



Importance of contractual relations, futures markets and extension of rules in the milk sector

Hungarian Interbranch Organization

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G rard Calbrix

Head of Economic Affairs

French Dairy Processing Association ATLA

The Futures markets in the European dairy sector



- When an operator signs a contract with a customer, it locks its **SELLING PRICE**.
- Therefore, he creates a **PRICE RISK** or risk of position for him: if the input price increases, its margin will decrease and can even become negative.
- To eliminate this price risk, the operator can lock its **PURCHASING PRICE** through the purchase of a futures contract on a financial market.
- Whatever will be the evolution of the **INPUT PRICE**, its purchasing price will not change

The Futures markets in the European dairy sector

- Futures financial market for dairy products: EEX in Leipzig (Germany)
- Futures contracts available → 3 commodities:
 - SMP
 - BUTTER
 - WHEY POWDER
- Current users of the EEX dairy Futures markets:
 - Food companies using dairy ingredients for their processing
 - Traders of dairy commodities
 - Quite none dairy processors
 - No dairy farmers

The Futures markets in the European dairy sector

EEX Butter									
Settle = Prior Day's Settlement Price									
Name	Bid	Ask	Settle	Net.Chng	Pct.Chng	Volume	Open.Int	Low	High
FABT NOV7	5,000	5,175	5,350	€0	0	0	417	-	-
FABT DEC7	4,800	5,250	5,200	€0	0	0	705	-	-
FABT JAN8	4,500	4,950	4,588	€0	0	12	575	4,600	4,600
FABT FEB8	3,500	4,850	4,500	€0	0	12	397	4,600	4,600
FABT MAR8	4,064	4,700	4,400	€0	0	0	348	-	-
FABT APR8	3,500	4,350	4,368	€0	0	0	201	-	-
FABT MAY8	3,500	4,350	4,310	€0	0	0	185	-	-
FABT JUN8	4,000	4,300	4,150	€0	0	0	166	-	-
FABT JUL8	3,950	4,350	4,125	€0	0	0	68	-	-
FABT AUG8	3,900	4,350	4,100	€0	0	0	67	-	-
FABT SEP8	3,850	4,350	4,075	€0	0	0	67	-	-
FABT OCT8	3,700	4,350	4,050	€0	0	0	49	-	-
FABT NOV8	3,700	4,400	4,025	€0	0	0	46	-	-
FABT DEC8	3,700	4,400	4,000	€0	0	0	46	-	-
FABT JAN9	-	4,400	3,975	€0	0	0	0	-	-
FABT FEB9	-	4,400	3,950	€0	0	0	0	-	-
FABT MAR9	-	4,400	3,950	€0	0	0	0	-	-
FABT APR9	-	-	3,950	€0	0	0	0	-	-

The Futures markets in the European dairy sector

EEX SMP									
Settle = Prior Day's Settlement Price									
Name	Bid	Ask	Settle	Net.Chng	Pct.Chng	Volume	Open.Int	Low	High
FASM NOV7	1,400	1,525	1,463	€0	0	0	219	-	-
FASM DEC7	1,430	1,530	1,473	€0	0	0	362	-	-
FASM JAN8	1,430	1,540	1,456	€4	0.27	25	426	1,460	1,470
FASM FEB8	1,440	1,550	1,450	€0	0	20	376	1,470	1,470
FASM MAR8	1,440	1,560	1,502	€0	0	20	350	1,470	1,470
FASM APR8	1,430	1,575	1,484	€0	0	5	195	1,490	1,490
FASM MAY8	1,440	1,600	1,495	€0	0	5	175	1,490	1,490
FASM JUN8	1,440	1,625	1,533	€0	0	5	158	1,490	1,490
FASM JUL8	1,530	1,650	1,590	€0	0	0	51	-	-
FASM AUG8	1,540	1,880	1,540	€0	0	0	51	-	-
FASM SEP8	1,550	1,900	1,550	€0	0	0	51	-	-
FASM OCT8	1,560	1,950	1,560	€0	0	0	51	-	-
FASM NOV8	1,570	1,950	1,570	€0	0	0	51	-	-
FASM DEC8	-	1,950	1,540	€0	0	0	51	-	-
FASM JAN9	-	-	1,550	€0	0	0	0	-	-
FASM FEB9	-	-	1,560	€0	0	0	0	-	-
FASM MAR9	-	-	1,570	€0	0	0	0	-	-
FASM APR9	-	-	1,580	€0	0	0	0	-	-

The Futures markets in the European dairy sector

EEX Whey									
Settle = Prior Day's Settlement Price									
Name	Bid	Ask	Settle	Net.Chng	Pct.Chng	Volume	Open.Int	Low	High
FAWH NOV7	550	620	588	€0	0	0	123	-	-
FAWH DEC7	550	615	578	€0	0	0	104	-	-
FAWH JAN8	565	615	592	€0	0	5	85	585	585
FAWH FEB8	565	620	595	€0	0	5	80	585	585
FAWH MAR8	560	630	598	-€13	-2.17	10	55	585	585
FAWH APR8	520	640	606	-€16	-2.64	5	0	590	590
FAWH MAY8	550	650	1	€0	0	5	0	595	595
FAWH JUN8	550	660	1	€0	0	5	0	600	600
FAWH JUL8	605	670	1	€0	0	5	0	605	605
FAWH AUG8	610	680	1	€0	0	5	0	610	610
FAWH SEP8	615	690	1	€0	0	5	0	615	615

The Futures markets in the European dairy sector

- Two questions for the dairy processors and the farmers:
 - Q1: Do they have a price risk / risk of position?

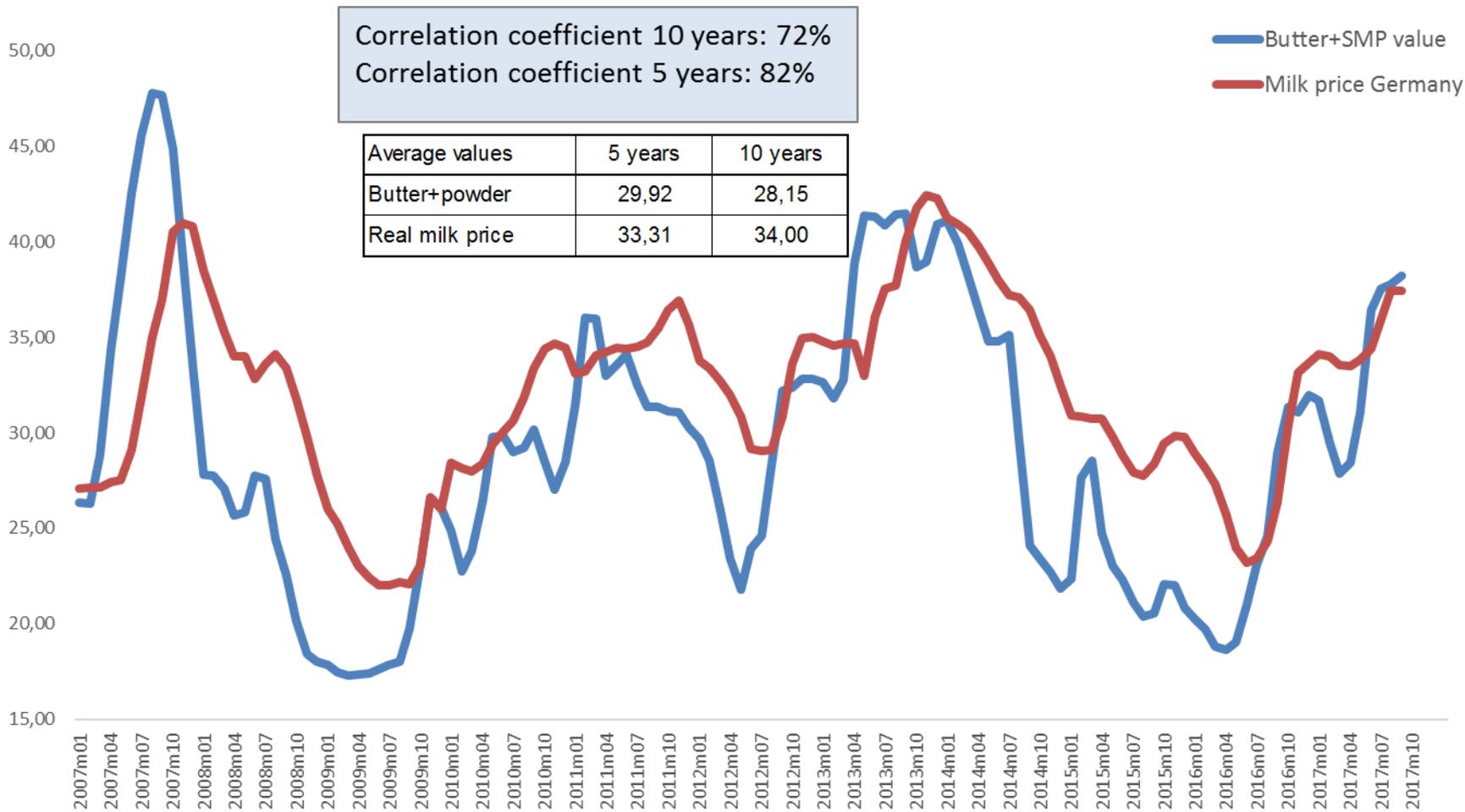
As far as a dairy does not commit on a milk price it will pay to its farmers in the future, this DAIRY PROCESSOR has NO PRICE RISK.

A dairy takes a price risk if it needs to commit to its farmers on the milk price level it will pay in the future and has not selling contracts for the dairy products it will process with this milk.

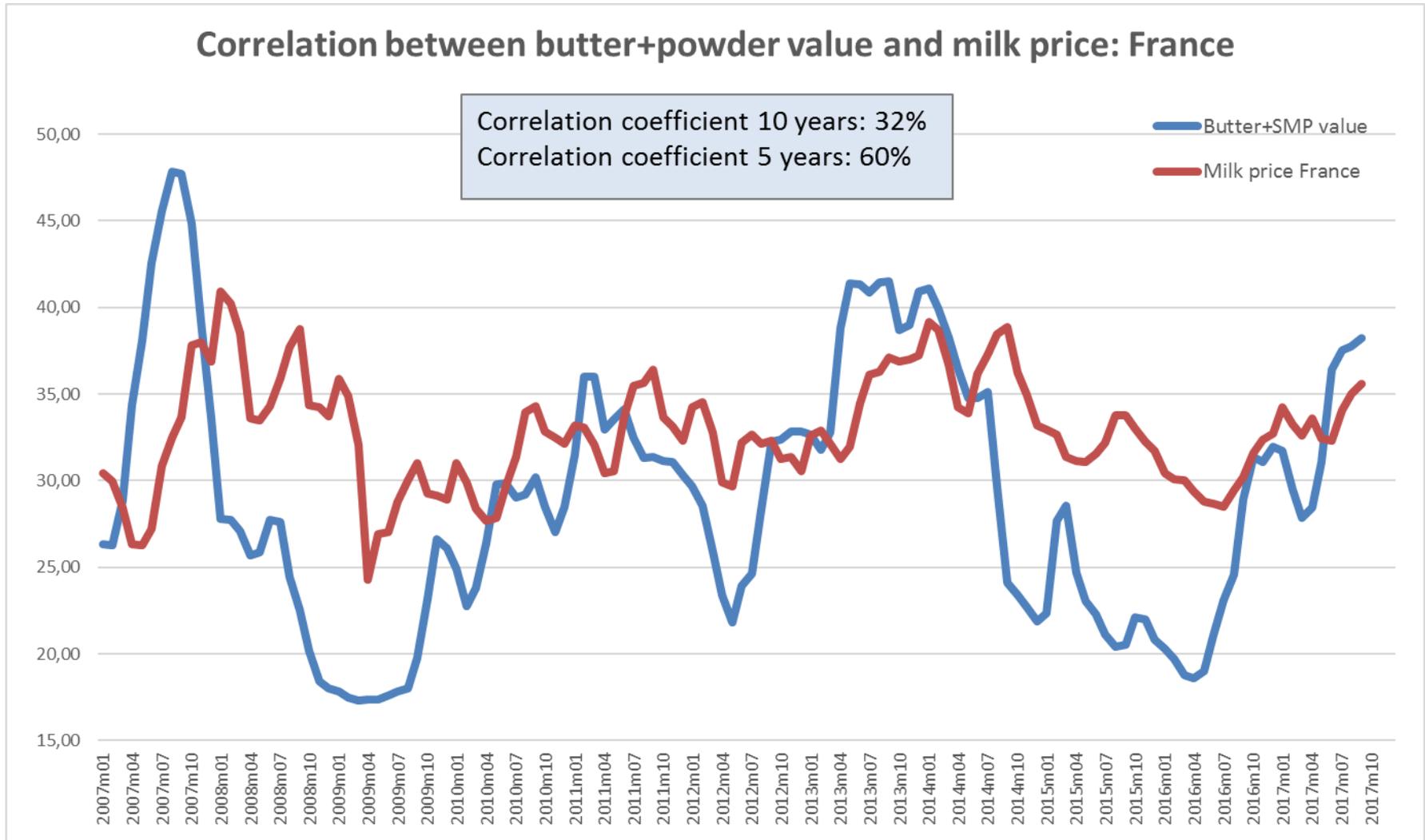
- Q2: Which correlation between the milk prices paid and the European quotation of block butter and SMP?

The Futures markets in the European dairy sector

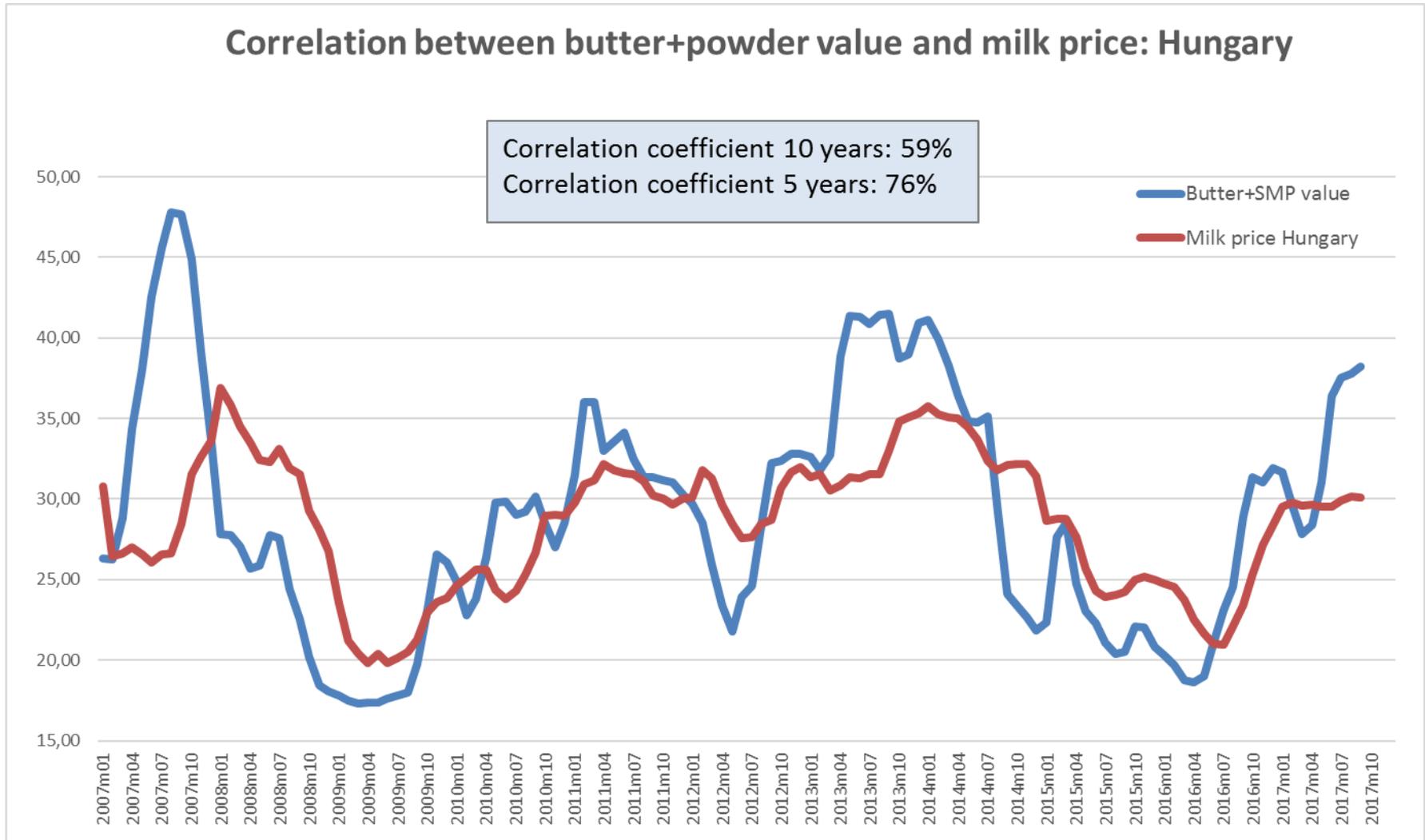
Correlation between butter+powder value and milk price: Germany



The Futures markets in the European dairy sector



The Futures markets in the European dairy sector

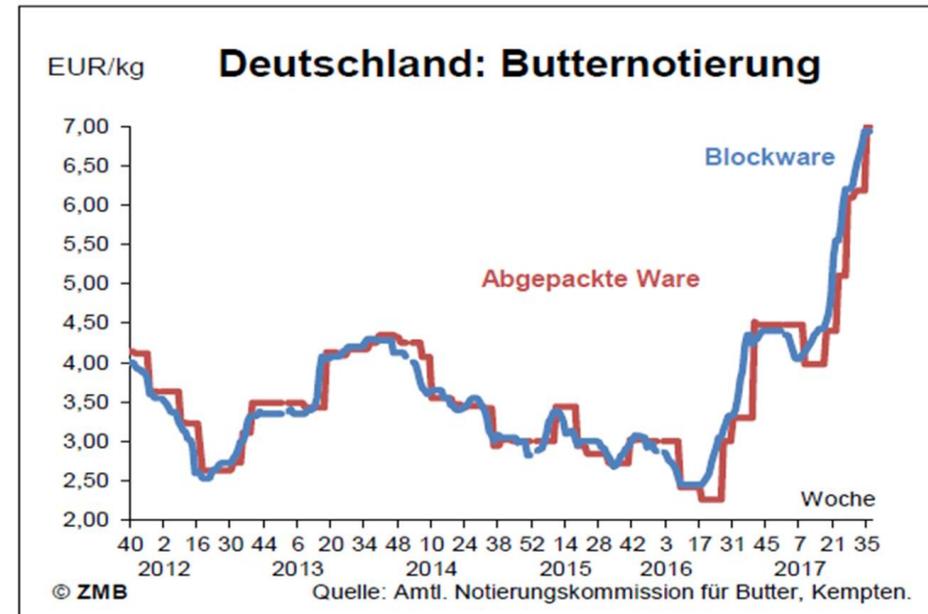
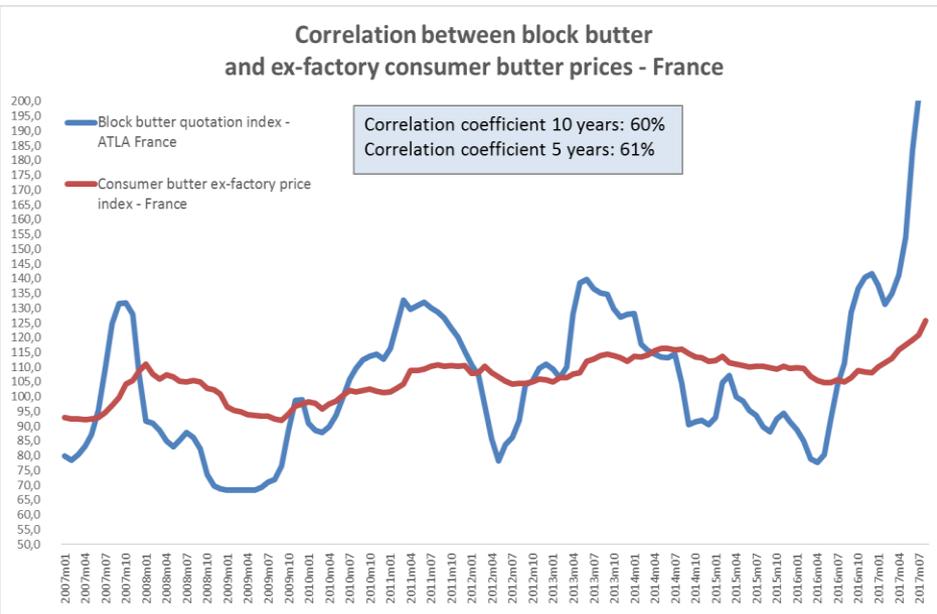


The limits of the Futures market in EU for dairy products

- One cannot lock higher SMP and butter selling prices on a Futures market than the consensus of the operators.
- Futures markets DO NOT REDUCE the market price volatility. Moreover, SMP and block butter are the most volatile dairy products.
- High costs of intervention: locking a price on a Futures market has a cost → Is there a benefit for dairies and/or for farmers?
- Based on commodity prices → low milk price equivalents for the farmers
- The traders and end-users of dairy ingredients intervening on the EEX have an interest to communicate about low prices of butter and SMP...
- Poor liquidity and limited number of operators → high risk of manipulations

The Futures markets in the European dairy sector

- **ADDING VALUE** to the milk should be the key objective for the dairy processors and dairy farmers.
- Added value products prices are **LESS VOLATILE** and should give a **BETTER RETURN** to the dairies and the farmers.



Inter Branch Organization in France

The public sector

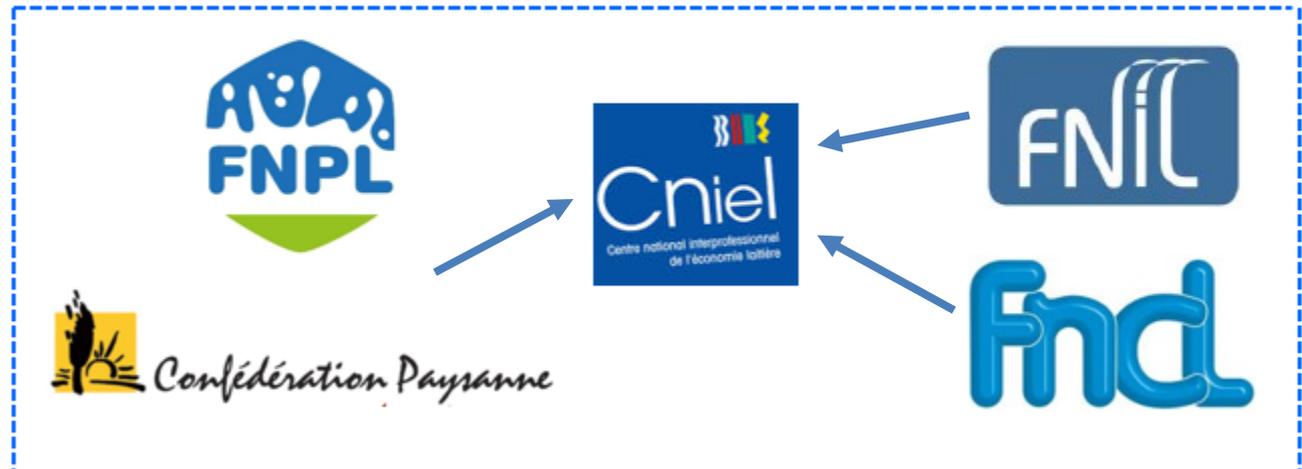


Dairy operators' organisations

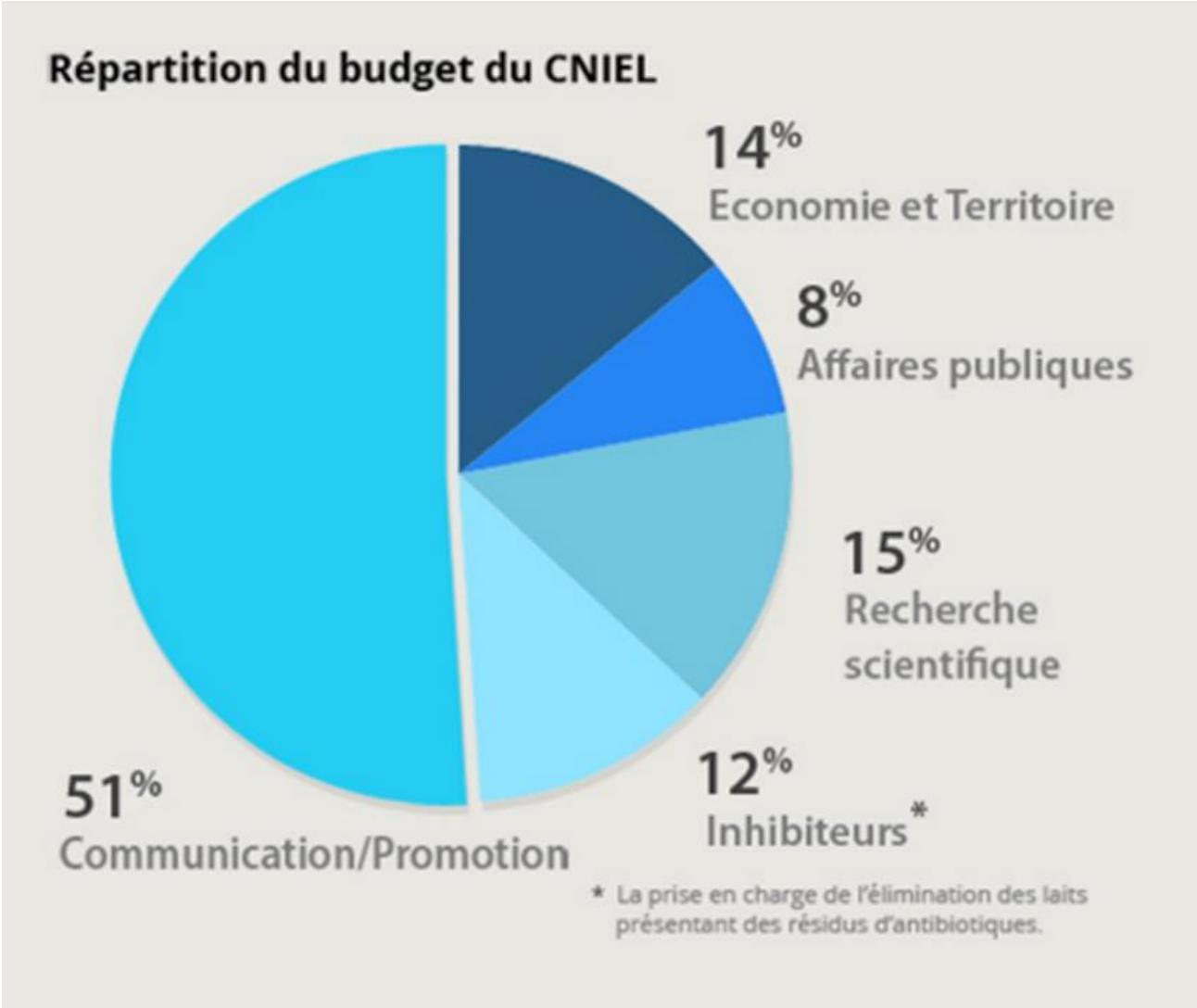
Farmers' federations

Dairy Inter-branch Organisation

Processors' federations



Inter Branch Organization in France



Inter Branch Organization

Extension of rules

- CNIEL founded in 1973
- Private organization, with a 40 millions € annual budget
- Funded by a mandatory fee paid by dairy farmers (70%) and dairy processors (30%), proportionate to the milk volume produced /processed
- All decisions taken by unanimity of the 3 ‘families’: farmers, dairy coops and private dairies

Extension of rules:

- The 3 CNIEL families can agree on a text covering a specific issue
- The agreement is transmitted to the Minister of Agriculture
- The Minister of Agriculture can make its application mandatory on the national territory through a ministerial decree.
- Creates new legal texts originated from the professionals

Examples:

- Creation of the mandatory fee to fund the IBO CNIEL (every 3 years)
- Agreements on milk quality requirements and management (antibiotics, bacteriological quality...)

Contractual relations between dairies and farmers

The French experience - 1

Before 1997:

- No written contracts but legal obligation to collect all the milk from the farmers for an unlimited period of time
- Milk volumes increase limited by the EU milk quotas
- Recurrent conflict situations between the dairies and the farmers on milk price
- Frequent interventions of the government to find price agreements

1997 to 2008:

- After a hard conflict, signature of a milk price agreement within the Inter Branch Organization CNIEL between the 3 federations: Farmers, dairy Coops, Private dairies.
- National recommendation on the evolution of milk price applied nationally based on a price formula:
 - Reference to market prices of processed dairy products: SMP, Butter, DE and NL cheese quotations
- Milk volumes managed by the milk quotas
- Unlimited commitment to collect all the dairy farms

Contractual relations between dairies and farmers

The French experience - 2

April 2008:

- Letter from the national competition authority to the CNIEL: collective negotiations on milk prices are illegal according to the competition law.
- Each dairy must negotiate with its farmers and set up its own milk price independently.
- Farmers' Union remains the negotiation on the farmers' side
- All dairies continue to apply the previous IBO milk price formula, adding some small changes specific to each dairies: A/B prices, new reference...
- Reflexion at the government's level on how to reinforce the negotiation power of the dairy farmers in front of the dairies

Contractual relations between dairies and farmers

The French experience - 3

2011-2012:

- Strong French government pressure on the European High Level Group → Dairy Package – October 2012
- Clarification of the roles of the Inter Branch Organization
- A member state can make written contracts mandatory at the national level
- Possibility for the farmers to create Producers' Organizations for collective negotiations with the dairies, including milk prices, with a derogation to the competition law.
- Possibility to manage the volumes for PDO cheeses, under certain conditions.
- Transparency on the milk volumes collected by each dairy

April 2011:

- The French government makes written contracts mandatory between private dairies and their producers.
- Similar provisions in the statutes of the dairy coops

Contractual relations between dairies and farmers

The French experience - 4

From 2012, WRITTEN CONTRACTS are mandatory in France

- The private dairies have an obligation to propose a written contract to their milk producers.
- Minimum duration of contracts: 5 years, 7 years for new producers
- The contract must include :
 - The annual volume of milk contracted with each farmer
 - A milk price or a price formula to calculate the monthly milk price to be paid
 - Prior notice of **1** year minimum for stopping the contract
- Similar provisions in the statutes of the dairy coops

PRODUCERS' ORGANIZATIONS:

- Each private dairy favoured the creation of POs by their producers
- Vertical POs per region +/- Association of POs per dairy group
- Around 60 POs agreed in France.
- Some horizontal regional POs at the initiative of Farmers' Unions
- Milk price negotiations take place with POs and the results apply to all farmers suppliers of the dairy.

Contractual relations between dairies and farmers

The French experience - 5

Roles of the Inter Branch Organization:

- Publication of monthly economic indicators that can be use in the negotiation of the milk prices,
- Agreed by the European Commission
- No further involvement of CNIEL in the milk prices determination.
- The CAP Omnibus introduces the possibility for the IBO to discuss the value sharing along the dairy supply chain



Thank you for your attention