

Living with Volatility in the Dairy Sector.

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A Few Questions.....

- Do you know what price you will get for your butter/SMP/WMP.....
 - Next Month?

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 - **Next February?**

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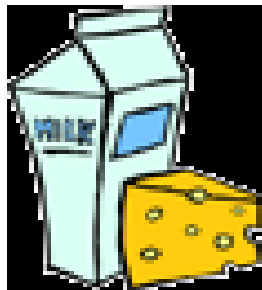
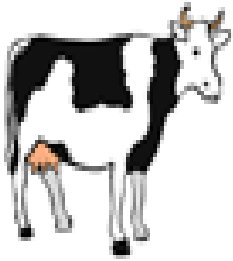
- Do you know what price you will get for your butter/SMP/WMP.....
 - Next Month?
 - Next February?
 - **Next April?**

A Few Questions.....

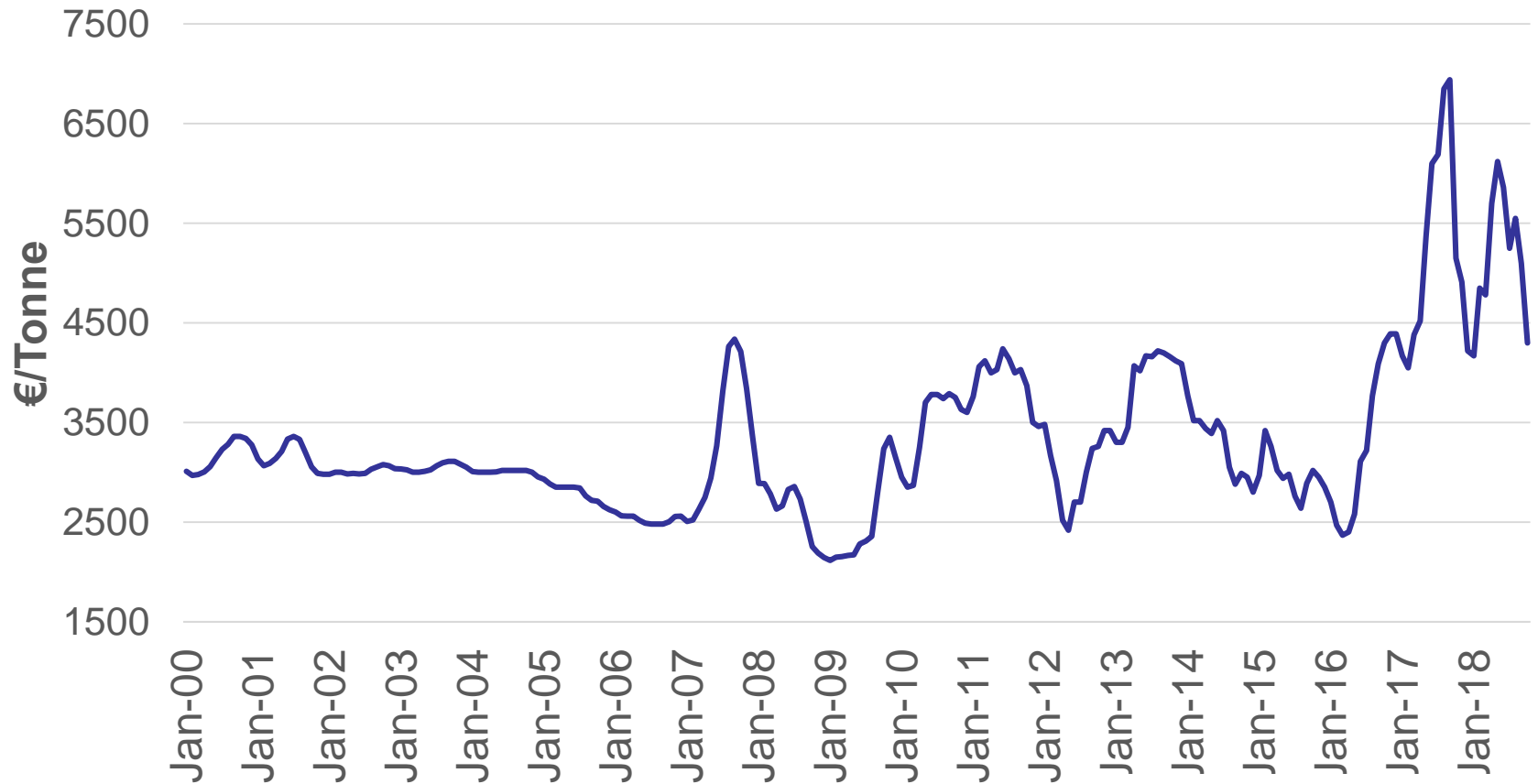
- Do you know what price you will get for your butter/SMP/WMP.....
 - Next Month?
 - Next November?
 - Next April?
- **Do you know what your cost of raw milk will be for these months?**

So this is a supply chain problem.

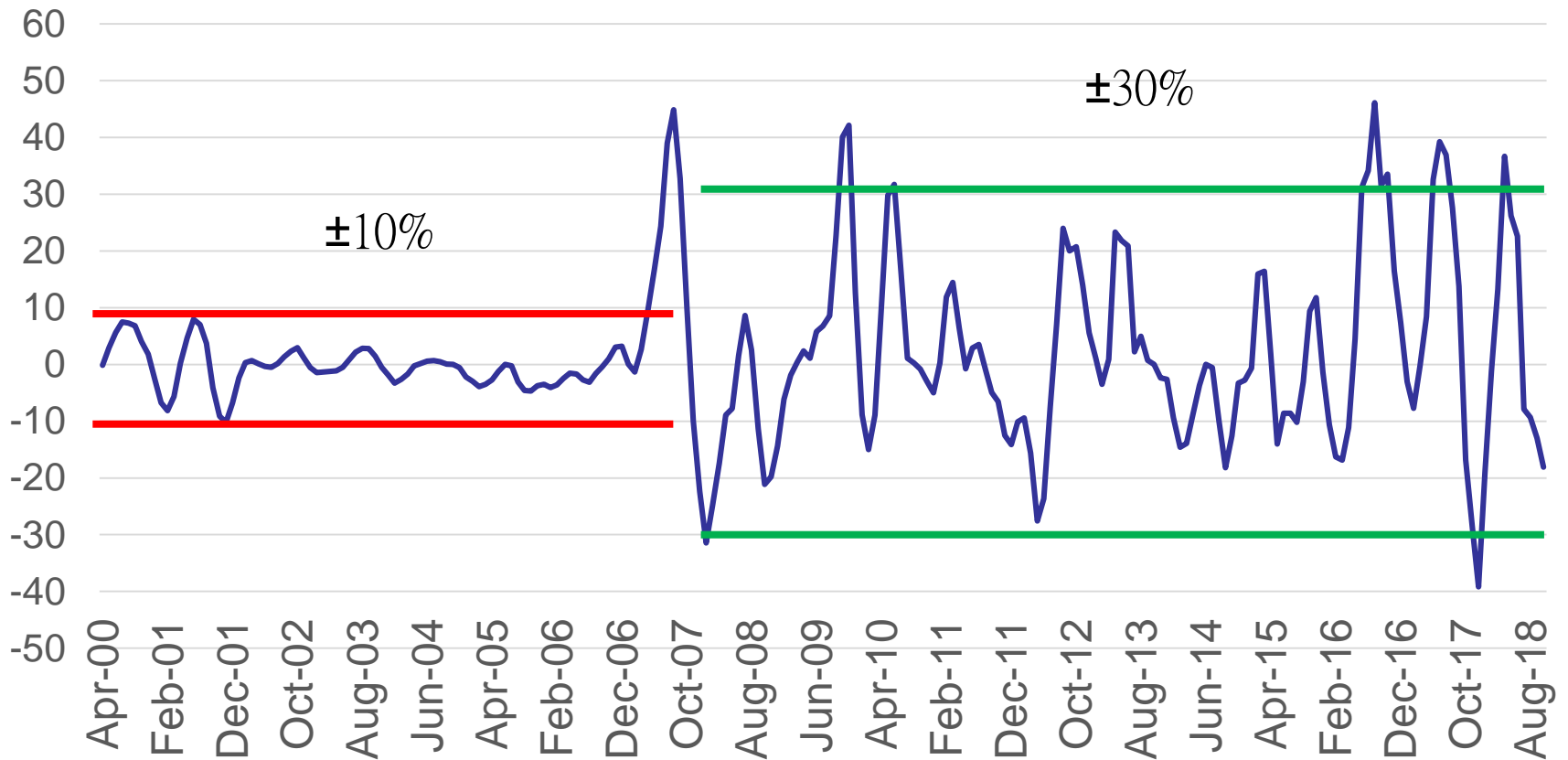
- **A long supply chain**
 - Who takes the risk?
 - Share or transfer it to third party?



EU Butter Wholesale Price (€/Tonne)



EU Butter Three Month % Change

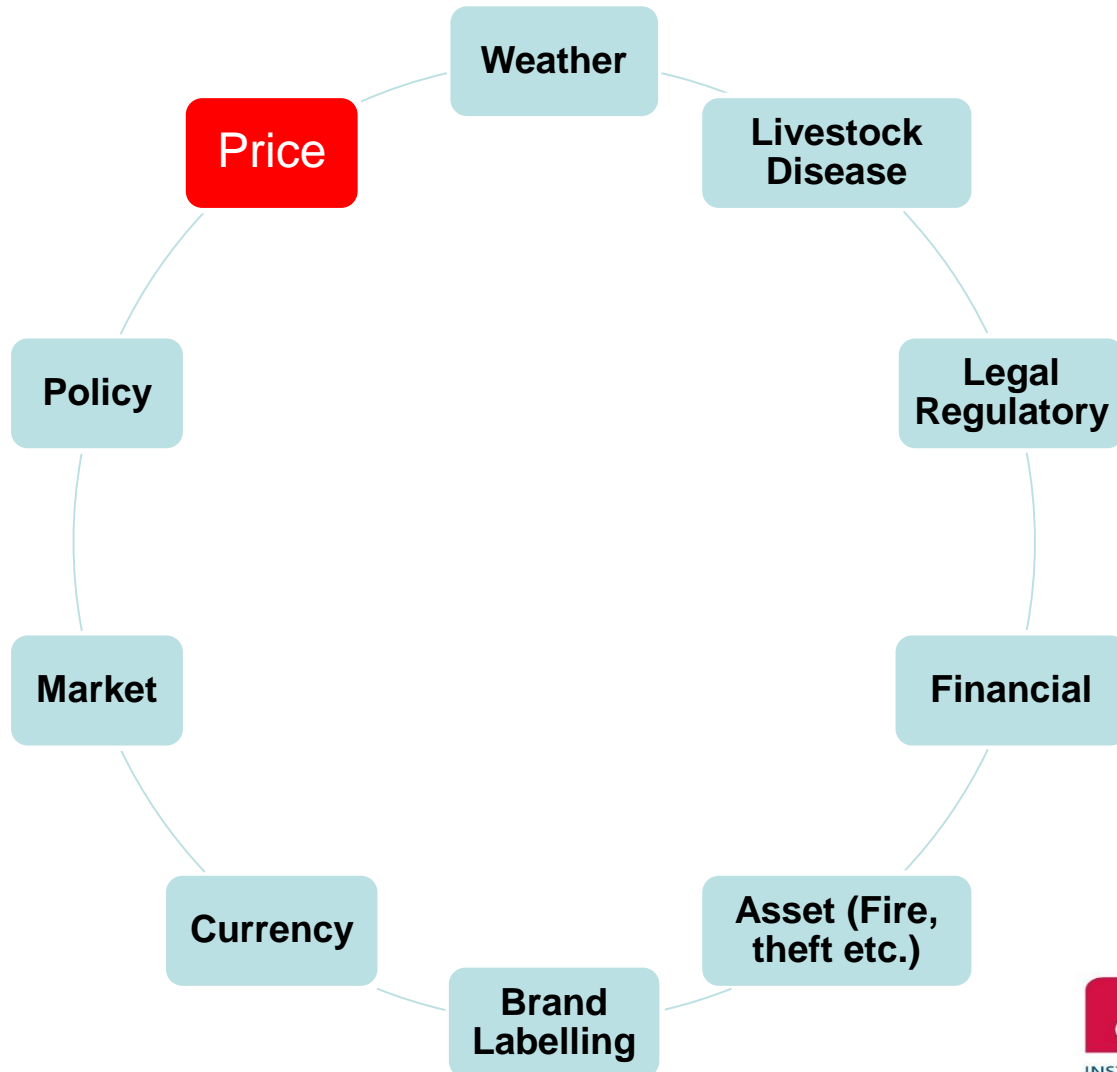


Definition of Price Volatility

- **Substantial** variations in the prices of products (agricultural) over a given period of time.
- “**Normal**” price volatility is desirable. It reflects changes in supply, demand and policy and provides price signals to facilitate efficient reallocation of resources.
- Volatility becomes problematic when price movements are large and **unpredictable**.

Note that sustained high or low prices (inadequate) do not constitute volatility.

Types of Risk in Dairy Sector



Risk in Dairy Sector Tend to Interact

- These can interact to increase or decrease risk
 - E.g. higher prices and poor weather might cancel each other.
 - Sometimes we get poor weather, poor prices and high interest rates.
 - Good weather, good prices and low interest rates.

Extreme Volatility – Adverse Consequences

- Cashflow
- Planning
- Contracting
- Investment
- R&D
- Substitution

Buyers (ingredient and retail) prefer to do business with suppliers providing stability, price and volume (retail prices are sticky)

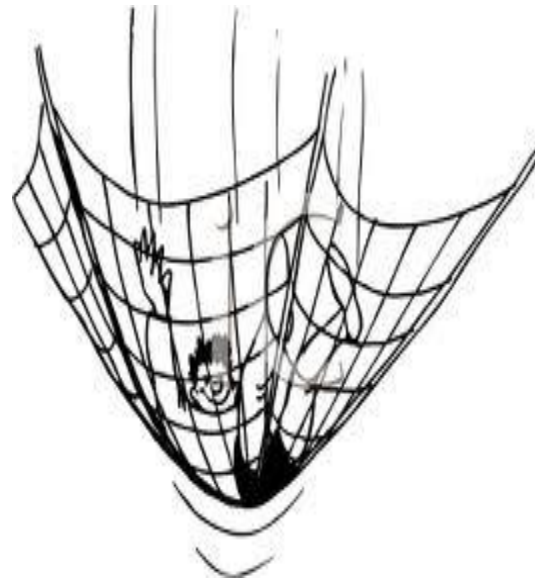
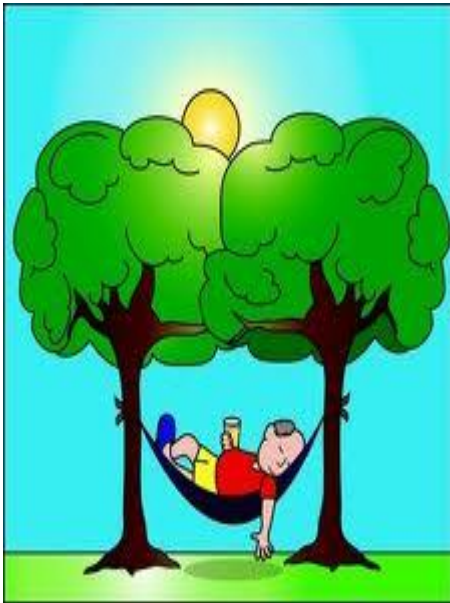
The role of EU Policy/CAP

- The “Old” CAP
 - Intervention Buying
 - Export Refunds
 - Import Levies
 - Subsidised Consumption
 - Aids to Private Storage
 - Quotas
- The “New” CAP (Post Luxembourg)
 - Direct Payments
 - Pillar II
 - Market support reduction,
 - » e.g. lower intervention, price and volume, tendering
- The “Future” CAP
 - Crisis Management
 - Risk Management

EU Policy Direction

- Private Storage Aid – PSA
- Direct Payments
 - Reducing for many.
 - Not Index Linked.
 - Brexit.
- Intervention Purchasing
 - Commissioner now favours tendering.
- Supply Management (Milk Reduction Scheme).
- Agri Cashflow Support Loan Scheme

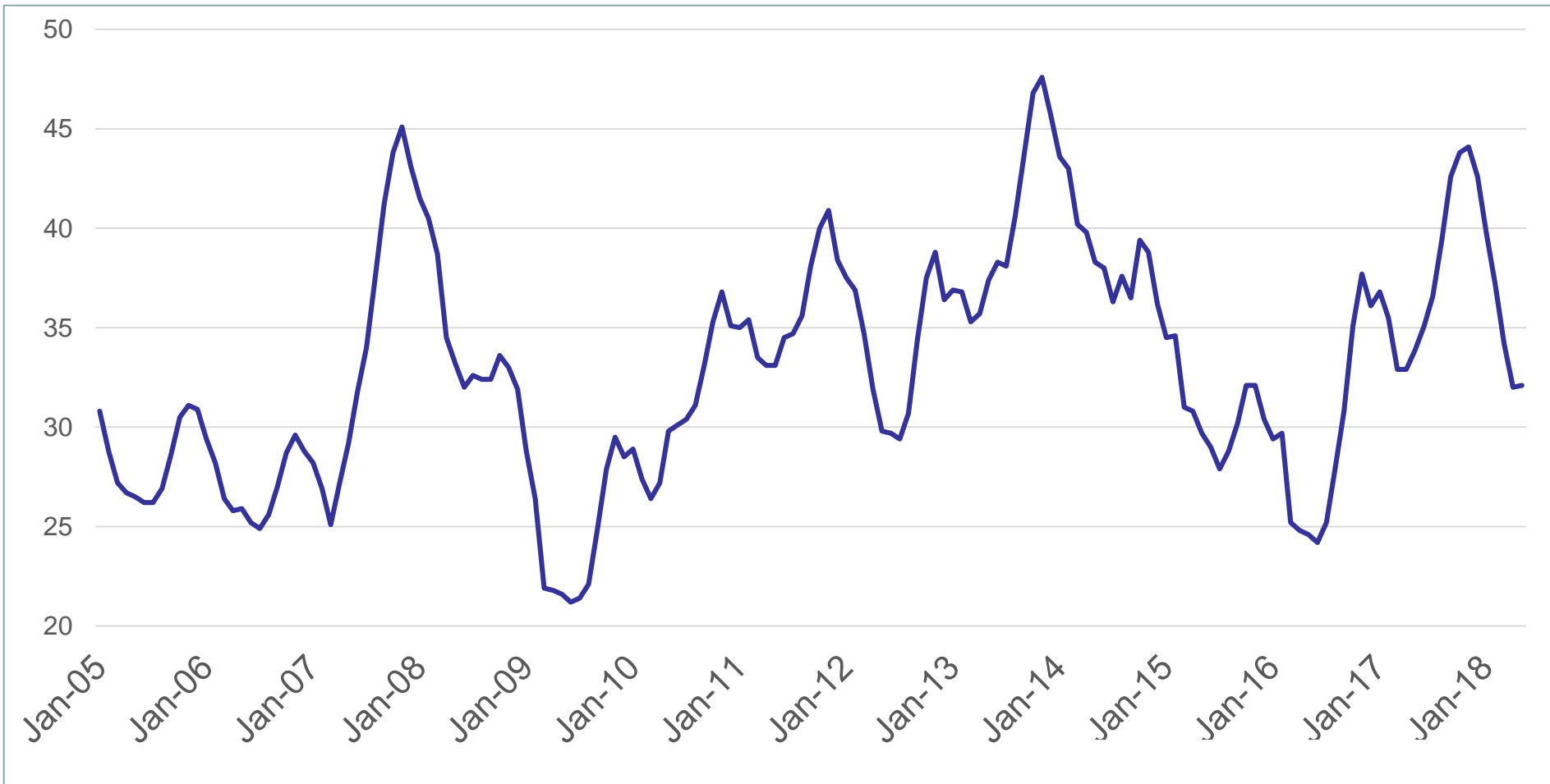
Hammock to Safety Net to.....



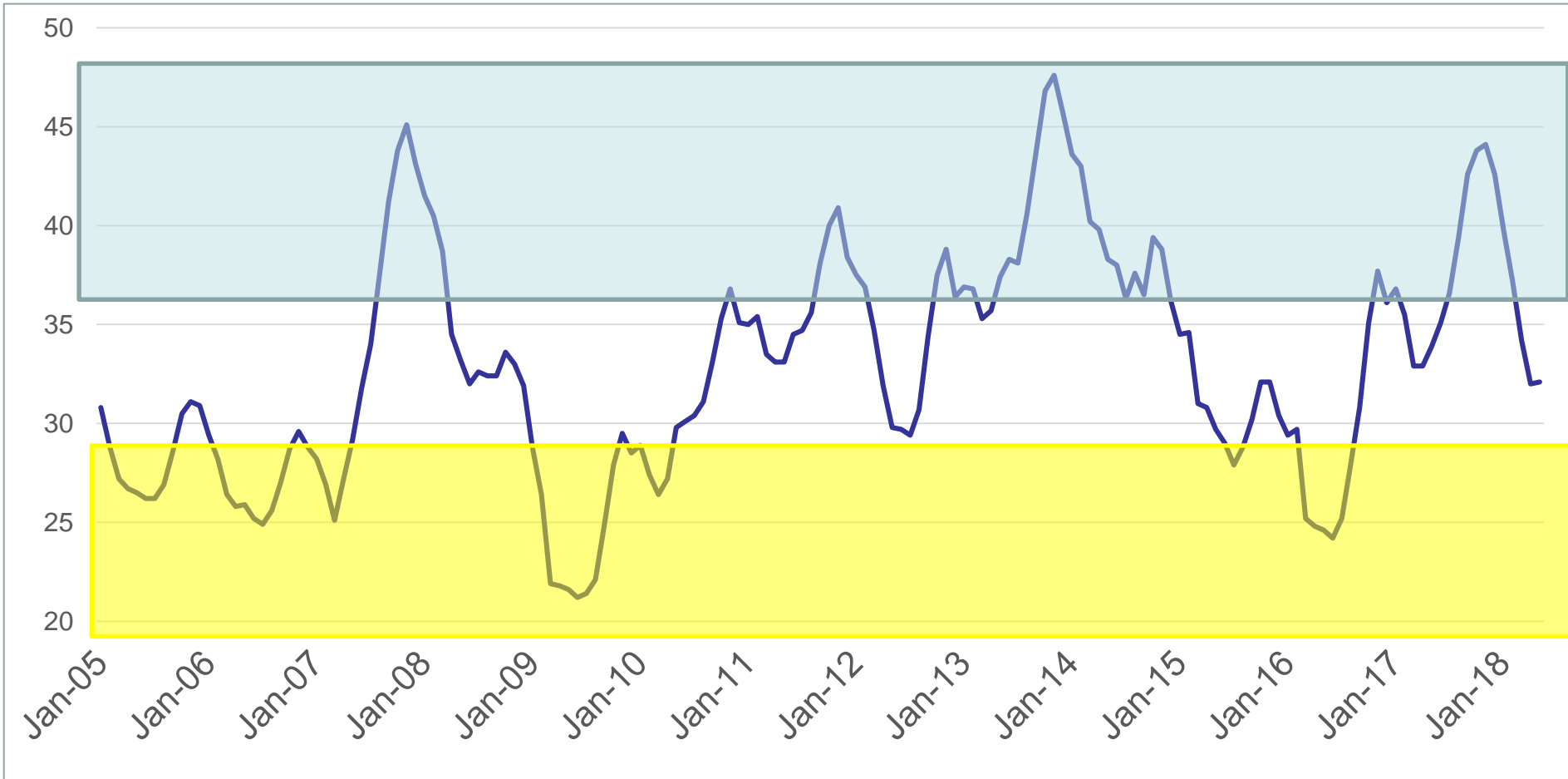
Private Risk Management Tools

- Forward Contracting.
- Futures Markets.
- Options (Put and Call).
- Over the Counter (OTC) Contracts.
- Insurance Products.

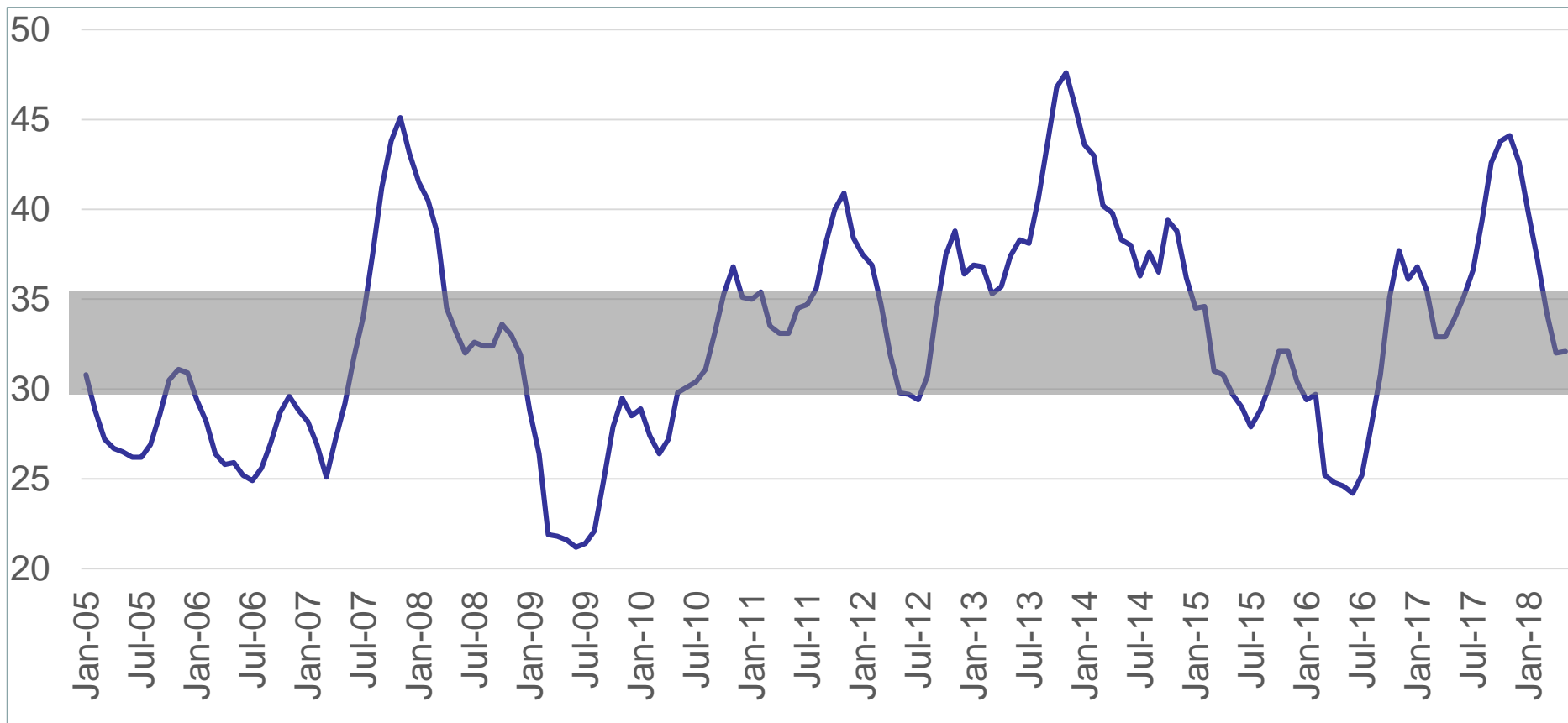
What do you see?



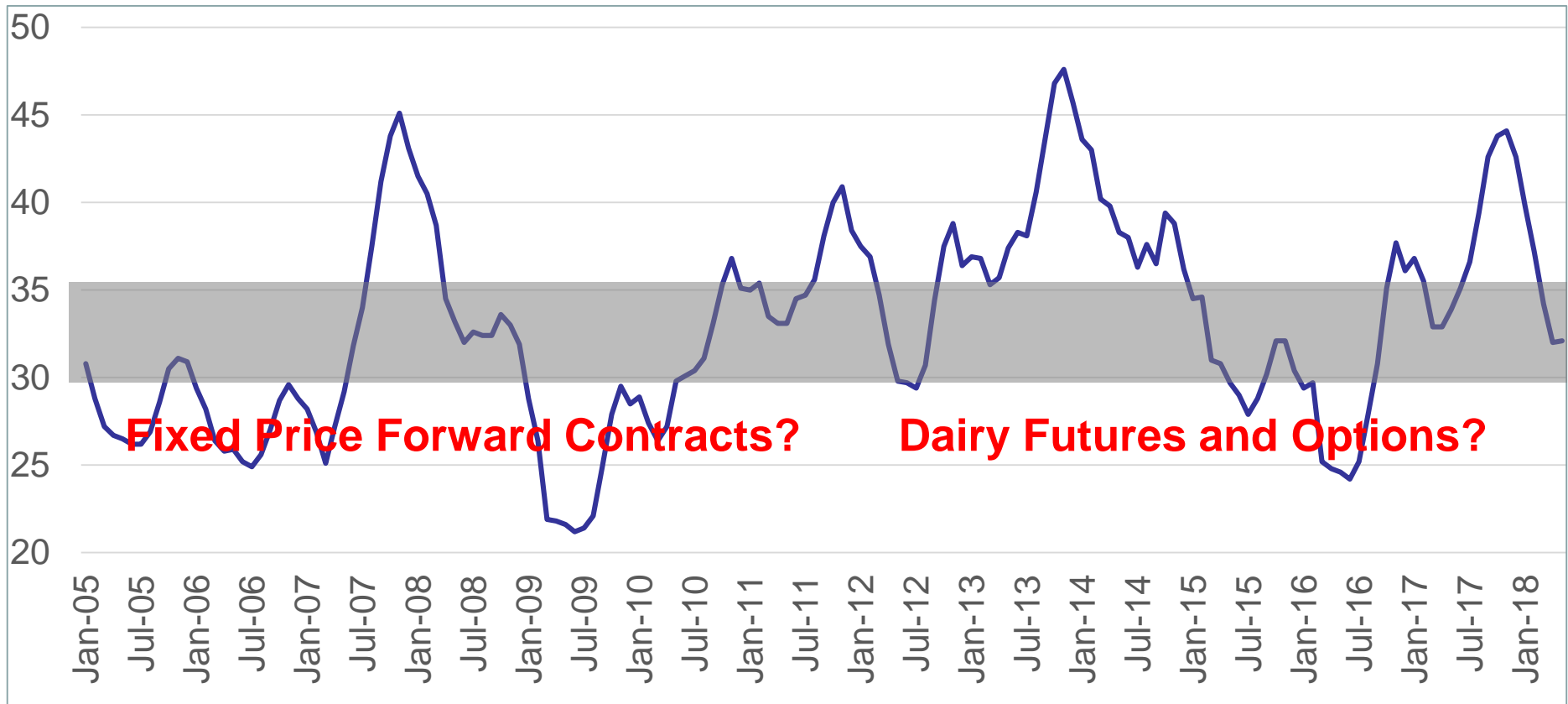
What do you see?



Is There a Range Where All Can Be Happier?



How?



Fixed Price Contracts

- Purpose?
 - Secure price
 - Secure outlet
 - Not to maximise price.
- These are legally binding.
- Never hedge 100%.
- **Are your inputs/outputs fixed?**

Why Fixed Price Contracts

- Provide certainty.
- Flexible (Quantities and delivery date).
- Allow risk sharing along the supply chain.
- Voluntary.
- A cent a litre when prices are low may be worth more than a cent when prices are high.
- Banks like them.

Fixed Price Milk Schemes (Concerns)

- How do we set the contract price?
- May be big winner and big loser (zero sum).
- They need to be backed out.
- Need transparency.
- Cannot reverse out of these contracts.
- Create a second pricing scheme (Fonterra).

Private Risk Management Tools.

Many of these tools are based on risk sharing or risk transfer so they will require

- Data (quality, timeliness)
- Support
- **Education**

PRICE VOLATILITY AND RISK MANAGEMENT FOR THE FOOD AND DRINK SECTOR

November 26th and 27th

Portlaoise



Conclusions

- Volatility in EU dairy is an established phenomenon.
- Everybody has unique circumstances which change over time. So a toolbox is desirable.
- Volatility is subjective. So no silver bullet.
- Volatility affects the entire supply chain.
This is a supply chain challenge.
- Unlikely there will be a policy led solution.

Conclusions

- There is a role and appetite for private risk management solutions (forward contracts, futures/options and OTC).
- However there are gaps
 - Data
 - Education
 - Critical Mass.
- Reward
 - competitive advantage
 - a more sustainable industry.

Conclusions

- You have to be clear on what you want to achieve if you use risk management tools.
- Solutions should be voluntary but nobody has a veto.

Thank you

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