

5. DAIRY

Market developments in the EU

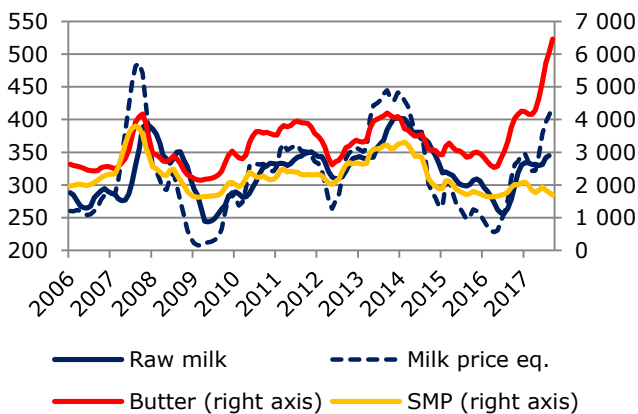
	2017	2018
Milk collection	▲	▲
Dairy herd	▼	▼

▲ up ▼ down ► equal (compared to previous year)

Butter prices to the roof and SMP on the floor

The dairy market situation is unprecedented, with butter prices at a record high, around EUR 6 500/t, and skimmed milk powder (SMP) at intervention price level (EUR 1 690/t) mid-September. Despite the low SMP price, the milk equivalent price (based on SMP and butter) is above EUR 40/100kg. The raw milk price paid to farmers is now above EUR 34/100kg (34 % more than the lowest point in June 2016).

Graph 19 EU dairy prices (EUR/t)



Note: The milk price equivalent is based on butter and SMP prices
Source: DG Agriculture and Rural Development

The milk price is supported by the strong butter prices and by rising global demand for cheese, dairy fats and powders (see box). This price, together with the good forage quality and quantity available (especially silage maize), and the low feed prices result in improved margins that may stimulate milk production in the EU.

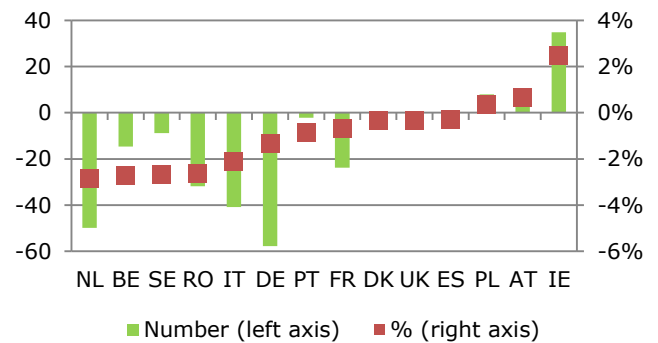
Therefore, more milk is to be expected on the global market in the coming months: the rebound of EU production, the steady rise in US supply and the start of the milk season in New Zealand all indicate more production. However, butter prices are expected to remain high (though below current levels), and generally the strong global demand for dairy products is expected to continue. Therefore, several factors will keep supporting milk prices, despite low SMP prices.

Fewer dairy cows but more milk

The Eurostat May-June livestock survey indicates a decrease of close to 1 % in dairy cow numbers compared to the same period last year. This significant drop confirms a changing trend, i.e. a return to a long-term decline. This comes after the steady increase in cow numbers since 2013 triggered by high milk prices in a context of the end of milk quotas in 2015.

The drop is particularly sharp in the Netherlands with 50 000 dairy cows less. This is linked to the obligation to reduce phosphates emissions. The decline is also strong in Germany (-1.4 %) partly because of the low milk price paid to farmers in 2016, in Italy, Belgium and Romania where productivity is increasing fast. By contrast, the dairy cow herd continues to increase in Ireland (+2.5 %) and remains stable in Poland.

Graph 20 Change in the number of dairy cows in the EU



Source: DG Agriculture and Rural Development, based on Eurostat

EU cow slaughtering, after a sharp increase in 2016 (+8 % compared to 2015), slowed down significantly in the first half of 2017 (-2 %), except in the Netherlands, Belgium and Ireland. This indicates that most of the herd reduction due to lower 2015-2016 milk prices may have taken place already.

Despite lower cow numbers, milk collection is expected to rebound by 0.7 % in 2017 compared to 2016. This is thanks to significant gains in productivity due to: a high replacement rate in 2016 with more productive heifers, good forage availability and the use of more purchased feed, made possible thanks to better milk prices and low feed prices. Therefore, milk yields are forecast to increase by around 2 %.

Milk collection is growing strongly in Ireland, Poland and Italy. By contrast, it is expected to decline in Germany and France, where the drop in milk collection in the first half of the year was too great to be fully compensated in the second half. In the Netherlands, the drop in production is expected to accelerate to reach 1.5 % for the whole year. This decline is less than anticipated.

In 2018, with higher milk prices, EU milk collection could grow further by more than 1 %, mainly due to a

recovery in Germany and France and additional yield gains.

DAIRY PRODUCTS

Market developments in the EU

	2017	2018
Production	▲	▲
Exports	▲	▲
Imports	▼	▲
Consumption	▲	▲

▲ up ▼ down ► equal (compared to previous year)

In 2017, the close to 1 million t of additional milk collected in the EU is mainly processed into cheese, because despite record high butter prices, best returns are obtained when processing milk into value added products like cheese. In addition, strong exports (up by close to 2 million t of milk equivalent) and continuous higher consumption of dairy products (+0.6 million t) are drying out EU private stocks.

EU cheese production supported by strong demand

EU cheese production is driven by increasing export demand and industrial use in the EU, and is forecasted to grow by 2 % in 2017. A similar increase is expected in 2018.

Cheddar prices remained stable at around EUR 3 500/t, a price level 11 % above last year, due to growing demand especially in Japan and South Korea. EU exports are expected to be 6 % higher than last year, at close to 850 000 t. In addition, *per capita* consumption may grow further but at a more moderate rate (+0.7 %) than in previous years. Most of this increase is expected in the eastern Member States while stabilisation is forecast in the EU-15.

Butter production down but cream up

In 2017, EU butter production is expected to be nearly 3 % down from 2016. Germany and France produce 40 % of EU butter, and from January until July their butter production was down 7 %. Thus at EU level, production was 5 % lower than in 2016 over the same period. With the expected rebound in milk collection, including in France and Germany, butter production may recover in the second half of the year. However, it may not be enough to offset the drop in the first half of the year. Nevertheless, butter supply will be just below the 2015 production level.

In addition, significant dairy fat was processed into cream, leading to a 3 % rise in production. Moreover, between January and July 2017, milk fat content was 1.7 % lower than in 2016 (this is linked to the higher share of young females in the herd and to the lower use of energy-rich feed).

The lower butter production in the EU combined with less production in New Zealand and strong global demand led to very high butter prices. As a consequence, EU butter exports are expected to be more than 10 % less than last year, and stocks should be very low at the end of the year. Despite high prices in the EU, New Zealand did not use its TRQs in 2017, and EU imports should also remain low in 2018 given that New Zealand will favour closer Asian markets.

Butter demand is expected to remain stable, notably because the processing industry cannot easily adapt recipes and switch to vegetable fat, and especially because consumers prefer butter. In addition, butter prices are anticipated to go down towards the end of the year thanks to increased supply during the peak of milk production in Oceania. Moreover, current record prices are related to limited quantities bought by buyers who did not anticipate their purchases. But many buyers have forward contracts with conditions that were negotiated when prices were not that high.

With more milk being produced and with a higher fat content, EU butter production could rebound in 2018 by 3 %.

SMP exports on strong upsurge

Until July, EU SMP exports were 39 % higher than in 2016 when levels were rather low. This rise in exports has been driven by strong demand from Algeria, China, the Philippines, Indonesia, Vietnam, Malaysia and Mexico. Exports may slow down in the remaining months of the year with the stronger euro and because many buyers may have already covered their needs. Nevertheless, exports could reach close to 780 000 t in 2017 (+35 % compared to 2016).

Exports grew while production declined (-9 % to July), implying that private stocks could be very low at the end of the year at 70 000 t. Despite the production decline forecast for the year (-5 %) and the strong demand, prices declined again to intervention level end of August, and additional buying-in took place. The working hypothesis used for this outlook exercise considers no change in public SMP ending stocks in 2017 at 351 000 t (meaning that the quantities