



Dairy market trends

April 2019

Executive summary

The supply of unprocessed milk in March 2019 is estimated at 257-million litres, **1.70%** less than in March 2018. The production trend for March in the previous three years was March 2016 **-4.13%**, March 2017 0.93%, and March 2018 8.14%. The production in March 2018 has created a high base that over-emphasises the apparent weakness of March 2019. If the March 2019 production level is compared to March 2017, production increased with 6% in March 2019.

Milk production in March 2016 was 240 million litres, March 2017 was 242 million litres, March 2018 was 261 million litres and the March 2019 preliminary figure is 257 million litres. Milk production has been under pressure since the end of 2018. It seems that price increases in March 2019 moderately supported production. The drivers influencing milk production negatively include more expensive grain, poor climatic conditions in certain parts of the country and increased electricity tariffs that can hamper milk production.

In March 2019 the SA dairy industry continued to be a net exporter of dairy products. A significant slow-down in imports for the first three months of 2019 is responsible for net exports realising strong growth. Cumulative net exports in March 2019 are 38 million/l compared to **-6** million/l in March 2018. The SA Dairy Industry regained its status as a net exporter of dairy products in 2018. Exports in 2018 exceeded imports with 82 million litres. Net exports in 2018 were higher than in 2017 and 2016 and only slightly below the level of 2015.

The total cumulative monthly milk supply, consisting of locally produced milk less net exports (total exports less total imports) is reflected in Figure 6. The total cumulative supply of milk in March 2019 is lower than in March of the previous four years except for 2016. The March 2019 supply is 11% lower than the March 2018 supply.

Demand for fresh milk in 2018 continued the downward trend of the previous 4 years while the demand for UHT milk and maas in 2018 showed strong growth and increased per capita consumption. Prepacked cheese, yoghurt and butter are increasing their market share. In the case of fresh milk the drivers of the downward trend are the changing profile of the traditional consumer and the profile of “new consumers”.

The FAO Food Price Index (FFPI) is holding steady. The sharp increase in dairy products and somewhat firmer meat prices were offset by the decline in cereal and sugar prices. The March 2019 FFPI is 3.6% down from the corresponding period last year.

The international dairy index shows strong growth since the middle of 2016. There are shorter cycles during this period and currently dairy prices are trending upwards with the butter price leading the pack. In December 2018 the dairy product price index was 170 points and increased to 204.3 points in March 2019 (20%). Increased dairy product prices are underpinned by increased import demand due to the seasonal decline in milk production in Oceania leading to the tightening of export availability from Oceania. The decline in milk production in Oceania is exacerbated by the drought in Australia. In the EU milk supply fell behind the level of the previous year providing further impetus to increased dairy prices. Milk production in most other important dairy exporting countries are also lagging behind or are stagnant

Price volatility in the Global Dairy Price Index reduced since the last quarter of 2016 and since then is trading between a support line at 900 index points and a resistance line at 1100 index points. The January 2019 price bounced off the support line (900 index points) and the upward momentum was continued in February and March with April showing a marked decrease in the upward momentum as prices get near to the resistance level. May will be indicative on whether the trend will test the resistance level of 1100 index points. On the back of the reduced momentum already detected in April, the probability of a strong breach of the resistance line is slim.

International price trends for milk powders, butter and cheddar cheese as reported by USDA in Rand/ton are changing. Three of the four dairy product prices are on an upward trend since December 2018. The EU dominated global cheese exports in the first two months of 2019 with the EU exporting more cheese than the next three countries combined: New Zealand, Belarus and the USA.

The SMP price in April turnaround and reduced with 7% in Rand terms. The US \$ price decreased by 5% which could mark the end of the run that the SMP price had since November 2018. The last SMP tender sale of EU intervention stock occurred on 16 April 2019 when 1 140 metric ton (Mt) remaining from European intervention stock was available. Bids ranged from 1 581 to 1 666 euros/Mt. The outcome was 33 Mt sold by Finland for 1 660 euros/Mt (R26 211/Mt). The next sale will occur on 14 May 2019.

The New Zealand Future Exchange reflects stable prices for skimmed milk powder (SMP) and for full cream milk powder (FMP) over the next 9 months. Both anhydrous milk fat and butter are declining over the same period with butter declining from US \$5 625/t to US \$4 840/t (14%) and anhydrous milk fat from US \$6 000/t to US \$5 660/t (6%). The current mood in the market is that both butter and anhydrous milk fat is in good supply and that the exorbitant prices of 2017 and 2018 are something of the past.

Frequently milk producers and other role players ask about the meaning and implications of specific market trends on the total dairy market balance and how it will change future markets. While the Milk Producers' Organisation cannot and will not try to predict the future in any detail, the possible general impact of specific changes will be discussed in this document. This information should not be regarded as financial advice.

While this report is compiled from sources that are deemed to be reliable, MPO cannot take responsibility for any decisions based on the information in this report.

Contents

Executive summary	2
The performance of the South African dairy industry in 2019 will be shaped by: Error! Bookmark not defined.	
Contents	4
List of figures	4
List of tables	5
1. Milk supply, demand and prices	6
1.1 Milk production	6
1.2 Dairy imports	7
1.1 Dairy exports and sales to BLNS countries	9
1.2 Net exports.....	9
1.3 Total milk supply	10
1.4 Milk demand.....	11
1.4 Producer prices	12
1.5 Retail prices	12
1.6 Feed prices	13
1.7 Input prices	15
1.8 International prices	16
1.9 Import parity and producer prices	18
2. Economic overview	19
2.1 International economic outlook.....	19
2.2 South African economy	20
2.2.1 Economic activity and growth	20
2.2.2 Household debt and income.....	22
2.2.3 Inflation	22
3. The performance of the South African dairy industry in 2019 will especially be shaped by:	23

List of figures

Figure 1 Monthly milk production (Mil.L.).....	7
Figure 2 Annual imports, mass and milk equivalent basis, 2009-2014.....	7
Figure 3 Monthly cumulative imports, (Mil.L.) milk equivalent basis	6

Figure 4	Monthly cumulative dairy exports (Mil.L.), milk equivalent basis	9
Figure 5	Cumulative net exports, milk equivalent basis (Mil.L.) , 2010-2015.....	10
Figure 6	Monthly milk supply 2011 - 2016.....	9
Figure 7	Monthly milk producer prices, 2010-2015.....	12
Figure 8	Monthly producer and retail prices, 2010-2015.....	13
Figure 9	Calculated dairy feed prices, 2010-2015	14
Figure 10	Milk:feed price ratio, 2010-2015	14
Figure 11	Quarterly milk production cost and producer price index, 2009-2014	15
Figure 12	Monthly FAO food price indexes, 2010-2015.....	16
Figure 13	Monthly international dairy product prices (US\$/ton), 2010-2015	17
Figure 14	International dairy product prices (Rand/ton), 2010-2015	17
Figure 15	Monthly producer and import parity prices, 2010-2015.....	19
Figure 16	International economic growth and estimated growth, 2010-2015	20
Figure 17	Leading and co-incident indicator of economic activity	21
Figure 18	Quarterly change in real gross domestic product, 2010-2015.....	21
Figure 19	Consumer price index and consumer price inflation, 2007-2015	22

List of tables

Table 1	Retail market growth	11
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1. Milk supply, demand and prices

1.1 Milk production

The supply of unprocessed milk in March 2019 is estimated at 257-million litres, **1.70%** less than in March 2018. The production trend for March in the previous three years was March 2016 **-4.13%**, March 2017 0.93%, and March 2018 8.14%. The production in March 2018 has created a high base that over-emphasises the apparent weakness of March 2019. If the March 2019 production level is compared to March 2017, production increased with 6% in March 2019.

Milk production in March 2016 was 240 million litres, March 2017 was 242 million litres, March 2018 was 261 million litres and the March 2019 preliminary figure is 257 million litres. Milk production has been under pressure since the end of 2018. It seems that price increases in March 2019 moderately supported production. The drivers influencing milk production negatively include more expensive grain, poor climatic conditions in certain parts of the country and increased electricity tariffs that can hamper milk production.

The strong growth in milk supply experienced in 2018 (year on year growth +4.82%) is still supporting stock levels.

Producer price increases that were announced are playing a positive role in the market. The MPO is of the opinion that producers who have not yet received a price increase are not being treated reasonably especially in light of the coming winter and the difficult climatological circumstances of the previous season. The MPO appeals to these milk buyers to familiarise themselves with the situation in the industry and act responsibly. The same applies to low price increases that are not taking into account the negative milk production drivers present in the market.

The impact of the drought and high grain prices will in the coming months cause further upward pressure on producer prices.

Monthly milk production is reflected in Figure 1 below.

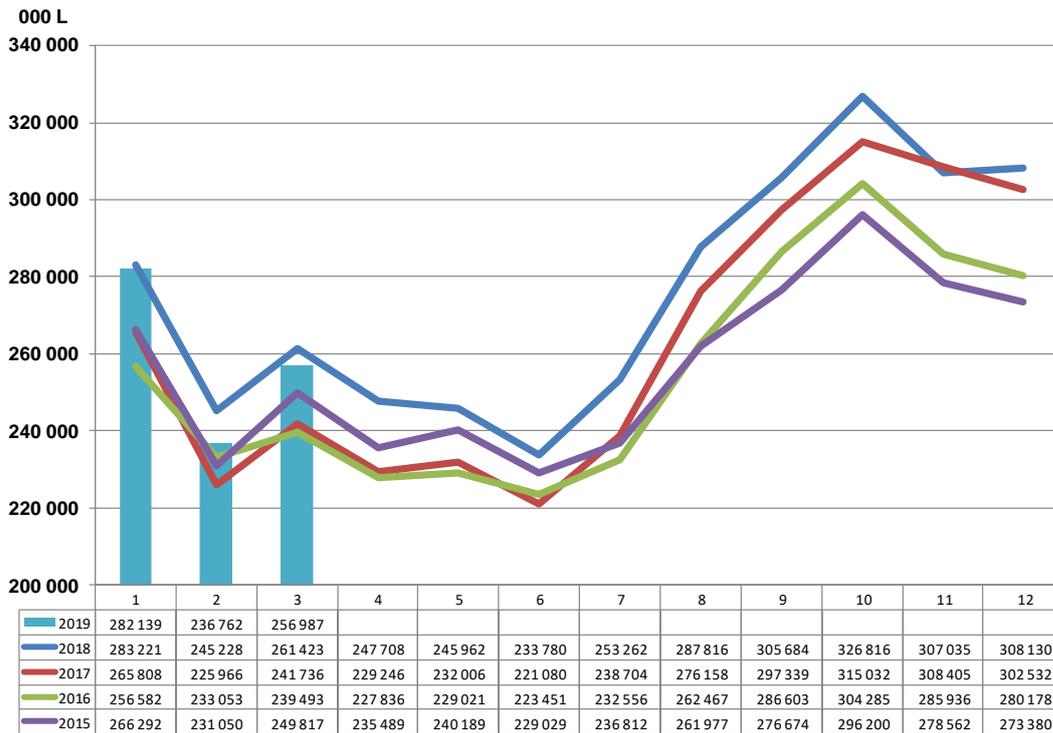


Figure 1 Monthly milk production ('000 L.).

Source: Milk SA, Feb/19 and March/19 preliminary

1.2 Dairy imports

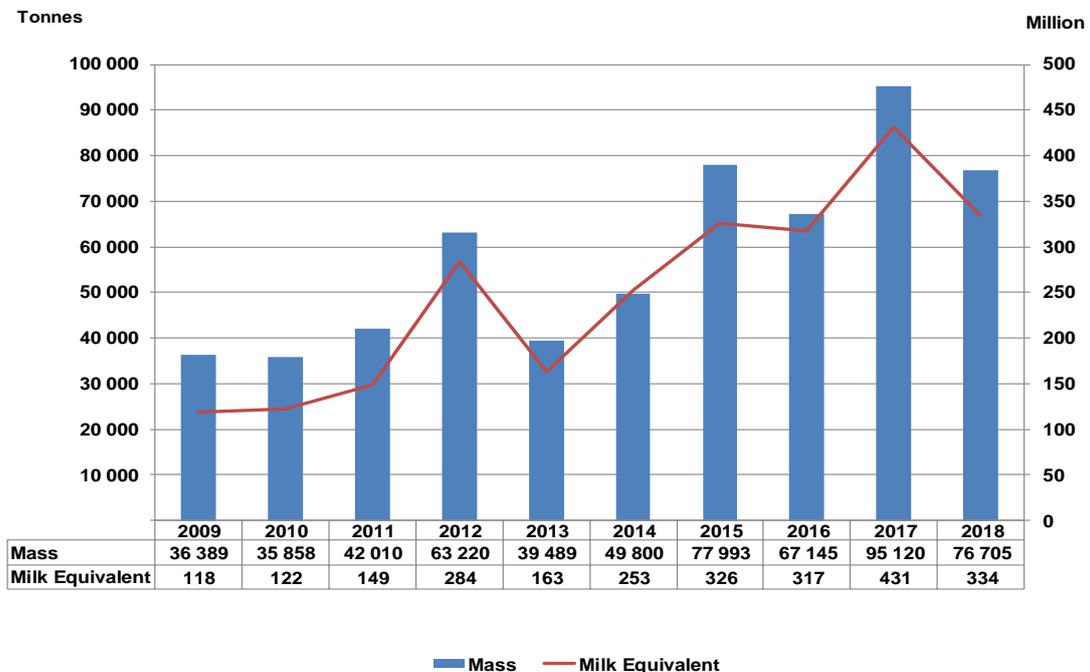


Figure 2 Annual imports, mass and milk equivalent basis, 2009-2018

Figure 2 illustrates the fluctuation in dairy imports on a mass and milk equivalent basis over the past 10 years. Imports for 2018 are at the same level as in 2015, registering a 19% drop in imports when compared to 2017. This is mainly due to reduced imports of UHT milk due to high levels of milk production in SA and the accelerated depreciation in the value of the rand in the second and third quarter of 2018.

Figure 3 illustrates cumulative dairy imports with January through March 2019 at very low level.

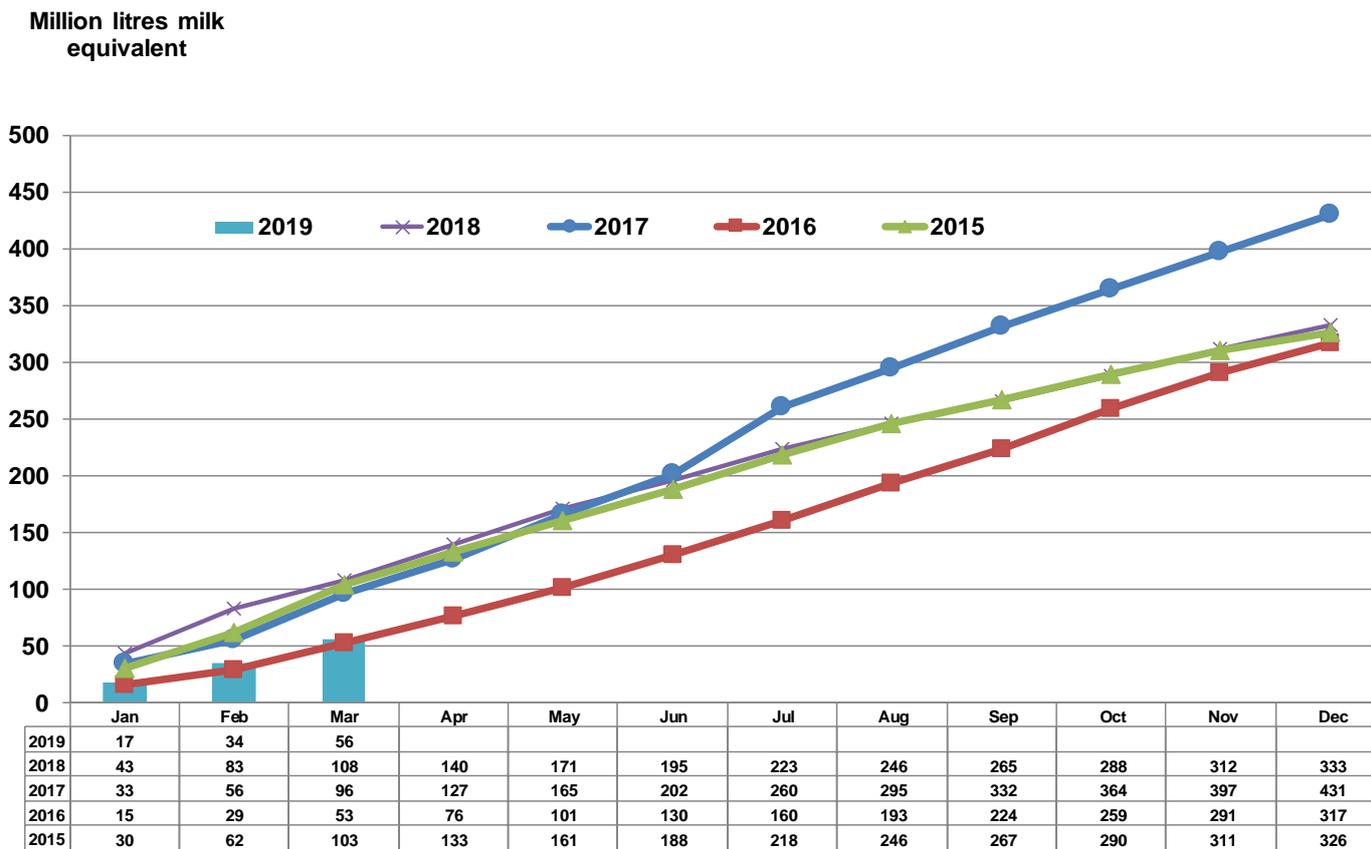


Figure 3 Monthly cumulative imports, (Mil. L.) milk equivalent basis

1.1 Dairy exports and sales to other SACU countries

Monthly cumulative exports on a milk equivalent basis are reflected in Figure 4 below. Cumulative dairy exports in March 2019 are slightly higher than in March 2018. Dairy exports in 2018 were slightly less than in 2017 (8 million litres).

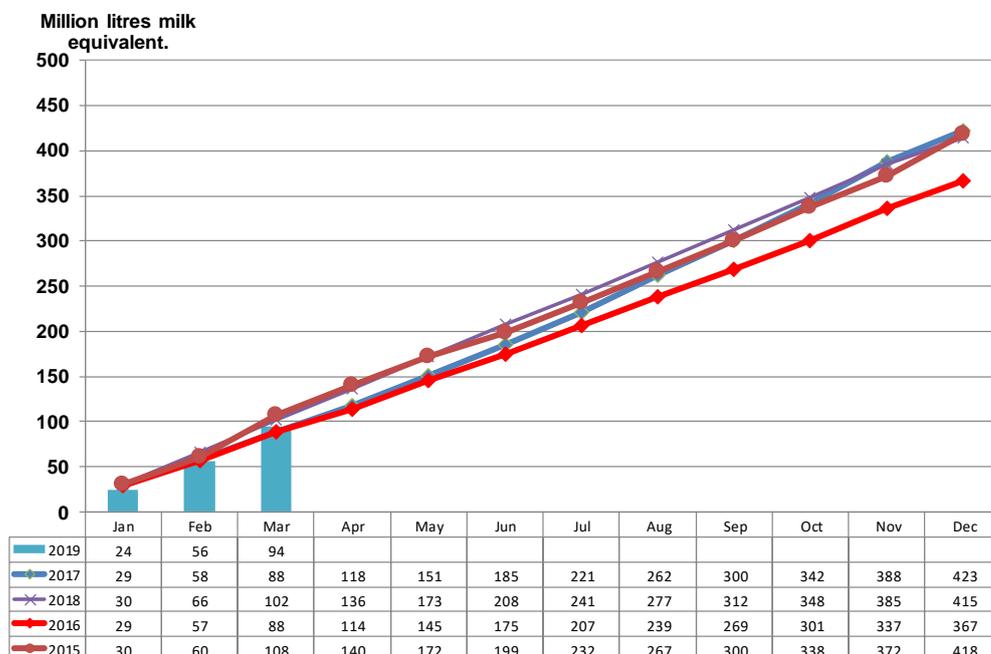


Figure 4 Monthly cumulative dairy exports (Mil. L.), milk equivalent basis

Source: Agrilnspec

1.2 Net exports (inclusive of sales to other SACU countries)

In March 2019 the SA dairy industry continued to be a net exporter of dairy products. A significant slow-down in imports for the first three months of 2019 is responsible for net exports realising strong growth. Cumulative net exports in March 2019 are 38 million/l compared to **-6** million/l in March 2018. The SA Dairy Industry regained its status as a net exporter of dairy products in 2018. Exports in 2018 exceeded imports with 82 million litres. Net exports in 2018 were higher than in 2017 and 2016 and only slightly below the level of 2015. Cumulative net exports (total exports less total imports) on a milk equivalent basis are shown in Figure 5 below.

Mil. L. ME

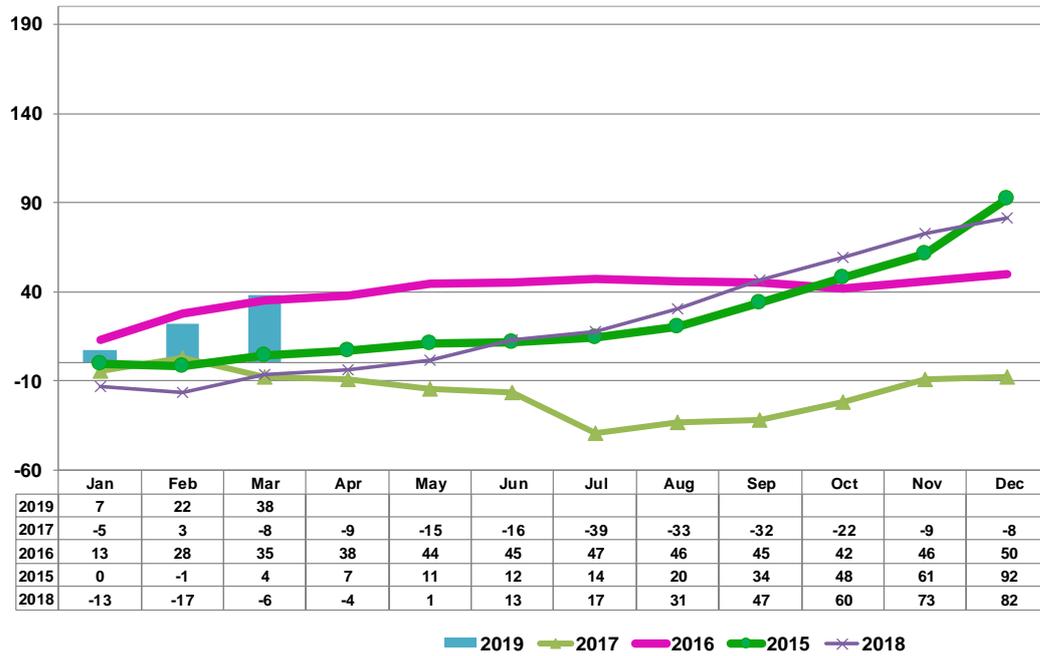


Figure 5 Cumulative net exports, milk equivalent basis (Mil. L.)

Source: *Agrilnspec*

1.3 Total milk supply

The total cumulative monthly milk supply, consisting of locally produced milk less net exports (total exports less total imports) is reflected in Figure 6. The total cumulative supply of milk in March 2019 is lower than in March of the previous four years except for 2016. The March 2019 supply is 11% lower than the March 2018 supply.

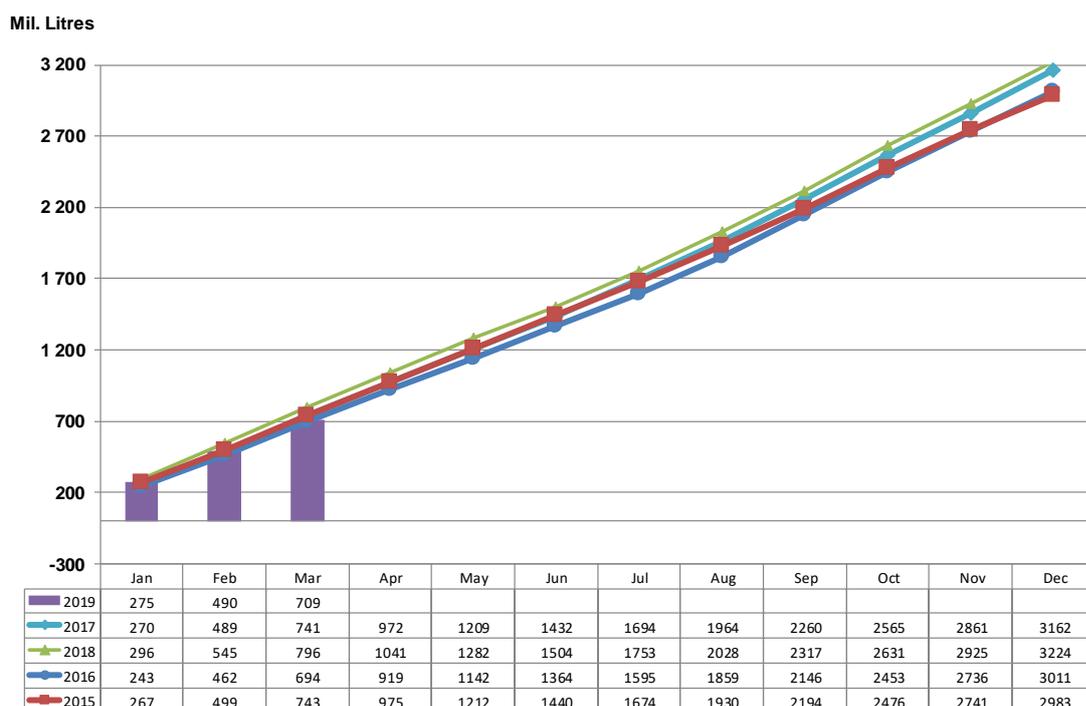


Figure 6 Total Cumulative monthly milk supply

Source: MPO calculation

1.4 Milk demand

Table 1 contains information with regard to the change in retail demand for dairy products for different periods. Demand for fresh milk in 2018 continued the downward trend of the previous 4 years while the demand for UHT milk and maas in 2018 showed strong growth and increased per capita consumption. Prepacked cheese, yoghurt and butter are increasing their market share. In the case of fresh milk the drivers of the downward trend are the changing profile of the traditional consumer and the profile of “new consumers”.

Table 1 Retail market growth, formal market

Product	Percentage growth for 12 months to:					
	Dec-13	Dec-14	Dec-15	Dec-16	Dec-17	Dec-18
Fresh milk	-5,9	1,2	-1,6	-3,9	-3,7	-5,2
UHT milk	8,0	4,1	14,4	1,0	9,0	14,5
Flavoured milk	1,5	-2,2	6,7	5,5	-6,7	5,8
Yoghurt	1,2	2,5	6,5	3,7	-0,1	3,1
Pre-packed cheese*	17,1	29,0	7,2	10,8	8,2	6,8
Butter	17,2	1,4	5,0	-2,1	-5,5	1,5
Maas		5,3	8,6	9,2	4,0	15,9

* Market movement from bulk to pre-packed cheese may have inflated figures in the past.

Source: Nielsen figures supplied by SAMPRO

1.4 Producer prices

Producer prices are indicated in Figure 7. Milk buyers have announced price increases from 1 March 2019 onwards. The price increases are on average 14% coming from a low base. The producer price is an estimated average producer price. Producer prices were under significant pressure from March through September 2018 falling 95 cents (19%) in seven months.

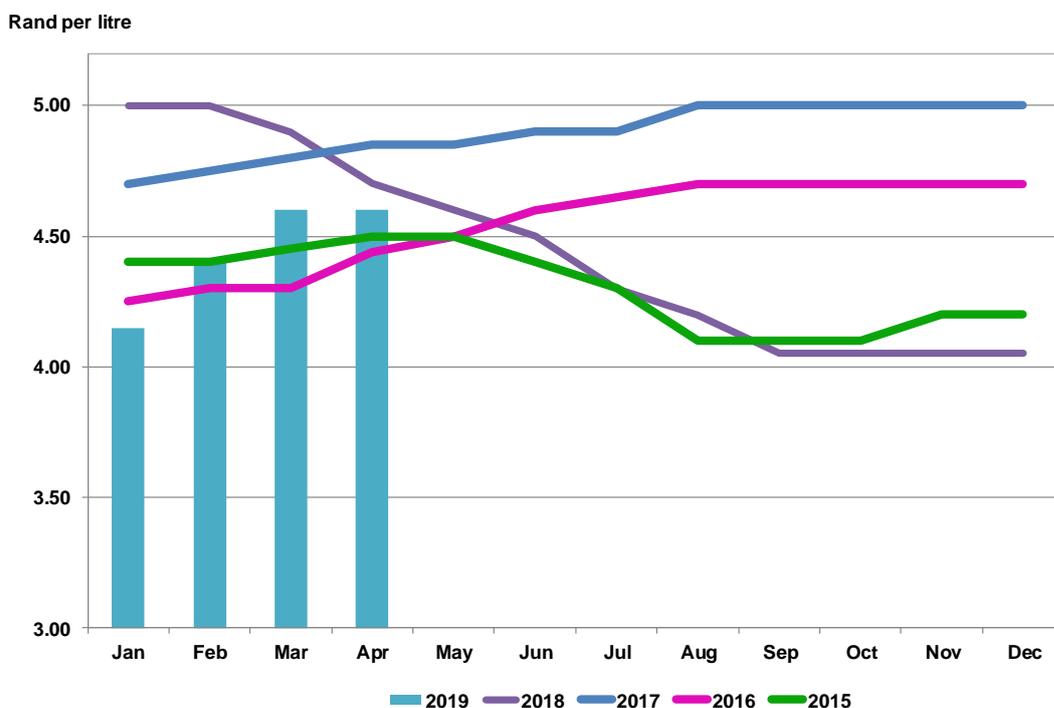


Figure 7 Monthly milk producer prices, 2015-2019

Source: MPO calculations

1.5 Retail prices

Retail prices of fresh milk in different packaging are supplied by the South African National Consumer Union (SANCU). The retail prices of fresh milk per litre for milk packaged in 2-litre plastic containers are compared to producer prices in Figure 8. The graph indicates that the spread was most favourable for retailers in July 2016 due to a strong uptick in retail prices while producer prices were kept level. The spread has bottomed out towards the end of 2017 and has been increasing again from April 2018 to July 2018. The spread has been moving sideways since August 2018 but is reducing since the beginning of 2019.

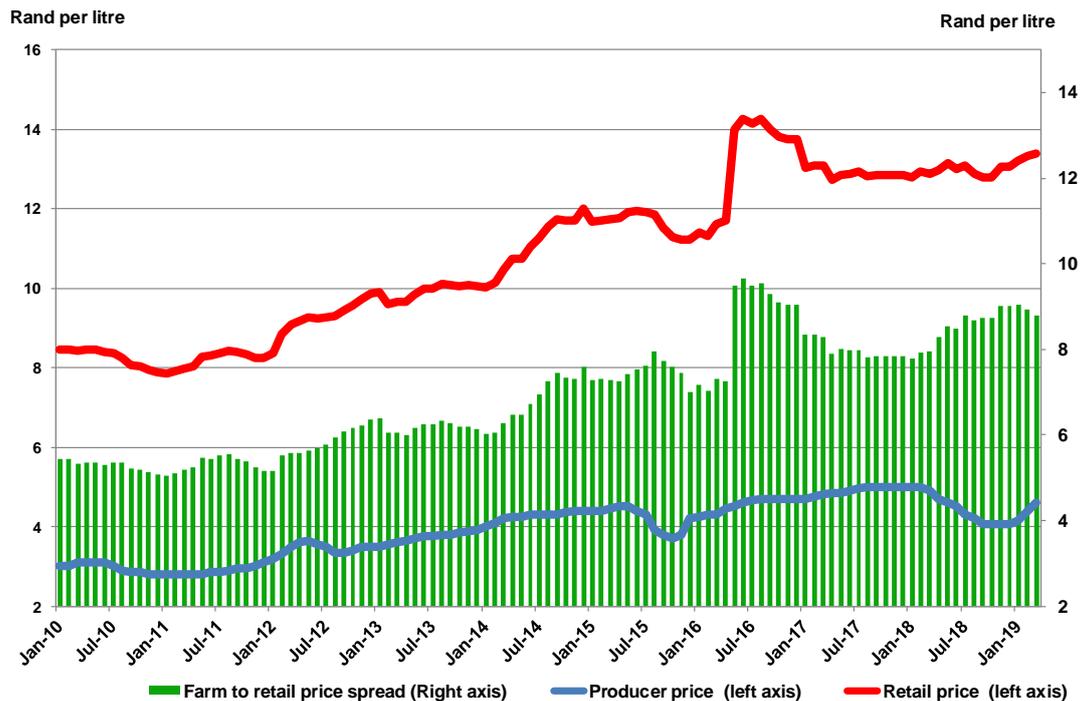


Figure 8 Monthly producer and retail prices, 2010- 2019

Source: MPO, SANCU

1.6 Feed prices

Feed cost is the most important cost item for milk producers. Internationally the price of maize and soybeans are used as a proxy for feed prices. A derived feed price is thus defined as the weighted price per kilogram of maize and soybeans (70% maize, 30% soybeans). Feed prices, based on Safex nearest month prices, are reflected in Figure 9. Farmers' production decisions are not based on absolute prices, but on relative prices. If producer milk prices decrease in relation to feed prices, farmers will tend to produce less, and if prices increase relative to feed prices, production will increase. Unfavourable milk: feed price ratios will result in slower production growth or lower production over time. The April 2019 milk: feed price ratio of 1.42 reflects higher producer price versus a slight decrease in soybeans and yellow prices. At a milk:feed price ratio of 1.4 milk production will be mildly stimulated with some farmers reaching breakeven and low profitability levels.

The upward trend in feed cost is clearly visible since July 2018 while December prices registered a spike as a result of late and inadequate rain in many summer crop producing areas. The spike was maintained in January 2019, prices pulled back slightly in February 2019 increased again in March and reduced slightly in April again.

The milk: feed price ratio is illustrated in figure 10.

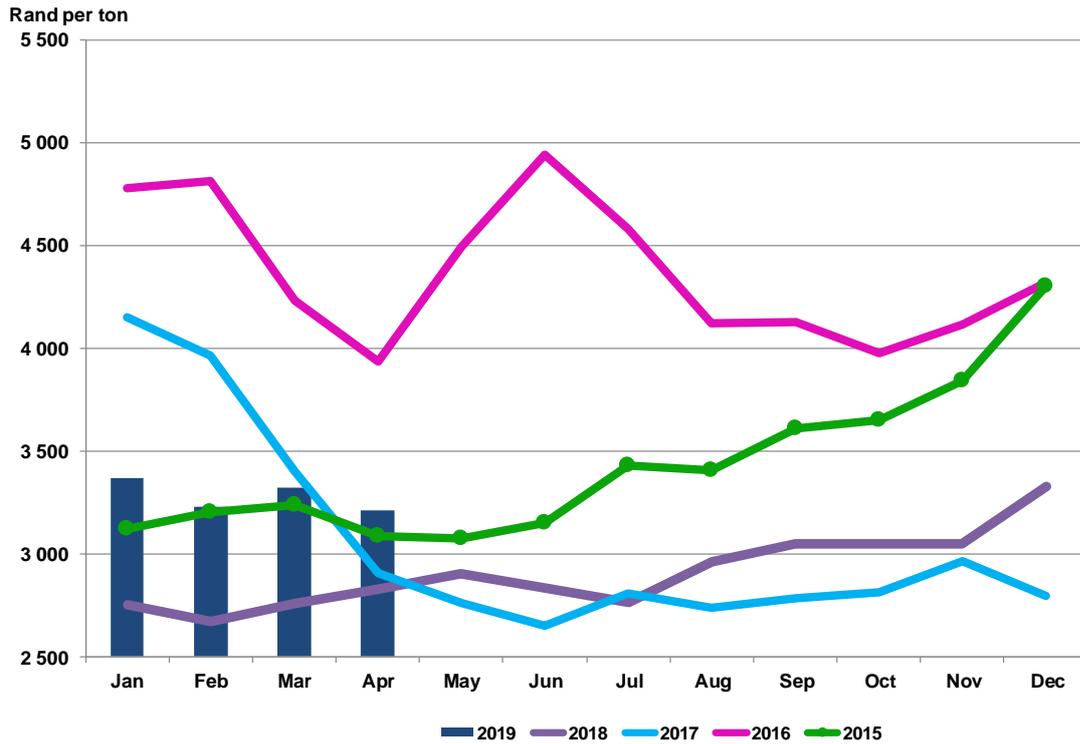


Figure 9 Calculated dairy feed prices, 2015-2019

Source: Safex nearest month data

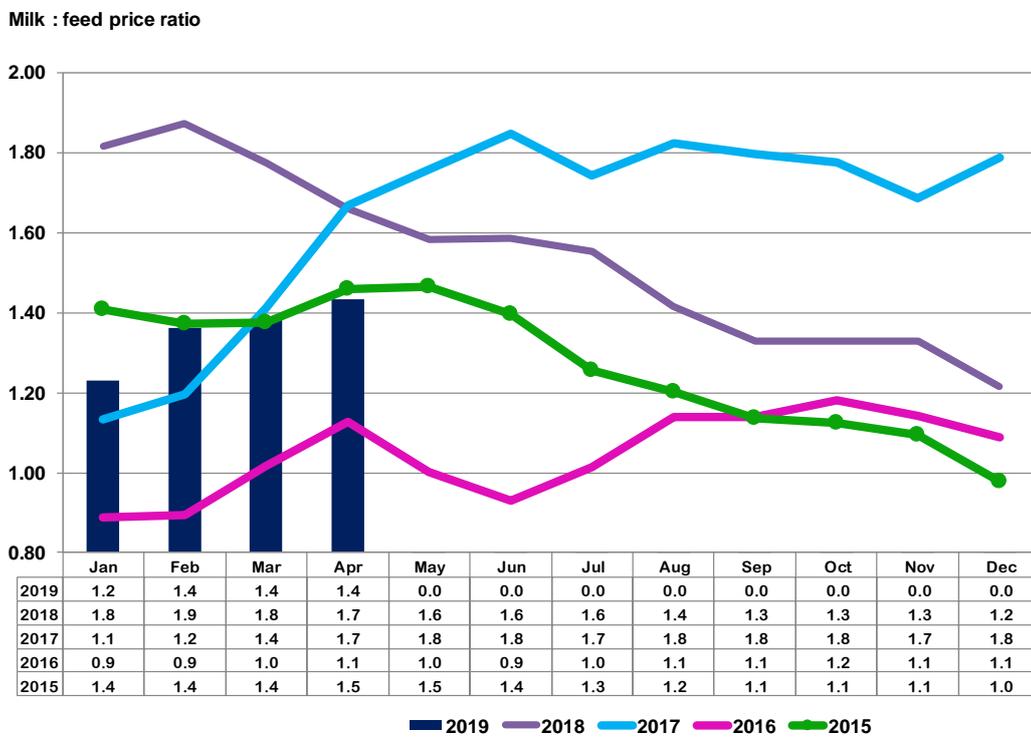


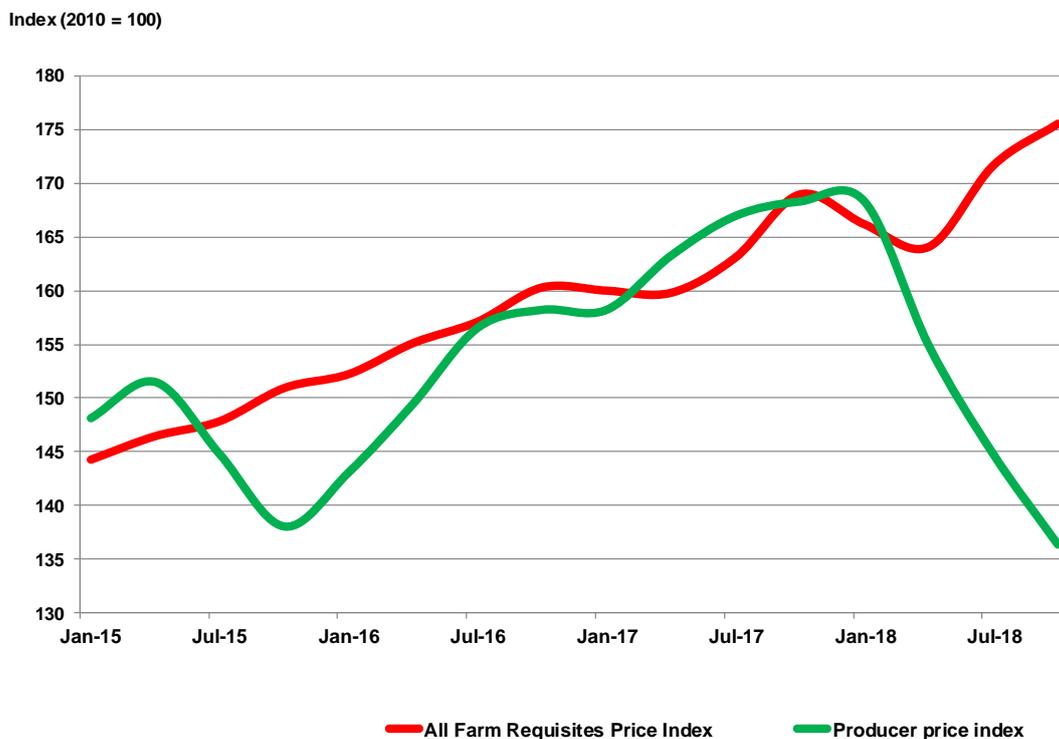
Figure 10 Milk: feed price ratio, 2015-2019

Source: MPO calculations

1.7 Input prices

The Department of Agriculture, Forestry and Fisheries publishes price indexes for farm requisites on a quarterly basis. As with all indexes, this index simplifies a very complex data-set to a level that does not correspond to individual farm data-sets. However, the trend in this index gives an indication of the direction of input price changes. The farm requisite index and producer price index are shown in Figure 11. The current development indicates that dairy farmers will feel the brunt of the cost price squeeze severely. Cost management will be crucial over the coming months and optimising energy utilisation will play a big role in containing costs.

The slope of the current downward trend in producer prices is more severe than the slope of the trend that occurred in July 2015 which resulted in financial difficulty for many farmers. The downward trend depicted in the All Farm Requisite Price Index from the beginning of 2018 was reversed in the second quarter of 2018 on the back of the continued weak rand resulting in amongst other higher fuel and fertiliser prices. The cost price squeeze in the third quarter of 2018 was severe in the dairy industry.



Source: DAFF, MPO calculation

Figure 11 Quarterly Farm Requisites Price Index and Producer Price Index

1.8 International prices

The price index of food and the other foodstuffs in figure 12 started to increase since middle 2016 (excluding sugar), as the world economy started with an expansive cycle that resulted in increased demand for food. There are shorter cycles evident within the different time series that are food type specific. The sugar spike was a result of adverse weather conditions in South America that created a shortage on the world market. The high volatility of the sugar market is clearly visible in the graph while the meat market exhibits a lower volatility compared to all the other foodstuffs.

The FAO Food Price Index (FFPI) is holding steady. The sharp increase in dairy products and somewhat firmer meat prices were offset by the decline in cereal and sugar prices. The March 2019 FFPI is 3.6% down from the corresponding period last year.

The dairy index shows strong growth since the middle of 2016. There are shorter cycles during this period and currently dairy prices are trending upwards with the butter price leading the pack. In December 2018 the dairy product price index was 170 points and increased to 204.3 points in March 2019 (20%). Increased dairy product prices are underpinned by increased import demand due to the seasonal decline in milk production in Oceania leading to the tightening of export availability from Oceania. The decline in milk production in Oceania is exacerbated by the drought in Australia. In the EU milk supply fell behind the level of the previous year providing further impetus to increased dairy prices. Milk production in most other important dairy exporting countries are also lagging behind or are stagnant.

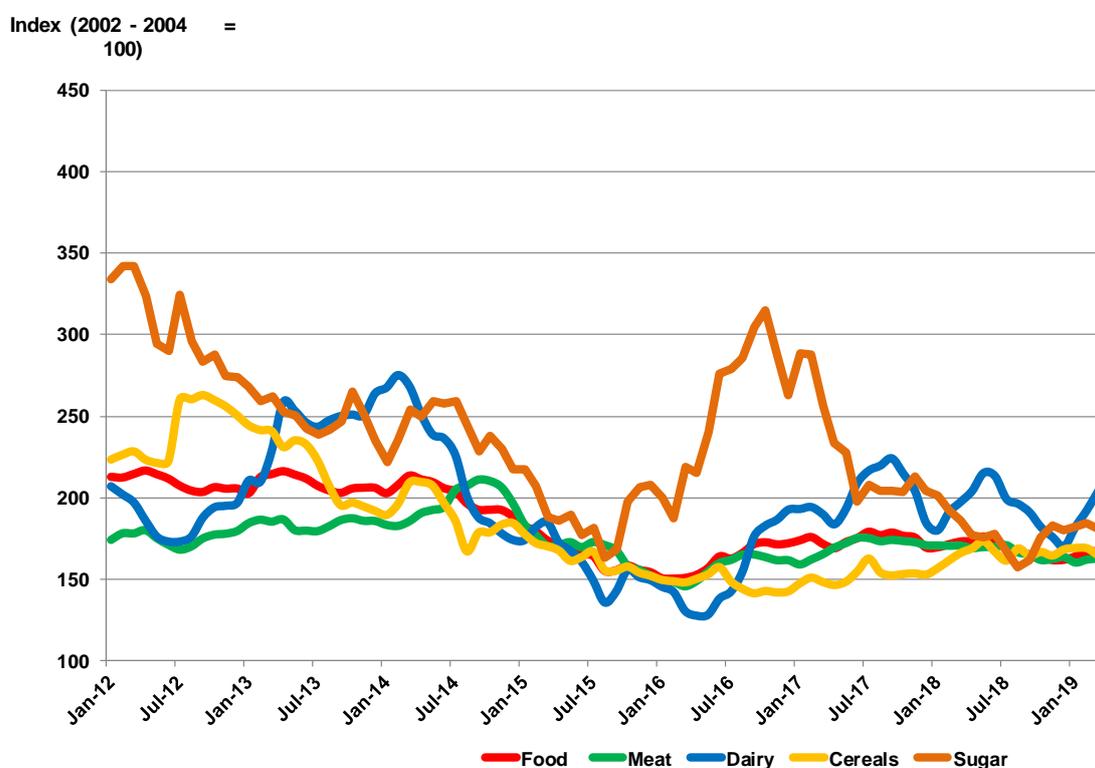


Figure 12 Monthly FAO food price indexes

Source: FAO food price index

Figure 13 shows the movement of the Global Dairy Trade (GDT) price index inclusive of April 2019. Price volatility reduced since the last quarter of 2016 and since then is trading between a support line at 900 index points and a resistance line at 1100 index points. The January 2019 price bounced off the support line (900 index points) and the upward momentum was continued in February and March with April showing a marked decrease in the upward momentum as prices get near to the resistance level. May will be indicative on whether the trend will test the resistance level of 1100 index points. On the back of the reduced momentum already detected in April, the probability of a strong breach of the resistance line is slim.

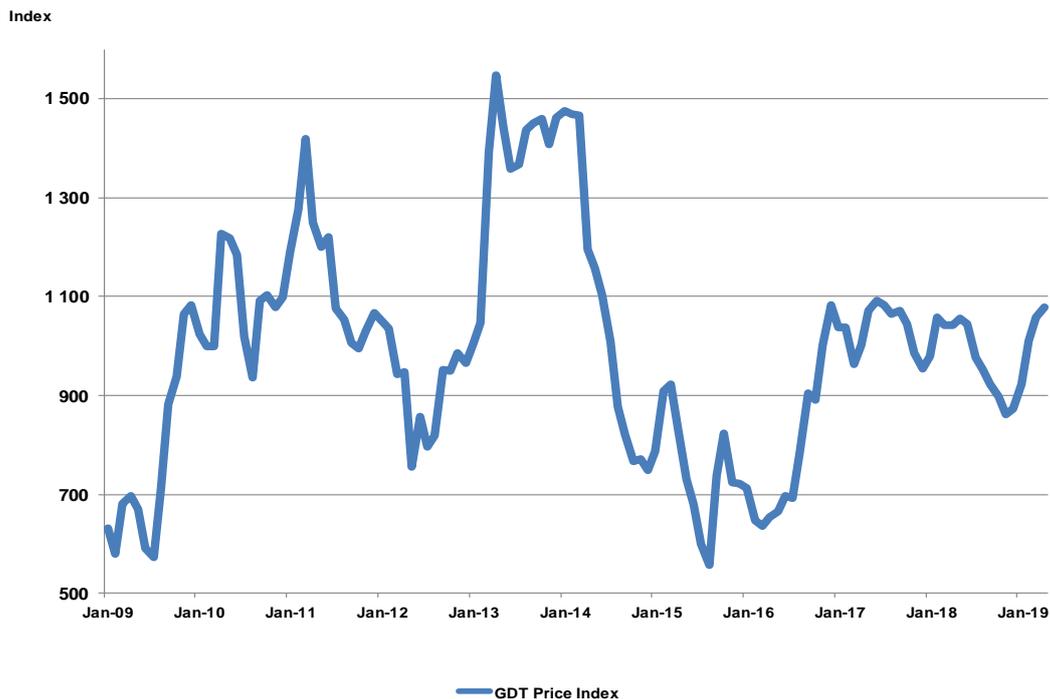


Figure 13 Global dairy trade-weighted price index

Source: Global dairy trade

Figure 14 shows international prices for milk powders, butter and cheddar cheese as reported by USDA in Rand/ton inclusive of April 2019. Three of the four dairy product prices are on an upward trend since December 2018. The EU dominated global cheese exports in the first two months of 2019 with the EU exporting more cheese than the next three countries combined: New Zealand, Belarus and the USA.

The SMP price in April turnaround and reduced with 7% in Rand terms. The US \$ price decreased by 5% which could mark the end of the run that the SMP price had since November 2018. The last SMP tender sale of EU intervention stock occurred on 16 April 2019 when 1 140 metric ton (Mt) remaining from European intervention stock was available. Bids ranged from 1 581 to 1 666 euros/Mt. The outcome was 33 Mt sold by Finland for 1 660 euros/Mt (R26 211/Mt). The next sale will occur on 14 May 2019.

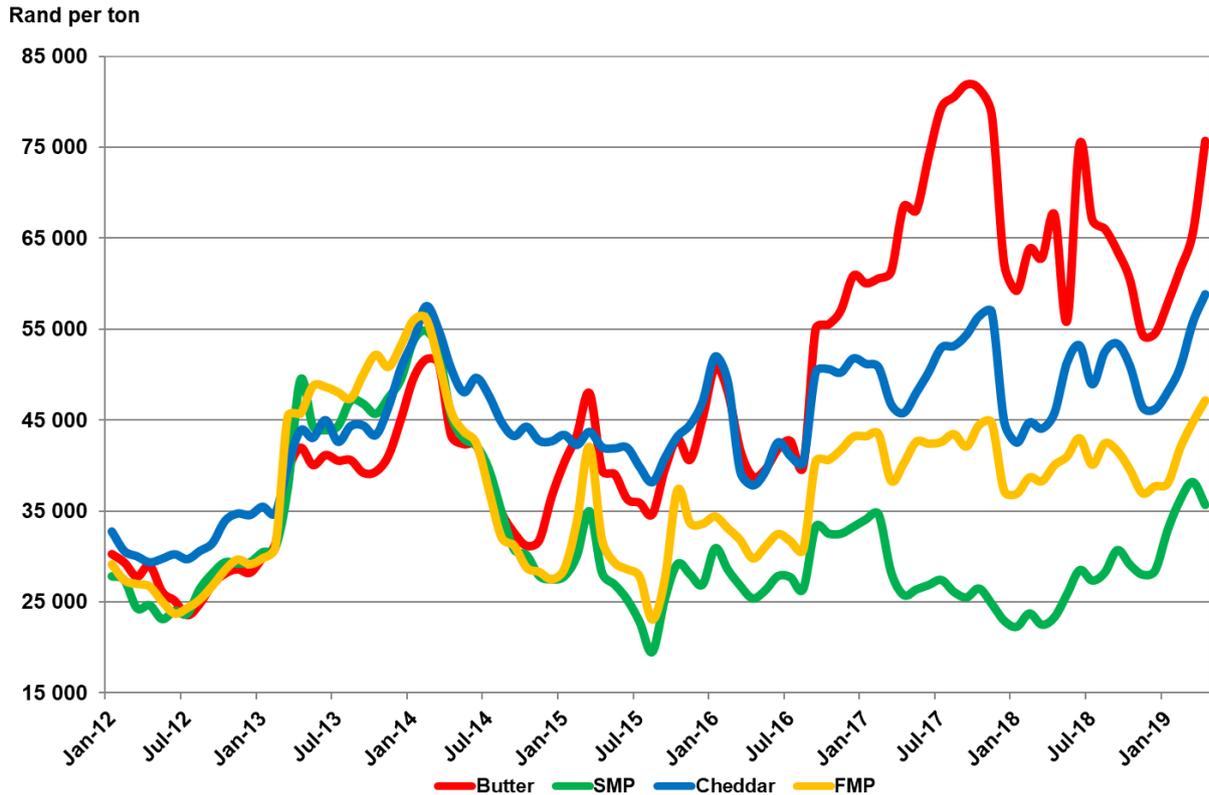


Figure 14 International dairy product prices (Rand/ton)

Source: USDA, SA Reserve Bank

1.9 Import parity and producer prices

Import parity is above the SA Producer price since August 2016.

The decrease in international product prices since September 2017 pushed import parity and SA producer prices closer but the reducing trend of the SA producer price since March 2018 and the Rand taking a beating from the US\$ created a large gap between import parity and the SA producer price of unprocessed milk.

The upward movement in international dairy product prices since December 2018 seems to offset the announced increases in producer prices in SA and the stronger Rand. The gap is increasing. A factor that can cause the import parity price to be somewhat inflated is the record butter prices experienced internationally.

The MPO's benchmark import parity is based on the published USDA prices, SA Rand/\$ exchange rates, standard import tariffs and import and production cost as supplied by industry sources. The calculation methodology is standardised and while import parity may differ for a specific importer, based on a specific import mix and individual cost structure, the trend indicated by the import parity index is applicable to all importers

Import parity and producer prices are reflected in Figure 15.

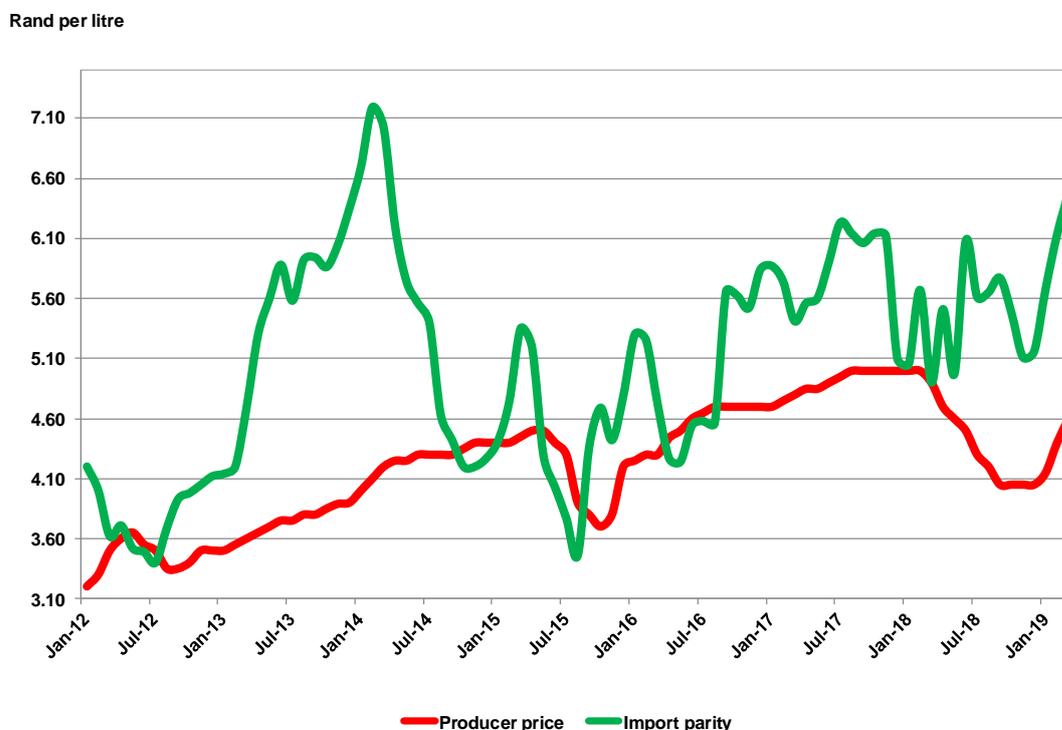


Figure 15 Monthly producer and import parity prices

Source: MPO calculations

Import parity and producer prices

Import parity at or below average producer prices implies that processors can import dairy products at current international prices at a lower price per litre than they have to pay local producers. An importing processor will still have to service the fixed cost on infrastructure and an importing retailer has to pay for packaging and manage returns.

2. Economic overview

2.1 International economic outlook

The global economic expansion has softened with 2018 estimated at 3.7% down from 3.8% in 2017. In the January 2019 publication the IMF again adjusted growth predictions slightly downward. The influencing factors are a softer momentum in demand in the second half of 2018 in countries like Germany and Italy, the contraction in Turkey being deeper than anticipated and the high level of public and private debt. The international economic growth and estimated growth is shown in Figure 16. SA is not participating adequately in the current expansion of the world economy or in the growth levels achieved in the emerging economies.

Although the projected growth for SA in 2019 and 2020 is higher than 2018 it is uncertain. Government remains unclear on policy with continued utterances of policy directions that failed in other countries and internal conflict regarding government’s role in the economy.

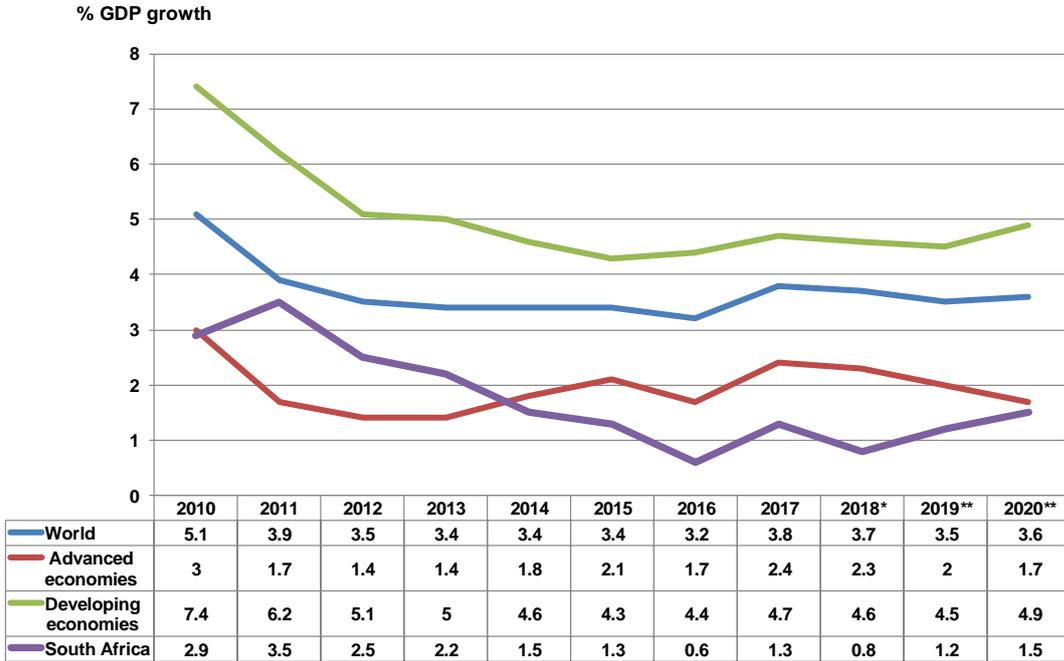


Figure 16 International economic growth and estimated growth

* Estimate ** Projection

Source: IMF WEO Jan 2019

2.2 South African economy

2.2.1 Economic activity and growth

Indicators of economic activity are provided by the SA Reserve Bank in the form of a co-incident, leading and lagging indicator. The monthly movement of the leading and co-incident indicator of economic activity is reflected in Figure 17. The leading indicator signals future economic activity while the co-incident indicator reflects what is happening now in the economy. The co-incident indicator reflects an uptick in the economy in October and registering a sideways move in November, while the leading indicator reflects a slowdown in economic activity in November and December.

Figure 18 shows the quarterly growth rate of the SA Gross Domestic Product (GDP). The growth rate for the fourth quarter of 2018 was 1,4%. The main contributors to the growth were the manufacturing, finance, real estate and transport sectors. In contrast the catering, accomodation, wholesale trade, motor trade, construction and mining sectors contracted. GDP growth for 2018 was 0.9%

Index (2000 = 100)

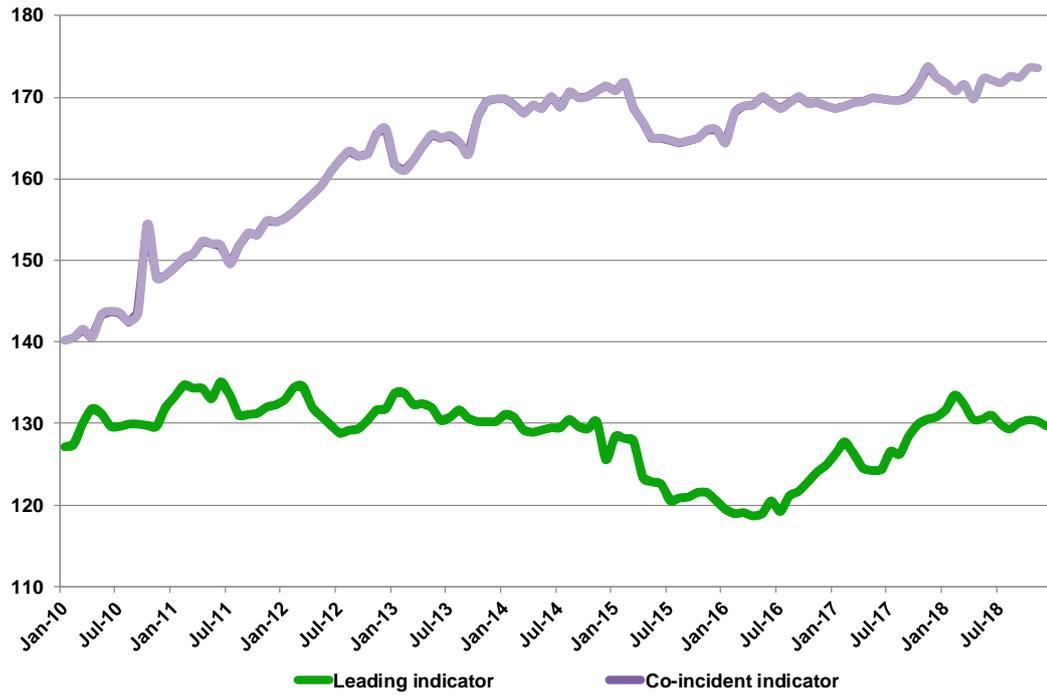


Figure 17 Leading and co-incident indicator of economic activity

ource: SARB

Annual % change

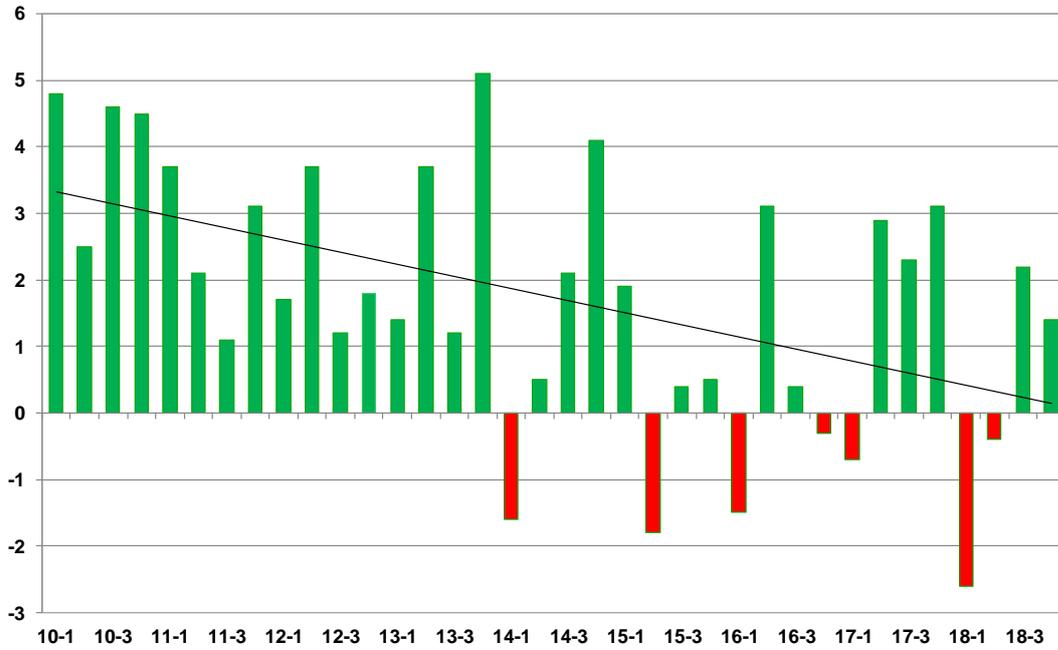


Figure 18 Quarterly change in real gross domestic product

Source: Stats SA

2.2.2 Household debt and income

Household debt at current prices as a percentage of house hold income has been on a steady decline since the first quarter 2008. Household debt decreased from 87.8 to 71.3 in the third quarter of 2018.

2.2.3 Inflation

The consumer price index and monthly inflation rate are reflected in Figure 19. A record low inflation rate in March 2018 enabled the South African Reserve Bank (SARB) to decrease the repo rate in March 2018. There was a slight upward trend in the inflation rate from March 2018 to July 2018, but the trend was reversed in August 2018 going down from 5.1% to 4.9%, September staying on 4.9%, rising to 5.1% in October and staying on 5.1% in November and a strong move down to 4.5% in December. The slowdown in the inflation rate for December is mainly due to the reduced price of fuel in December and the decrease in the price for food and non-alcoholic beverages flowing through to February 2019 with a further reduction in the inflation rate down to 4.1%.

The March inflation rate comes in at 4.5% with the main driver being increased fuel prices. Never the less, inflation is under control with the SARB doing a sterling job.



Figure 19 Consumer price index and consumer price inflation, 2007-2019

Source: Stats SA

3. The performance of the South African dairy industry in 2019 will especially be shaped by:

- Dynamic information flow and the objective interpretation of the market situation on a regular basis.
- The responsiveness downstream in the value chain regarding a balancing act between timeous producer price increases at the correct increments, levelling off at the rate time and level and increases in grain and other feed prices.
- The successful containment of the Foot and Mouth Disease outbreak in Vhembe and Mopani districts in Limpopo province.
- The occurrence of winter precipitation and early frost.
- The performance of the SA economy and the ability of the government to stop corruption.
- The reliability and availability of electricity.
- The New Zealand Future Exchange reflects stable prices for skimmed milk powder (SMP) and for full cream milk powder (FMP) over the next 9 months. Both anhydrous milk fat and butter are declining over the same period with butter declining from US \$5 625/t to US \$4 840/t (14%) and anhydrous milk fat from US \$6 000/t to US \$5 660/t (6%). The current mood in the market is that both butter and anhydrous milk fat is in good supply and that the exorbitant prices of 2017 and 2018 are something of the past.

The higher demand for food resulted in higher prices for food due to the world economy growing at 3.8% in 2017 and 3.7% in 2018. This stimulated the production of food creating increased supply. Prices started to decrease as supply met demand with volatility consequently decreasing and prices levelled off. The estimated growth of the world economy for 2019 is 3.5% and 2020 is 3.6% which could leave supply and demand in the food market close to balance barring any unexpected events in the big food producing countries/regions relating to climate, policies and politics.