milk supply.

**Allocation of extra quota decided**

DEFRA has announced how it intends to allocate the 1.5% additional milk quota awarded to the UK as part of the CAP reform package. Additional quota will be allocated on the basis of 0.5% of the net quota (owned + leased in quota - leased out quota) held by an individual on the 31 March preceding the 2006/07, 2007/08 and 2008/09 milk years. For example, for the 2006/07 milk year, a farmer's additional quota will be calculated based on his or her net quota holding on the 31st March 2006.

Quota Prices (4.00%)	Clean			Leased			Average Farmgate Milk Price: November						
Day End 02/02/06	4.27ppl			0.21ppl			2005	19.69ppl			2004	19.51ppl	
Wholesale Dairy Prices	Butter (unsalted)			Skimmed Milk Powder			Mild Cheddar			Bulk Cream			
02/02/06 £=1.779\$	Jan 06	Dec 05	Jan 05	Jan 06	Dec 05	Jan 05	Jan 06	Dec 05	Jan 05	Jan 06	Dec 05	Jan 05	
02/02/06 €=0.678€													
UK £/tonne	1,780	1,800	1,990	1,360	1,390	1,400	2,100	2,100	2,100	7,90	830	900	
World £/tonne	1,104	1,146	1,065	1,189	1,260	1,198	1,528	1,633	1,491	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)			
Jan 06	52.3			82.7			82			485			
% Change vs Jan 05	+7.4			+3.9			1.2			+8.3			

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