



Dairy Market Update

22 July 2010

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Discounters gain market share

Retail sales of pasteurised milk have increased by approximately 0.8% year-on-year since June 06 to stand at 4.2 billion litres in June 10, according to the latest data from Kantar Worldpanel. The main discounters have experienced a significant growth, with the four largest discounters, Aldi, Iceland, Lidl and Netto more than doubling their sales within four years and achieving a 10.7% share in June 10, up from 4.9% in June 06.

The market share of the multiple retailers paying premiums on their milk (Asda, M&S, Morrisons, Sainsbury's, Tesco and Waitrose) has fallen since 2008, losing share in the past two years partly to other multiple retailers, and partly to the discounters, likely on the back of lower prices. Their share of the market is now back to 2006 levels. For example, in the 52-week period ending 13 June 2010, the average price for one litre of milk in the discounters was 17ppl (25.3%) lower than in the multiple retailers.

Annual sales volumes (million litres) & Share of total market					
	Jun-06	Jun-07	Jun-08	Jun-09	Jun-10
Total Market	4,086.70	4,087.40	4,130.70	4,201.70	4,211.60
Multiples paying premium	2,489.4 (60.9%)	2,568.6 (62.8%)	2,616.3 (63.3%)	2,632.7 (62.7%)	2,545.1 (60.4%)
Discounters	200.1 (4.9%)	238.2 (5.8%)	300.9 (7.3%)	314.9 (7.5%)	452.4 (10.7%)

In context:

Some of Britain's largest multiple retailers introduced bonus payments to producers to secure their milk supplies. This has enabled some farmers to benefit from a more stable and higher price. While total retail sales volumes have continued to grow, the distribution of sales has changed, and less milk was sold through this group of retailers in the past year relative to other outlets. If the retailers who are paying premiums continue to see a decline in their share of the market, it may mean that the proportion of milk sold under dedicated contracts will decrease.

Global milk production

The largest milk producing regions across the world have experienced a slow start to the 2010 year. In the first five months of 2010, milk output in the EU stood at 57.1million tonnes, 0.7% lower than in 2009. In the US, milk production for the January – June period shows a small rise (0.8%) compared to 2009. In Oceania, production in New Zealand finished the 2009/10 season only slightly ahead of the previous season. Finally, between January and April, Australia saw its production 3.3% down on 2009.

Figures show, however, that some countries have started to respond to the improved market conditions. June's production in the US was up by 2.4% compared to June 2009 and the USDA is forecasting annual US production will be 1% higher in 2010 than in 2009. Although May's production in the EU was only up by 0.8% on last year, recent reports suggest that milk output in some of the largest EU countries was ahead of last year.

In context:

With the northern hemisphere now in seasonal decline, the southern hemisphere will play a key role in establishing the supply and demand situation during the autumn. As Australia experienced a poor 2008/09 year, its production is expected to be higher. In New Zealand, the Ministry of Agriculture recently forecast that milk production will increase by 14% in the 12-month season starting in May 2010. Although some commentators are sceptical over this figure, this could have the potential to dampen any futures rises in commodity prices on the world market.

Feed prices volatile

Latest figures for July show that prices for straights were generally below the same period last year. For example, Soyameal hipro averaged £262/tonne, £47/tonne (15.2%) less than in 2009. Feed Wheat prices are also down compared to the previous year, although only by £2/tonne at £109/tonne.

Market commentators are sending mixed signals on what the market will do in the coming months. Some have suggested that a combination of poor growing conditions and lower than expected plantings could lead to reduced crop yields, limited supply and hence increased prices – particularly in Europe. In contrast, US forecasts suggest a bumper crop for maize and there is a belief that wheat stocks are healthy which could bring prices back.

In context:

Although milk production for 2010/11 is currently running higher than last year, grass growing conditions have been challenging and there are some concerns over the amount of silage that can be produced for winter feeding. GB dairy farmers may need to look to other sources to meet their requirements. With the harvest coming soon, and its outcome still dependent on the weather, any prediction on future feed prices is difficult. A clearer picture will emerge once the harvest is under way.

Butter prices stable for now

Having risen by 42% between February and May from £2,400/tonne to the record level of £3,400/tonne, UK wholesale butter prices have stabilised, with June prices 1% lower than in May at £3,350/tonne. This follows the same trend as the EU, where the rate of increase slowed in June, due in part to the sale of the 23,700 tonnes of butter sold out of intervention.

However, some factors suggest that the market could be very tight during the autumn trough. EU butter production is estimated to be down 9% year on year in the first four months of 2010 while exports were up 9%. The amount of

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butter in Private Storage Aid (PSA) for release during the winter reflects this tight situation, with currently only 72,662 tonnes in PSA, well below the 108,855 tonnes there at the same time last year. Although most of the 65,000 tonnes that have been allocated to charities has yet to come out from intervention, many operators are concerned about availability later in the year.

In context:

The butterfat market is set to remain firm for the rest of the year which would help to support the farmgate price. It is possible that prices could rise further later in the year. However, if the shortage is too acute, there is a risk that prices rising too high could impact long term demand for butter with consumers switching to other products such as margarine and some manufacturers switching to non-dairy fat products.

Trade discussions could impact dairy farmers

Trade talks between the Mercosur group of South American countries and the EU resumed in June, having been stalled since 2004. The talks aim to establish a bi-regional free trade agreement which would remove tariffs on Mercosur imports into the EU, and EU exports to Mercosur.

The EU is Mercosur's main market for its agricultural exports, particularly for cereals, livestock, pigs and poultry. This accounted for close to 20% of total EU agricultural imports in 2009. EU exports to Mercosur focus largely on industrial products. There is significant opposition to an agreement, with farming unions warning an influx of cheap food would undercut local producers and cause serious damage to the livestock, pig and poultry sectors.

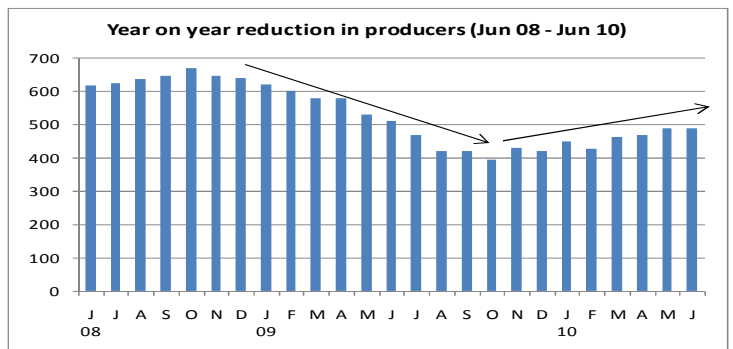
The impact on the dairy sector is less clear. Whilst Mercosur does not export to the EU, there is significant dairy production in both Brazil (27 million tonnes) and Argentina (9.5 million tonnes). Argentina currently exports milk powder and cheese to other South American countries and to North Africa. IFCN data shows that the Argentinean industry has large dairy farms (averaging 156 cows) with costs of production around 40% lower than in the UK on average.

In context:

Any deal with Mercosur appears unlikely in the short term. The last set of talks lasted nine years before being suspended without agreement. If a free trade agreement is reached it is likely that quotas will be put in place to limit imports into the EU. Whilst we do not currently import dairy products from Mercosur a free trade agreement may change this. Argentina appears to be the most likely country to benefit, as it already exports some dairy products and has low costs of production.

Producer numbers

Latest producer numbers show that in June 2010 there were 11,256 milk producers in England and Wales. This is a fall of 487 farms (4.1%) compared to June 2009. The graph below shows that the rate at which farmers are leaving has increased over the past nine months.



The number of farmers leaving the industry was on a reducing trend, falling until October 09, when the year-on-year reduction stood at 394 farms. Since then, the number of farmers leaving year on year has started to increase again. If the current trend continues, the number of dairy producers in England and Wales will fall below 11,000 by the end of 2010. In Scotland, monthly figures are not collected. In 2009, there were 1,298 Scottish dairy producers, 3.9% fewer than in 2008.

Quota Prices (4.00%)	Clean	Lease	Exchange Rate €/£		UK Average Farmgate Milk Price: May			
16/07/10	0.30	0.10	0.8407		2010	23.62	2009	22.50
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)
June 10	17.9	30.7	30.24	8.63	3,350	2,000	2,800	1,550
May 10	18.5	30.5	30.40	8.11	3,400	1,950	2,800	1,450
June 09	18.3	19.1	24.87	5.34	2,025	1,450	2,500	930
Retail Prices	Liquid Milk (retail) (ppl equivalent)		Doorstep (ppl equivalent)		Butter Branded (p/250g)		Mild Cheddar Non-branded (p/kg)	
June 10	0.66		1.01		125		621	
% change v June 09	-2.7%		+0.3%		+11.6%		-2.2%	

*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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