



Market Derivatives in the EU Dairy Sector

The Challenge is not Regulation

3rd Meeting of the Expert Group on agricultural
commodity derivatives and spot markets

18 June 2013



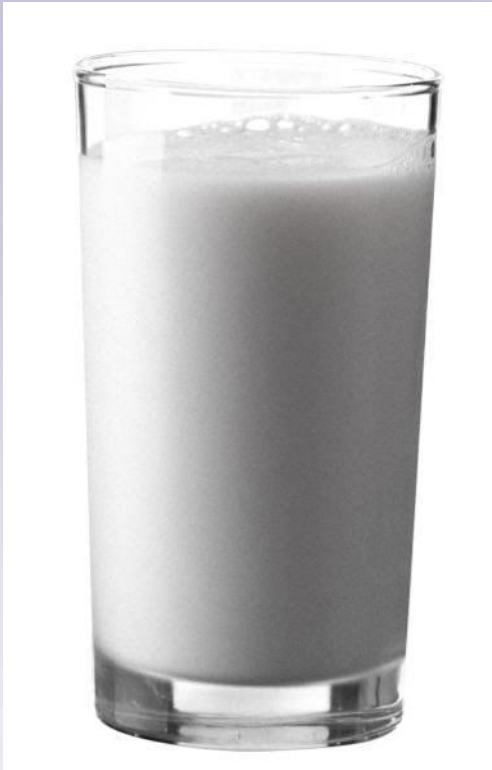
Market Derivatives in the EU dairy sector



- Introduction: Milk & Dairy Products
- Overview of available price risk tools
- Current usage of the tools
- What are the challenges?
- What are the opportunities?



Milk & Dairy Products



Milk fat

Insoluble protein

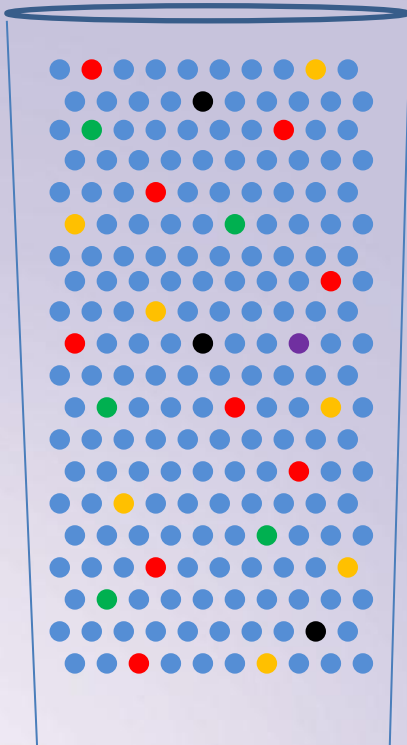
Soluble protein

Milk sugar

Milk minerals



Milk & Dairy Products



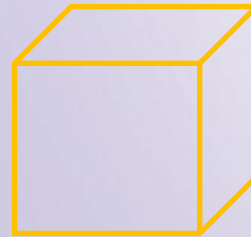
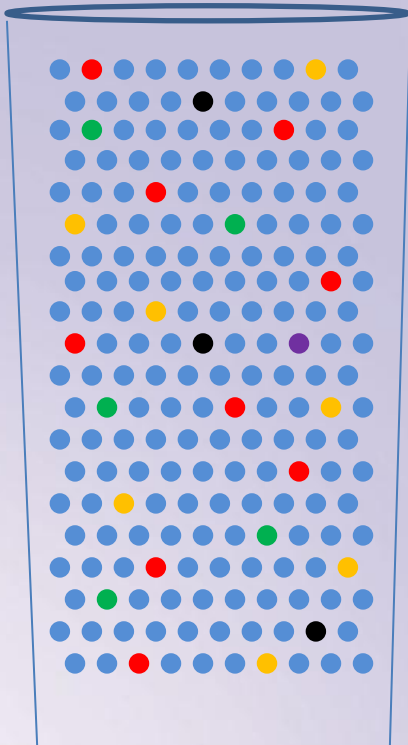
Cheese



Whey powder



Milk & Dairy Products



Butter



Skimmed
Milk Powder



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Available Tools



- There is a wide variety of dairy futures and options contracts at various exchanges world wide.
- Chicago Mercantile Exchange contracts have been traded more than 15 years. Contracts on European (Eurex & NYSE Liffe) and NZ (NZ-X) exchanges are more recent.
- Both contracts with **physical delivery** and **cash settled** contracts are offered.



What contracts are available



- Chicago Mercantile Exchange

- Class III Milk

- Cheese

- *Cheese Spot Call Blocks*

- *Cheese Spot Call Barrels*

- Dry Whey

- Class IV Milk

- International Skimmed Milk Powder

- Nonfat Dry Milk

- *Nonfat Dry Milk Spot Call Grade Extra*

- *Nonfat Dry Milk Spot Call Grade A*

- Butter

- *Butter Spot Call*



What contracts are available



- Eurex
 - EU Butter
 - EU SMP
 - EU Whey Powder
- NYSE Liffe
 - EU SMP
- NZ-X (New Zealand)
 - WMP
 - AMF
 - SMP
- OTC
 - Flexible contracts



Type of Contracts



- **Contracts with Physical Delivery**
 - Open interest contracts at expiry date require physical delivery.
 - Ability to cover future product needs
 - High liquidity requirement
 - Examples
 - CME International Skimmed Milk Powder
 - NYSE Liffe EU Skimmed Milk Powder
 - Main Issue
 - Physical delivery mostly undesirable in the dairy sector



Type of Contracts



- Cash Settled Contracts

- Open interest contracts at expiry date are cash settled against reference price.
- No ability to cover product needs
- Lower Liquidity requirement
- Examples
 - All EUREX contracts
 - All NZ-X contracts
 - CME Milk, SMP, Butter, Cheese & Whey futures
- Main Issue
 - Correlation of settlement price with physical market price



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What is trading today

Open interest (futures)



- CME: (24 months)
 - 28 500 tons of SMP (2012 P: 900 000 MT)
 - 1.6 % of estimated 2 year production
 - 100 000 tons of Butter (2011 P: 850 000 MT)
 - 6 % of E2Y production
 - 100 000 tons of Cheese (2012 P: 5 000 000 MT)
 - 1% of E2Y production
 - 29 000 tons of whey powder (2012 P 780 000 MT)
 - 1.9 % of E2Y production
 - 2 000 000 tons Class III milk (AP: +/- 40 million MT)
 - 2.5 % of E2Y production
 - 200 000 tons of Class IV milk (AP: +/- 10 million MT)
 - 1 % of E2Y production



What is trading today

Open interest



Class III Futures Weekly Average Open Interest





What is trading today

Open interest (futures)



- NZ-X : 18 months
 - WMP: 890 MT
Compare to NZ 2012 exports : 1 260 000 MT
 - SMP: 565 MT
Compare to NZ 2012 exports: 390 000 MT
 - AMF: 414 MT
Compare to NZ 2012 exports: 195 000 MT



What is trading today

Open interest (futures)



- Eurex: 18 months
 - SMP: 30 MT
EU annual production 1 250 000 MT
 - Whey powder: 125 MT
EU annual production: 1 660 000 MT
 - Butter: 990 MT
EU annual production: 2 120 000 MT



Market Derivatives in the EU dairy sector



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What are the challenges for dairy futures in the EU



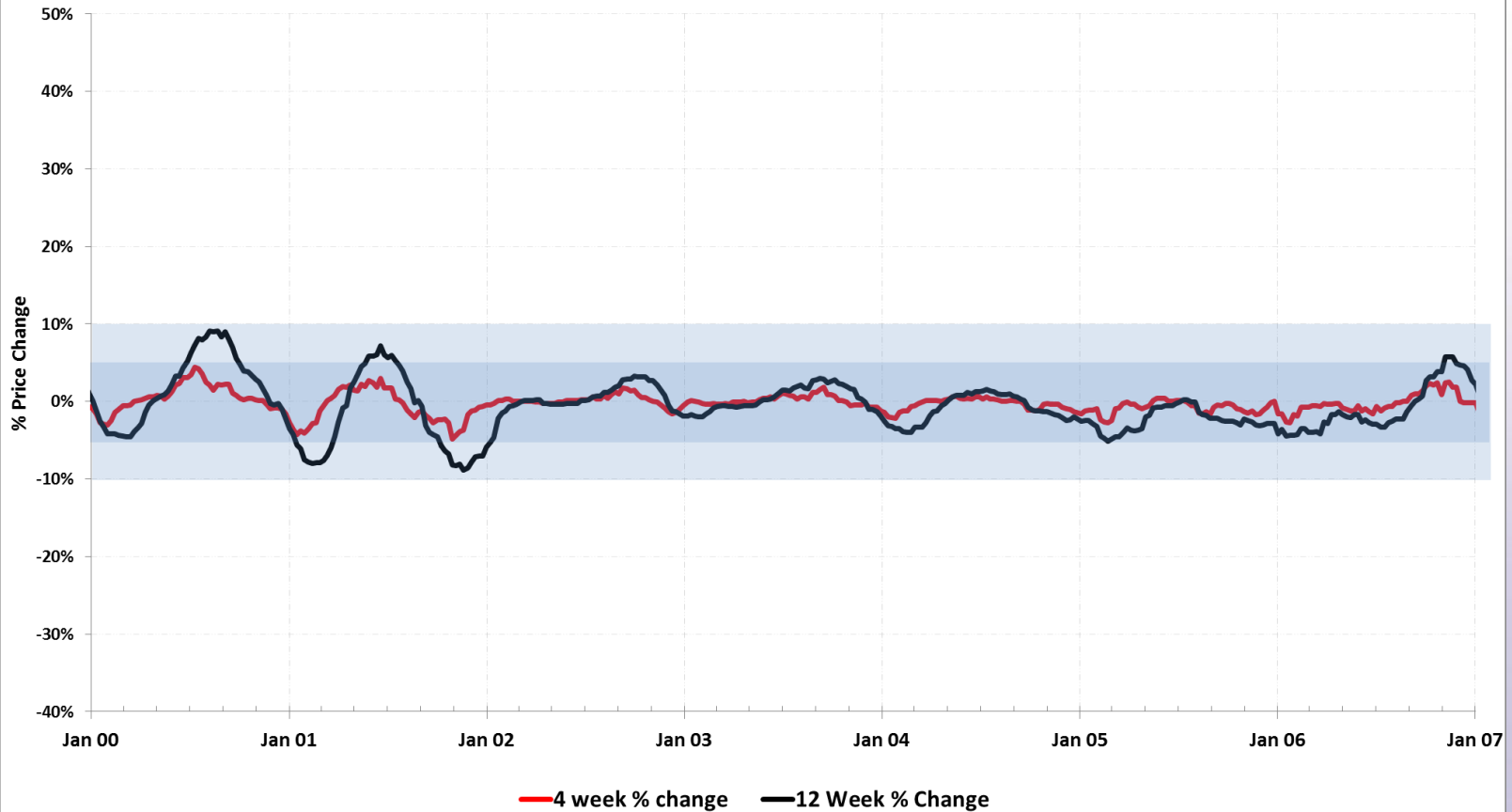
- The EU dairy market has long time been shielded from price volatility



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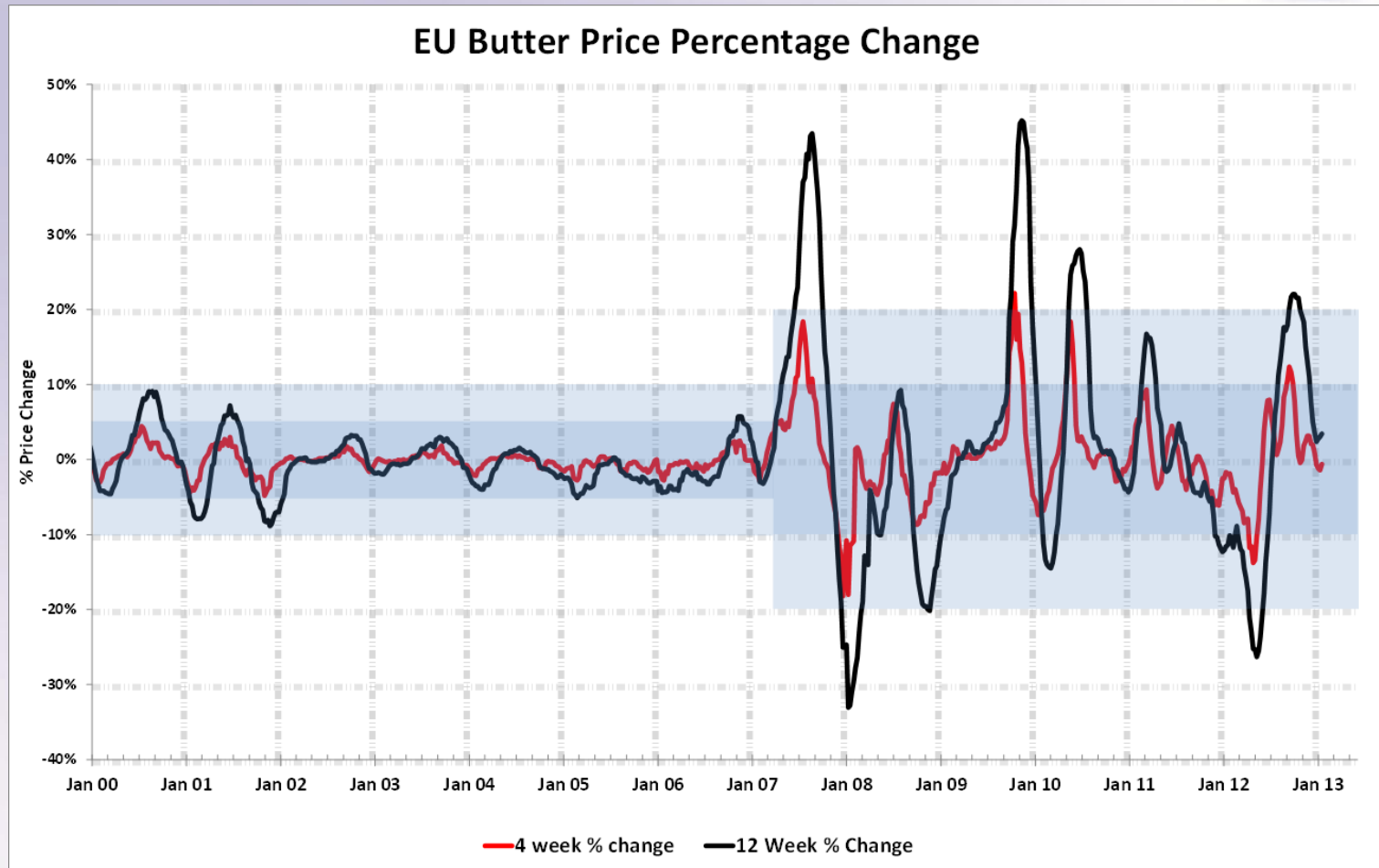


EU Butter Price Percentage Change





What are the challenges for dairy futures

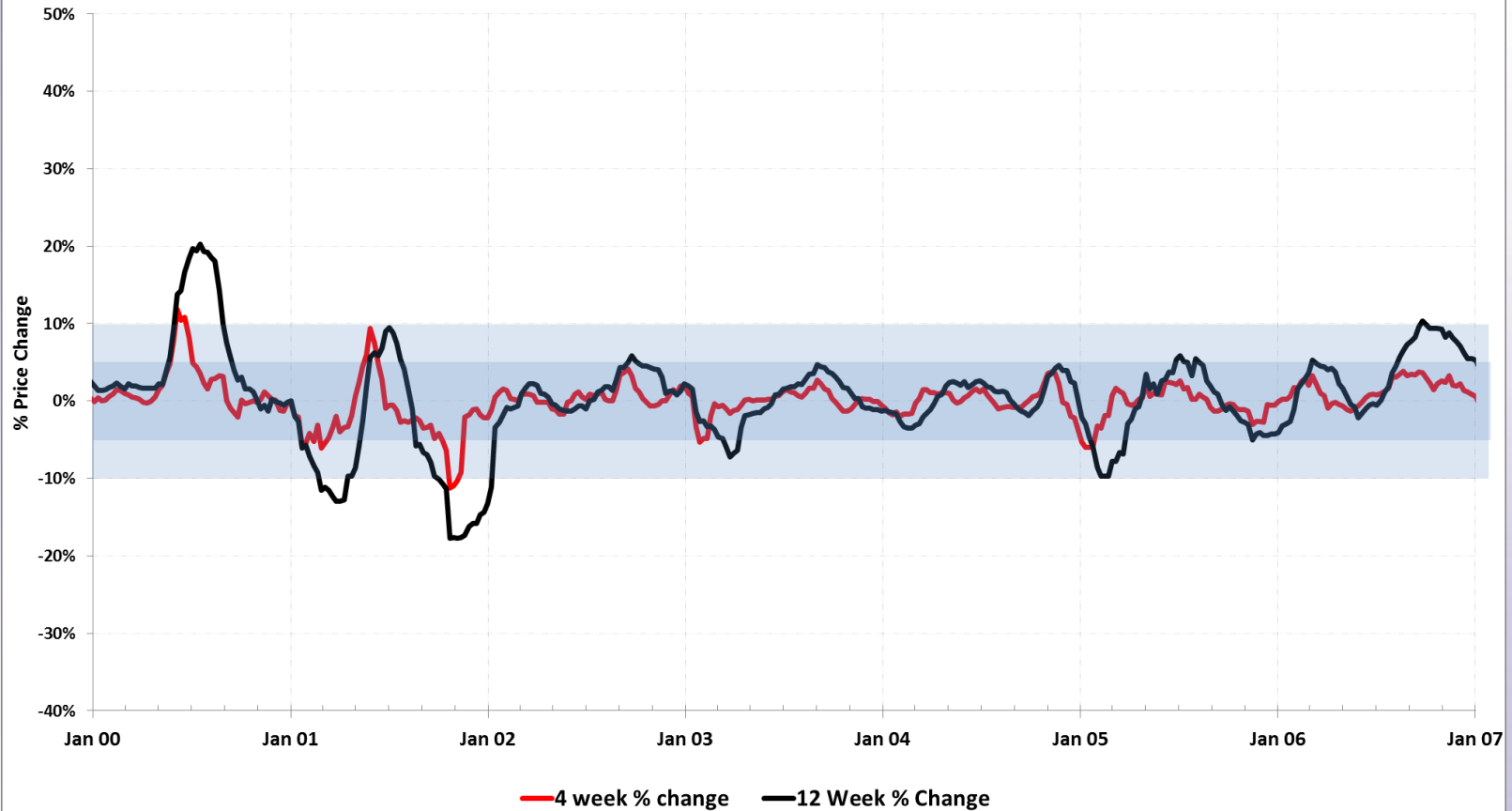




What are the challenges for dairy futures



EU SMP Price Percentage Change

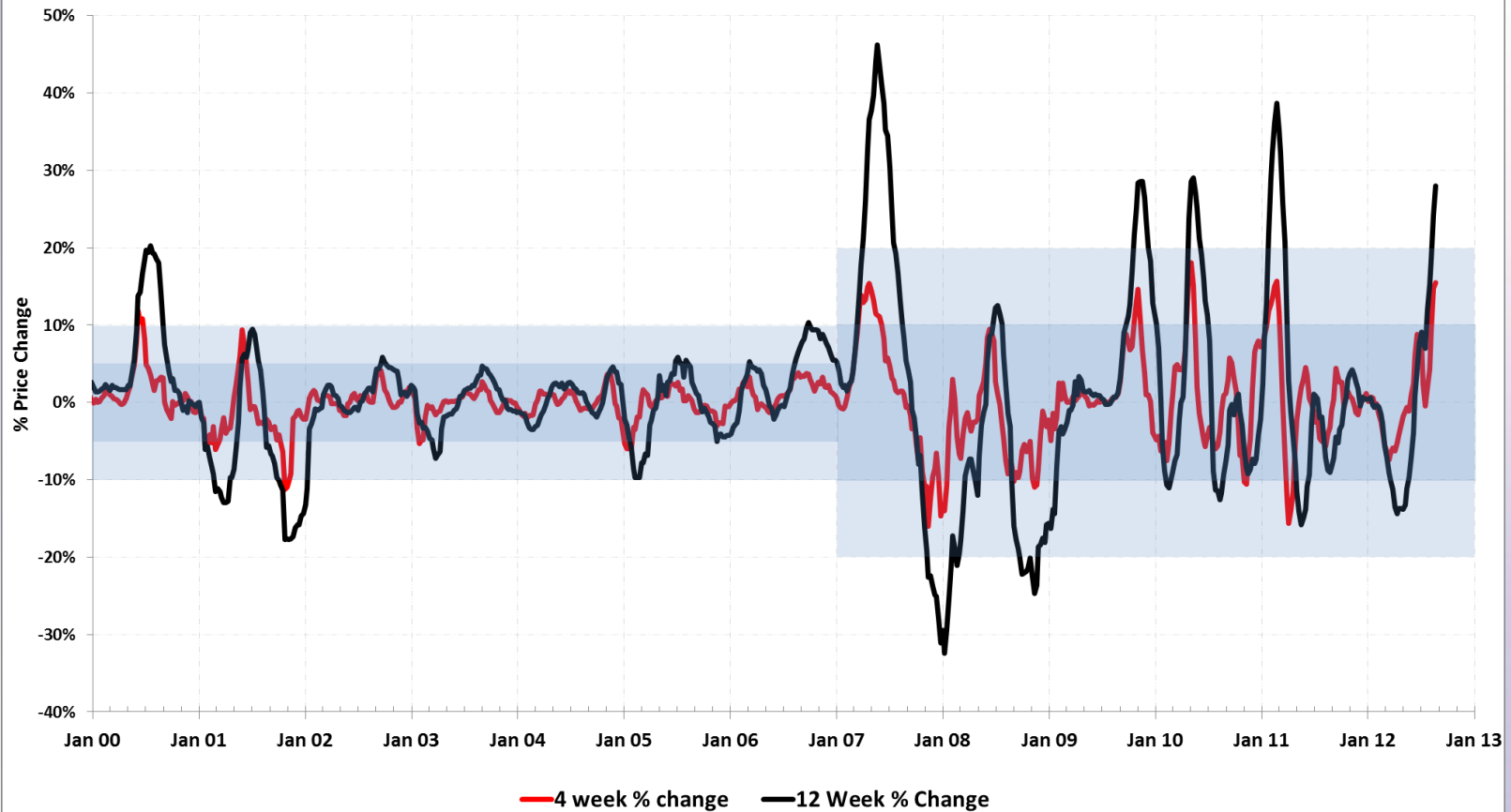




What are the challenges for dairy futures



EU SMP Price Percentage Change





What are the challenges for dairy futures in the EU



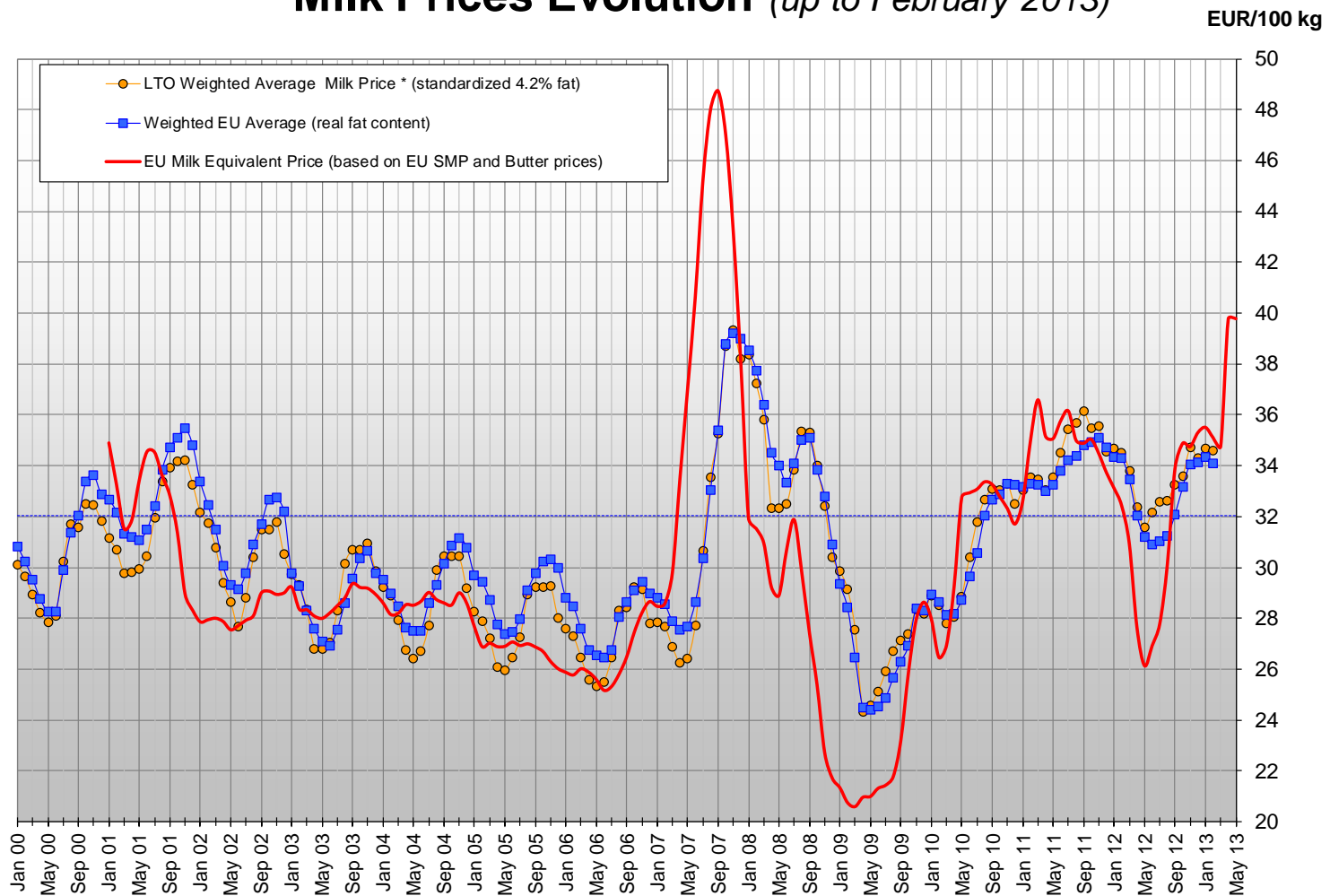
- The EU dairy market has long time been shielded from price volatility
- EU Farm gate milk price and commodity prices have limited correlation.



What are the challenges for dairy futures in the EU



Milk Prices Evolution (up to February 2013)



Source :MS' communications under reg. 562/2005 & 479/2010 + LTO : Land- en Tuinbouworganisatie Nederland



What are the challenges for dairy futures in the EU



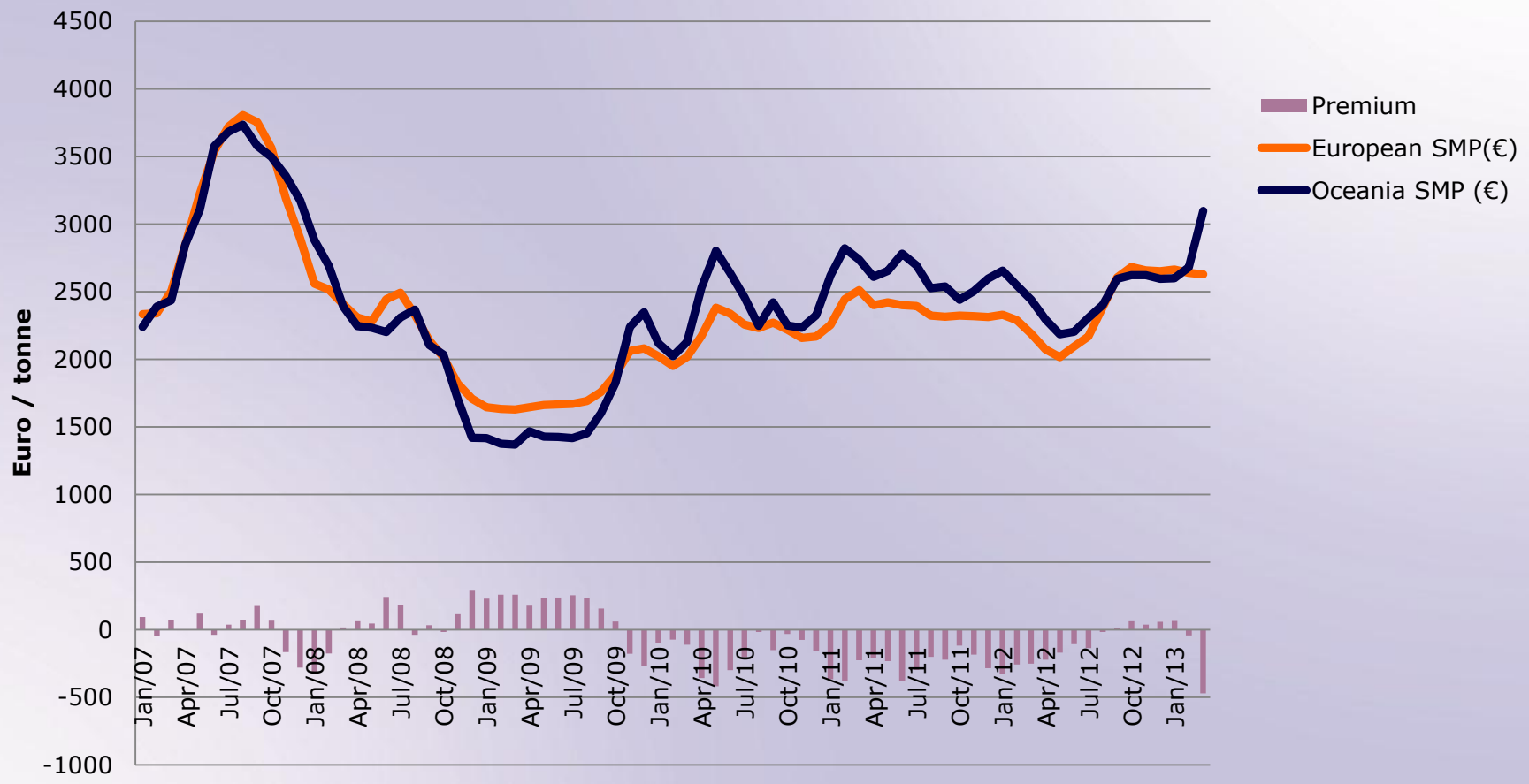
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- Farm gate milk price and commodity prices have limited correlation
- Global market, EU market and US market are not (yet) perfectly aligned



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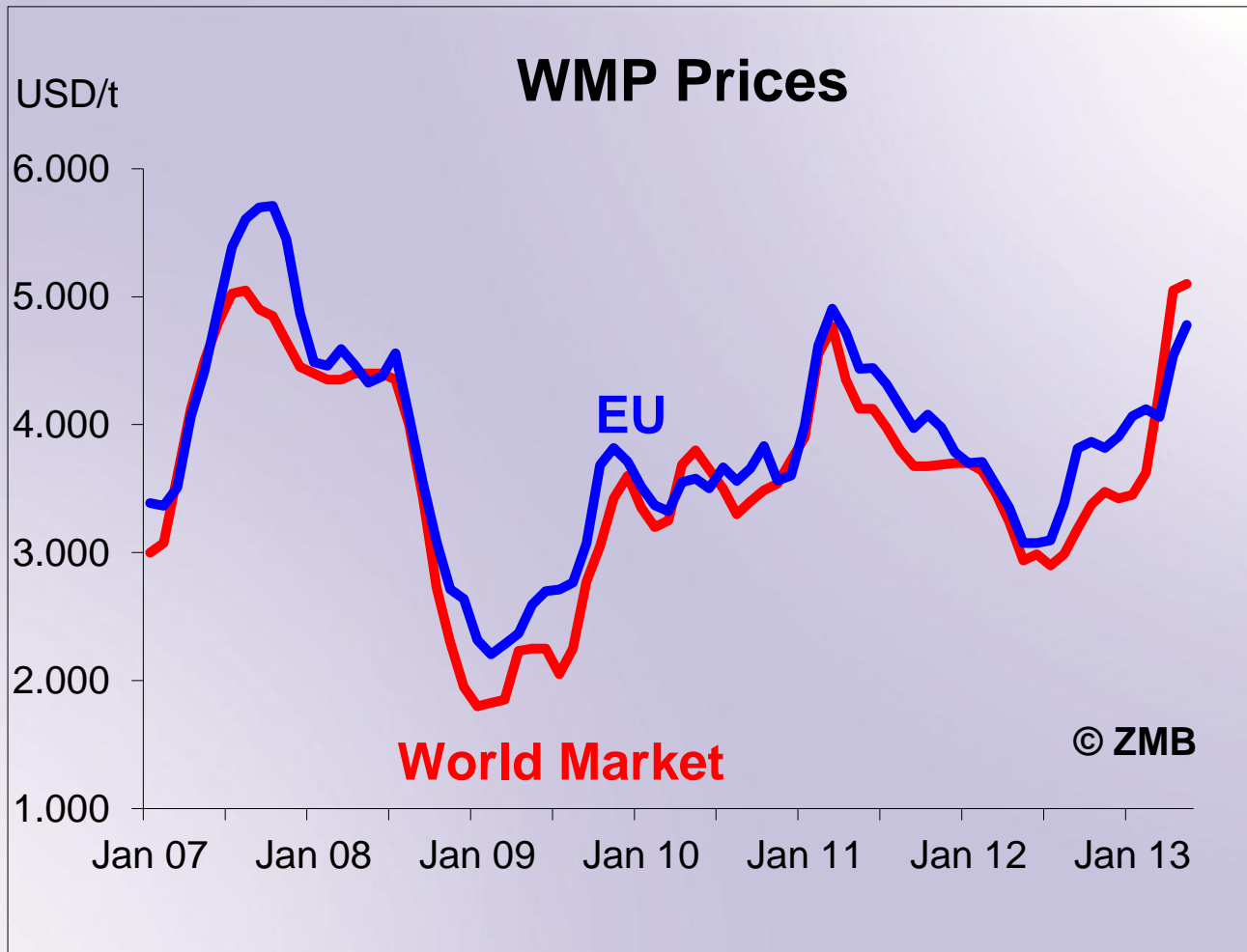


SMP market prices





What are the challenges for dairy futures in the EU





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- The majority of dairy products do not behave like commodities



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- The EU dairy market has long time been shielded from price volatility
- Farm gate milk price and commodity prices have limited correlation
- Global market, EU market and US market are not (yet) perfectly aligned
- Settlement mechanism for cash settled contracts is not yet fully trusted
- The majority of dairy products do not behave like commodities
- **Everybody is waiting for more liquidity to start trading**



The opportunities for dairy futures in the EU



- Surplus milk after end of quota will be most likely priced on commodities
- Contracts and settlement mechanism will improve
 - OTC serves as experimental market place
- Increased correlation with global markets
 - NZ-X and CME contracts becoming valid price risk tools for EU market
- More experience and more trust
 - Dairy companies hiring traders from other sectors



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Thank you!

Bart Van Belleghem
Secretary General – Eucolait