

The GVH's report on the dairy market: the following factors are contributing to high inflation

GVH contributes to reducing inflation by providing competition advocacy proposals and expert consultations.

20 April 2023, Budapest – The Hungarian Competition Authority (GVH) has published for public consultation a draft report summarising the results of its accelerated sector inquiry into the milk and dairy products market. In the food markets the GVH's experts first analysed the competition law reasons behind the large increase in consumer prices in the milk and dairy products market. Based on the findings of the analysis, the competition authority has made six proposals. In these, the GVH's experts propose, among other things, a review of the price formula for raw milk, offer professional assistance for future legislative considerations on food price caps, suggest strengthening the comparability of consumer prices, propose a rethink of the pricing of plant-based beverages and call for further regulatory actions in the food trade sector. Industry stakeholders have one month, until 20 May, to comment on the draft report, which is available on the GVH's website. In this framework, the GVH invited professional organisations representing the sector to a personal professional consultation on 26 April, next Wednesday.

The rapid rise in food prices is causing difficulties for the population and all economic actors across Europe. Tackling inflation is therefore a common goal and national competition authorities must use all the means at their disposal to protect families, the economy and market competition.

Consumer prices for milk and dairy products increased sharply. At the same time, the signals received by the GVH showed a weakening trend in the supplier positions of domestic operators producing and processing in the dairy sector. Therefore, on 20 January 2023, the Hungarian Competition Authority opened an accelerated sector inquiry into the market for milk and dairy products, due to the potential distortion of competition in the sector.

The GVH's experts carried out a number of on-site inspections at dairy processors and food retail chains during the accelerated sector inquiry. In parallel, the Authority carried out extensive data collection at all levels of the dairy value chain in Hungary, including dairy farmers, dairy processors, cooperatives, retailers and professional associations. The GVH's experts assessed more than 140 submissions, so the findings and recommendations of the sector inquiry are not based on individual opinions, but on sector-wide facts. In the course of the investigation, the GVH experts analysed in detail the price evolution of seven basic dairy products (1.5% ESL milk, 2.8% ESL milk, 20% sour cream, 80% butter, semi-fat cottage cheese, Trappista cheese, natural yoghurt), which are the most popular among the population.

Competition advocacy proposals to reduce inflation:

1. Review of the prognosis for raw milk base price

The GVH proposes to revise the methodology used by the Milk Interprofessional Organisation and Product Board for the prognosis for raw milk base price.

The methodology that significantly determines the price of raw milk is currently based on a price formula, some elements of which could further increase the price of dairy products in 2023, and thereby contributing to high inflation. The GVH is therefore proposing to the Product Board to review the price formula, to which the national competition authority is offering its professional support. The Authority's proposal will protect both Hungarian consumers and Hungarian producers, as the revision could not only help to reduce inflation but also strengthen the competitiveness of the Hungarian dairy producers.

2. Professional advice on the food price cap

Considering the distortive effect on economic competition of food price caps introduced for social policy purposes, the GVH offers technical advice to assist future legislative considerations on price caps.

The GVH's investigation showed that retailers sought to reduce their losses due to price caps on certain food products, which were temporarily introduced as a social support measure, by achieving higher margins in 2022 for certain products not affected by the price caps. However, the GVH's analysis looked at the price trends of only seven specific products, while the retail sector operates with tens of thousands of items and aggregated financial statements show a reduction in profits for the majority of retailers in 2022.

3. Development and operation of an online price monitoring system

Based on the findings of the accelerated sector inquiry and the experience of some EU Member States, the President of the GVH has proposed to the Government the creation of an online price monitoring database and application to monitor consumer prices of food products, which is currently being implemented.

In the GVH's view, this type of development could increase competition through transparency and better comparability of retail prices, which could have a long-term moderating effect on prices and increase (consumer) awareness. International experience gathered during the study confirms this expectation. The design of the price monitoring system is based on the results of consumer research and the analysis of domestic and foreign examples to ensure that the system is able to meet the needs of a wide range of potential users.

4. Pricing and promotion of plant-based drinks

The GVH proposes to improve the position of consumers of plant-based drinks and soy yoghurts through trade policy instruments.

Lactose intolerance and milk allergy are very common food allergies, affecting up to 35% of the Hungarian population. The GVH's experts therefore reviewed the price trends of plant-based drinks (almond drinks, rice drinks, oat drinks) and soy yoghurts, as well as the pricing practices of some actors in the distribution chain. The results of the analysis show that the import price of these products barely increased between 2019 and 2022, but the sales prices of domestic distributors, and thus their margins, started to rise from autumn 2022. This is presumably linked to the increase in the price of dairy products as close substitutes, which in turn is a negative inflationary trend. Another important finding that concerns many is that the retail margins and VAT levels for plant-based drinks and soy yoghurts are higher than for related dairy products, which represents a significant additional burden for consumers with various food sensitivities who are vulnerable to these issues and environmentally conscious consumers.

5. Promoting sustainable packaging

The GVH proposes to encourage operators at the processing level of the domestic dairy value chain, as far as practicable, to sell dairy products (mainly milk, sour cream and yoghurt) in returnable packaging.

Based on the cost analyses carried out in the accelerated sector inquiry and the statements of several market players (processors), it can be concluded that packaging materials have become significantly more expensive in the recent period. In view of this and from a sustainability point of view, it would be beneficial to encourage the sale of suitable dairy products in returnable packaging.

6. Continuous actions by the national competition authority

The national competition authority will continue to pay particular attention to the commercial sector in order to increase competition and reduce prices.

For several of the products under review, the increase in retail gross margin in HUF was higher than the increase in costs per product, so the average profit realised by retailers on the product increased significantly by 2022 compared to 2019, 2020 and 2021.

However, this was not the reason for the very significant price increase of the product in question, as the profit level of the retailers constitute only a small fraction of the gross consumer price, for example, in the case of Trappista cheese, the average profit of retailers was only 6.3% of the gross consumer price in 2022, while the consumer price of the product increased by 161% from 2021 to 2022. The same can be said of taxes. Taxes built into the gross margin have

contributed only marginally to the very significant increase in consumer prices for the products under review. For example, of the average consumer price of a kg of Trappista cheese, the average tax paid by retailers (excluding VAT) amounted to HUF 12.4, which is only 0.42% of the average consumer price. However, there are significant differences between retailers.

However, encouraging retail competition is of paramount importance as it can have a positive impact on the whole supply chain. Retailers can also influence the lower levels of the supply chain through their purchasing negotiations, as confirmed by the GVH's price transmission analysis. Increased competition also increases business efficiency and helps to contain higher prices. The competition authority's aim is to ensure that as many of these benefits as possible are passed on to Hungarian consumers and will therefore continue to pay particular attention to the retail sector and the analysis of consumer prices. The justification for this is further strengthened by the fact that the significant price reductions observed during the period of the accelerated sector inquiry (especially for milk and dairy products covered by the analysis) - among many other external factors - also suggest that the targeted investigation and official procedures of the GVH may have contributed to the reduction of inflationary pressures and the decline in consumer prices.

The draft report based on the results of the sector inquiry has been made available for public consultation on the GVH's website. Market players have one month, until 20 May to submit their comments, and the competition authority has invited the professional organisations representing the sector and those affected by the draft report's proposals (Milk Interprofessional Organisation and Product Board, National Trade Association, Hungarian Trade Association, Association of Responsible Food Producers, Association of Consumers Advocates, National Association of Plant-Based Food Producers and Distributors, Milk Allergy Support Group) to a personal professional consultation on 26 April.

After the deadline, the national competition authority will publish the report on the outcome of the accelerated sector inquiry, a summary of the comments received and, if requested, the full comments on its website. The draft report of the accelerated sector inquiry is [available here](#):

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