



# Position Paper

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## EDA POSITION ON FUTURES MARKETS

### Summary

- › EDA is analysing the potential of futures markets for the EU dairy sector and their adjustments to the specificities of the European dairy sector. It is committed to assess the possibilities offered by these tools to respond to price issues in the European dairy sector, as regards to the growing price volatility and to the medium-term visibility wanted by all operators of the dairy chain to secure their investments.
- › While this policy option could play a role in coping with price volatility for the dairy sector, its efficacy would only be limited due to the unique specificities of the dairy sector compared to other agriculture sectors.
- › Futures markets may only be used to a limited extend, for example to offer buyers of some products like butter a predictable price. This type of instrument would not be efficient for the raw milk market in the foreseeable future.
- › EDA stresses that it is up to individual market players to decide upon the use of such instruments as it is part of its internal business strategy and risk management.
- › The public authorities could help the dairy sector by improving the transparency of EU dairy markets in terms of data availability and quality.

### Background

- › The milk market situation today is characterised by:
  - moderate demand on the internal market
  - stressed markets globally, characterised by lower purchasing in China and exacerbated by the prolonged Russian import ban
  - less demand from other third countries.
- › Price volatility is an inherent feature of de-regulated agricultural markets and episodes of significant price variation in the dairy sector can be expected to continue indefinitely in the current globalised market environment.
- › The futures markets has offered financial tools to the EU dairy sector since 2010. Institutions and stakeholders are reflecting if these alternatives can be used as a solution to cope with price volatility.

### Specificities of the dairy sector (see Annex 1)

- › Dairy products have unique characteristics compared to other agricultural commodities traded on the futures markets such as wheat, corn, coffee, cocoa, oil etc...
- › The raw milk collected on the dairy farms is a non-storable agricultural product prior to its processing and a bulk product which cannot be transported over long distances. Because of these characteristics, there is no "raw milk market" and therefore no "unique milk market price" in the European Union.



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- › Raw milk undergo a transformation stage to get to the level of finished products offered on the consumer products and dairy ingredients markets. The vast majority of dairy products transformed by processors are industrially processed products which do not meet the definition of "agricultural commodities".
- › The market prices of these finished products depend on business-to-business negotiations, especially with large retailers or the food service industry. Prices contracted in these markets depends on many commercial and marketing parameters which have a relatively low correlation with the farmgate milk price paid. The volatility of prices for these products is lower than for other agricultural and dairy commodities traded on futures markets.
- › The "commodities" that are subject to dairy quotations on futures markets: block butter, skimmed milk powder and whey powder represent a small share of the raw milk product outlets in the European Union, variable depending on the countries, regions and processors. Moreover, a significant share of the production of these dairy commodities results from a disposal of surplus milk.

## Conclusions

- › EDA believes that the decision whether to use the tools offered by financial futures markets is up to each individual processing company based on its business strategy and risk management. It is the same for other potential stakeholders in the dairy sector: milk producers, traders and industrial users of dairy ingredients.
- › Public authorities could facilitate the market orientation and predictability of the dairy sector, which are important for the potential development of financial tools like futures markets, by improving the transparency of EU dairy markets. This could be done by providing better data information (accurate and prompt publication of data).
- › EDA is available to provide information and discuss the value of these tools with all stakeholders in the dairy sector and the opportunities they can offer. But it is not within his remit, as a trade association, to make recommendations to its members on this subject; doing so could also create difficulties in terms of competition rules.



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## Annex 1 – Specificities of the Dairy Sector in the context of the futures markets

1. The dairy industry presents some specific features compared to other agricultural product supply chain (wheat, corn, sugar, coffee...) regarding the possible use of futures markets to help farmers.
2. The agricultural product: raw milk produced at the farms' level is a highly perishable product that cannot be stored at the farm level or at the purchasers' level. It must be processed in a few days after the production. So the dairy farmers cannot delay their milk sales.
3. The raw milk produced at the farm level is composed of 85% of water. As a ponderous and perishable product, it cannot be transported at long distances from the producing farms.
4. The two characteristics above imply that there is no marketplace for raw milk where dairy farmers could sell their milk to potential purchasers and the direct consequence is that there is no market price for raw milk.
5. Everywhere in the world, the dairy farmers are linked with a milk purchaser (coop or privately own purchaser) through medium or long term contracts, with a reciprocal obligation to sell and purchase all the milk or a quantity of milk set in the contract.
6. As there is no raw milk market, there is no market price for raw milk, locally, nationally or globally. The prices paid to the farmers for raw milk is determined by the purchaser, generally a dairy processor, depending on the return obtained on the markets by the processor with the range of finished dairy products (liquid milk, yoghourts, cheese, butter consumption cream, milk powders, casein, whey products...) it produces with the raw milk.
7. In the European Union, the raw milk price is totally free and show large variations at the same time between the regions, countries and even the different processors in the same region. These variations are highly correlated to the product mix of each processor.
8. A large part of the European Union raw milk is processed into branded added value consumer products (pasteurised or UHT milks, yogurts and probiotics, dairy desserts, consumer packed butter, hundreds of different cheeses...) for which market prices are poorly correlated with dairy commodities. The farmers get much higher raw milk prices from these added value product returns than from dairies commodities.
9. In the European dairy sector, futures markets can only be set up for dairy commodities produced by the milk processors: milk powder, block butter, whey powder, eventually commodity cheeses like cheddar. A significant part of these productions comes from surplus milk or by-products raw dairy material derived from the production of added value products. The market operators interested in these products' markets are the dairy processors (for an extremely variable part of their dairy production), traders and final users of these dairy commodities.