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Dawn of the post-EU-quota era

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The dawn of a new era in the dairy world is fast approaching, as more than 30 years of the European Union's production quota system slips into history. The quota system expires at the end of March. While observers recognize the implications, they cannot know the actual market effects. Many are striving to get a reading on the impact on domestic U.S. pricing.

Of late, EU dairy producers have scaled back production levels in order to remain under the radar of quota limits and avoid paying super levies. However, those in the Milk Belt of northern countries have had the ambition to hike production to the point where that region would become, over the next decade, the largest net dairy exporter in the world.

Meanwhile, in the coming months, the million-dollar question is whether milk production levels are going to ramp higher, and, if so, how much?

International dairy prices have been "rounding out a bottom" and attempting to probe higher. Also, the volatile climate in global currency markets has seen the precipitous rise in the U.S. dollar as well as the sharp depreciation of the euro. So, there have been credible arguments in favor of a combination of these factors as a catalyst for higher output in the absence of quotas.

Rather than slamming down on the accelerator right out of the gate next month, it seems more likely that most EU producers will take a gradual approach to expansion, for the near term at least.

Nonetheless, it bears mentioning that larger scale producers who have been profitable at current levels of quota-limited production may opt to put the pedal to the metal sooner than later.

For now, the export raceway is entirely conducive for EU expansion, especially considering the explosive rise of the U.S. dollar relative to the euro. If the current trajectory continues, the strong greenback is going to exacerbate the current squeeze on U.S. dairy exports, which likely will prove beneficial to EU exporters. A shift in demand to EU sources could prove to be a formidable obstacle to the U.S. market getting back on track in the coming months.

We can see that the globalization of dairy, growing demand in emerging countries, and the EU's new non-quota market are building a new pricing paradigm. Looking east to Europe and Asia, we're certainly "not in Kansas anymore."

Last year exemplifies just how sensitive markets have become to shifts in the supply and demand ratio, as well as how quickly price signals can be sent and echoed, generating volatile action and reaction. Moving forward, it is likely these price signals will be amplified to generate more volatility than the markets experienced in 2014.

It looks like the dawn of a new era is going to rise with the sun on April 1.

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