MPO Pointer 5/2019 (12 Nov 2019)

Dairy farmers need to plan to grow unprocessed milk production with less than 2% per year.

This is obviously easier said than done but ultimately that is the only way in which businesses at the beginning of the value chain can create an environment where producer prices will be progressive. With the current drought and high summer temperatures production will most probably reduce already but the emphasis should be on the planning thereof in normal circumstances.

Planning per dairy farm needs to focus on optimizing the milk price as oppose to the trap of chasing turnover for as long as variable cost is covered. Optimizing the producer price of milk will be a long shot but it is the only way to create adequate capital yields. This is obviously complicated by the climate over which producers have no influence, the level of producer prices nine months down the line which is always a surprise for the farmer and many other factors.

Behaviour at dairy farm level is driven by as long as the operation covers variable cost and contribute some to fixed cost or only cover variable cost. Production will be maintained until surplus funds/borrowings covering the fixed cost are exhausted. The main driver here is safeguarding capital sunk into the business, but this behaviour exacerbates the problem of high production growth in unprocessed milk production. The behaviour is circumstance specific and way off the economic principle of optimum production where marginal cost equals marginal income. This circumstance seems to prevail more frequently and it is because of continued low producer prices.

The main contributing factor to low prices is that the growth in unprocessed milk production in SA is too high. Take the table below as an example.

The table below illustrates growth (%) in unprocessed milk production in the **major dairy exporting** countries and South Africa. SA is included in the table to provide perspective only, since we are not a noteworthy player on the international market.

	2015	**2016**	**2017**	**2018**
USA	**1.2**	**1.6**	**1.7**	**1.1**
EU	**2.1**	**0.2**	**2.1**	**1.4**
AUS	**2.2**	**-6.9**	**0**	**0.9**
NZ	**-1.4**	**-2.0**	**1.7**	**1.3**
ZA	**6.4**	**-0.5**	**3.0**	**4.8**

It is clear that the growth factor in unprocessed milk production in the major dairy exporting countries is small compared to that of SA. The typical numbers are one and two percent over the last four years indicating that these power houses in the international market strategize to limit unprocessed milk expansion despite being major players in the international market. There could be various market factors and combination of factors creating this phenomenon but most probably the ability to offload higher supply disrupts the market significantly with the end result that prices take a dive.

How to create a mind-set amongst dairy farmers to plan for only a two percent growth in unprocessed milk output is not covered in the pointer. The MPO would like to invite farmers to participate in a zoom discussion where input on the matter raised above can be provided. The date of the discussion will be announced in due course.

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