Dairy Market Trends December 2019

Executive summary

Producer price level: If the below sets of data, trends and statistics in the executive summary do not create upward movement in the producer price one can assume that supply is adequate and that the primary sector needs to plan to grow production with zero percent in 2020.

Unprocessed milk production for December 2019 is estimated at 304 million litres, 1,5% less than in December 2018. Milk production in December contracted. Cumulative unprocessed milk production for 2019 (inclusive of December) is 3 419 million litres indicating a marginal growth of only 0,23%.

The primary industry is clearly haemorrhaging due to the cost price squeeze, which is exacerbated by the unfavourable climatic and economic conditions. The low producer price for unprocessed milk together with the price increases of yellow maize and soya beans reduced the milk to feed price ratio to levels where the majority of dairy farmers will not break even. The double dip in the above ratio that farmers experienced in 2019 will have a prolonged effect on supply.

International availability:
Changes (%) in cumulative unprocessed milk production in the major dairy exporting countries and South Africa 2015 – 2019 (2019 only first 11 months) is reflected in the table below. SA first 12 months, last two preliminary. Milk production at farm level is down for all the major exporting countries.

<table>
<thead>
<tr>
<th></th>
<th>2015</th>
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</tr>
</tbody>
</table>

International producer price trends:

The result of the above low growth factors can be viewed in the upward trend in the producer prices in the USA, EU and New Zealand in the graph below.
The marked convergence of producer prices since middle 2017 with producer prices staying within the 30 to 35 Euros per 100kg price band seems to be something of the past. Producer price volatility is emerging again reflecting to a larger extent country specific industry circumstances. In the above graph prices are pointing north.

Since the beginning of 2018 USA producer prices are on an upward trend with prices breaking through 35 Euros per 100kg in March 2019 and now going north of 45 Euros per 100kg. The low growth in unprocessed milk production in the USA is clearly fuelling the upward trend. Producer prices in the EU have been moving sideways since the beginning of 2019 but are now showing some upward momentum while New Zealand prices sliced through the 30 Euros per 100kg level in November 2019 showing some kinetic energy in reserve.

International dairy commodity price levels:

In dollar terms year on year - butter is up by 4%, SMP (skimmed milk powder) 50% and cheese 22%. FMP (full cream milk powder) in a counter cycle reduced by 23%.

In Rand terms all prices increased year on year - butter is up by 5%, SMP 51%, cheese 24% and FMP by 24%.

Imports, if available should be costly.

Farm to retail price spread:
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 spreads for September, October and November 2019 were at an all-time high.

SA Producer price:
Producer prices are indicated in Figure 7. The graph is calculated by the MPO based on information supplied by members and other role players, and is a national average. The current producer price (R4.30), which has been in place since Sept 2019, is at the same level as the producer price of July 2015 (R4.30). Using a different source – Stats SA: The producer price index for November 2019 of 130.2 points is at the same level as the producer price index for June 2015 of 128.2 points.
Demand side

The September year on year sales volumes and price changes are indicating that demand is more subdued than a year ago. Sales volumes are clearly under pressure with six of the nine products registering a negative growth, one product a small increase in volumes sold with the remaining two (yoghurt and maas) doing well. However, yoghurt and maas are not big volume players. Four product prices increased with less than inflation, two marginally more than inflation while three experienced more aggressive increases.

UHT milk that has been growing market share aggressively over the past three years with low price increases seems to be losing steam. Volumes sold in September 2019 is 9.3% lower than in September 2018. This will have a direct negative impact on the demand for unprocessed milk. Consumer spending has been under pressure for some time and will remain under pressure which will influence dairy demand negatively.

The UHT price increase over the 24 month period from September 2017 to September 2019 was 9.6% and over the 18 month period from March 2018 to September 2019 was 9.5%. The low price increases enabled UHT sales volumes to grow substantially but the low price increases set the stage for the product price to catch-up at some stage which appears to be happening now.

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.

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1. Milk supply, demand and prices

1.1 Milk production

Unprocessed milk production for December 2019 is estimated at 304 million litres, 1.5% less than in December 2018. Milk production in December contracted. Cumulative unprocessed milk production for 2019 (inclusive of December) is 3 419 million litres indicating a marginal growth of only 0.23%.

The primary industry is clearly haemorrhaging due to the cost price squeeze, which is exacerbated by the unfavourable climatic and economic conditions. The low producer price for unprocessed milk together with the price increases of yellow maize and soya beans reduced the milk to feed price ratio to levels where the majority of dairy farmers will not break even. The double dip in the above ratio that farmers experienced in 2019 will have a prolonged effect on supply.

Monthly milk production is reflected in Figure 1 below.

![Monthly milk production graph](image)

**Figure 1** Monthly milk production (‘000 L.).

*Source: Milk SA, November and December is preliminary*
1.2 Dairy imports

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 as a result of 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. Dairy imports started off slow in 2019 but picked up later in the year with the effect that the year to date imports for 2019 is at the same level as in 2018.
1.3 Dairy exports and sales to BLNS countries

Monthly cumulative exports on a milk equivalent basis are reflected in Figure 4 below. Dairy exports maintained the same volumes as in the previous years. The 2019 exports, year to date, is slightly higher than the previous four years. This is an indication that export markets are well looked after by the SA exporters and that the markets are satisfied with the product range and quality.
1.4 Net exports (Inclusive of sales to BLNS countries)

For the period ending November 2019, the SA dairy industry continued to be a net exporter of dairy products (net exports equal 85 million litres milk equivalent). 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 plus sales to BLNS countries less total imports) on a milk equivalent basis are shown in Figure 5 below.
### 1.5 Total milk supply

The total cumulative monthly supply of milk, consisting of locally produced milk less net exports (total exports inclusive of sales to BLNS countries less total imports) is reflected in Figure 6. The total cumulative supply of milk in November 2019 is at almost the exact level of 2018.
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</table>

Figure 6 Total Cumulative monthly milk supply  
*Source: MPO calculation*

### 1.6 Milk demand

Table 1 contains information with regard to the change in retail demand for different dairy products for the 12 month period from October 2017 to September 2018 compared to the 12 month period from October 2018 to September 2019 and the change in retail prices from September 2018 to September 2019. Only three of the nine products experienced a negative growth in sales volumes while four of the nine product prices increased with less than inflation. Four of the nine products experienced modest growth while yoghurt and maas had strong growth on the back of very low price increases.

Table 2 compares year on year September sales volumes and price changes. Sales volumes are clearly under pressure with six of the nine products registering a negative growth, one product a small increase in volumes sold and the remaining two doing well. Yoghurt and maas however are not big volume players. Four product prices increased by less than inflation, two marginally more than inflation while three with more aggressive percentages.

UHT milk that has been growing market share aggressively for the past three years with low price increases but seems to be losing steam as reflected in table 2. This will have a direct negative impact on the demand for unprocessed milk. Consumer spending has been under
pressure for some time and will remain under pressure which will influence dairy demand negatively.

The UHT price increase over the 24 month period from September 2017 to September 2019 was 9.6% and over the 18 month period from March 2018 to September 2019 was 9.5%. The low price increases over an extended time, set the table for the product price to catch up at some stage which appears to be happening now.

Dairy demand illustrated in table 1 is still positive despite the struggling SA economy and disposable income of consumers being under pressure, but the growth is subdued. An industry that can produce these levels of sales growth amid timid consumer financials needs to be looked after. The capacity in the value chain needs to be nurtured especially at farmer level given the multiplier effect up and down the value chain. If the industry can guard this capacity it will shine even more when proper economic growth is achieved in future.

**TABLE 1: PERCENTAGE CHANGE IN RETAIL SALES QUANTITIES FOR MAJOR DAIRY PRODUCTS FOR THE 12 MONTH PERIOD FROM October 2017 TO September 2018 COMPARED TO THE 12 MONTH PERIOD FROM October 2018 TO September 2019 AND THE CHANGE IN RETAIL PRICES FROM September 2018 TO September 2019**

<table>
<thead>
<tr>
<th>Product</th>
<th>Change in quantity sold</th>
<th>Change in retail prices</th>
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</thead>
<tbody>
<tr>
<td>Fresh milk</td>
<td>-3.2%</td>
<td>5.4%</td>
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<tr>
<td>Long-life milk (UHT)</td>
<td>4.2%</td>
<td>13.8%</td>
</tr>
<tr>
<td>Flavoured milk</td>
<td>4.0%</td>
<td>9.0%</td>
</tr>
<tr>
<td>Yoghurt</td>
<td>9.3%</td>
<td>2.2%</td>
</tr>
<tr>
<td>Maas</td>
<td>22.3%</td>
<td>1.9%</td>
</tr>
<tr>
<td>Pre-packaged cheese</td>
<td>4.6%</td>
<td>5.7%</td>
</tr>
<tr>
<td>Cream cheese</td>
<td>-0.3%</td>
<td>3.0%</td>
</tr>
<tr>
<td>Butter</td>
<td>5.3%</td>
<td>-1.2%</td>
</tr>
<tr>
<td>Cream</td>
<td>-2.8%</td>
<td>8.8%</td>
</tr>
</tbody>
</table>

Source: Nielsen figures supplied by SAMPRO

**TABLE 2: PERCENTAGE CHANGE IN RETAIL SALES QUANTITIES FOR MAJOR DAIRY PRODUCTS in the month of September 2019 versus the month of September 2018 AND THE CHANGE IN RETAIL PRICES FROM September 2019 TO September 2018**

<table>
<thead>
<tr>
<th>Product</th>
<th>Change in quantity sold</th>
<th>Change in retail prices</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fresh milk</td>
<td>-0.4%</td>
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<td>Long-life milk (UHT)</td>
<td>-9.3%</td>
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<tr>
<td>Flavoured milk</td>
<td>-6.2%</td>
<td>9.0%</td>
</tr>
<tr>
<td>Yoghurt</td>
<td>8.7%</td>
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Source: Nielsen figures supplied by SAMPRO
1.7 Producer prices

Producer prices are indicated in Figure 7. The graph is calculated by the MPO based on information supplied by members and other role players, and is a national average. The current producer price (R4.30), which has been in place since Sept 2019, is at the same level as the producer price of July 2015 (R4.30).

![Figure 7 Monthly milk producer prices, 2015-2019](image)

**Source:** MPO calculations

**Using a different source** – Stats SA: The producer price index for November 2019 of 130.2 points is at the same level as the producer price index for June 2015 of 128.2 points.
1.8 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 spread for September, October and November 2019 was at an all-time high.

![Figure 8: Monthly producer and retail prices, 2010-2019](image)

Source: MPO, SANCU

1.9 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 upward trend in feed cost is clearly visible since July 2018 and continued into 2019. The derived feed price for November 2019 compared to November 2018 is 20% higher and
compared to November 2017 23% higher. The derived feed price for December 2019 compared to December 2018 is 11% higher and compared to December 2017 32% higher.

The milk: feed price ratio is illustrated in figure 10. The ratio has been below 1,2:1 for the past three months and production will be slowing down. The effect will be limited in the short term but more severe in the medium term.

Figure 9  Calculated dairy feed prices, 2015-2019

Source: Safex nearest month data
1.10 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 developments early in 2019 indicate that the cost price squeeze has reduced slightly, however still at a severe level. 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 downward trend in producer prices during 2018 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. In the first quarter of 2019, the trend changed...
and continued down in the second quarter. The producer price index reflects the price increases at the beginning of 2019.

Figure 11  Quarterly Farm Requisites Price Index and Producer Price Index

1.11 International prices

The FAO Food Price Index in December 2019 is 4.4 points (2.5%) higher than the previous month marking the third consecutive month of increase. Buoyant prices in all the commodities, with the exception of cereals fuelled the index to its highest level since December 2014. However, as a whole the index is significantly lower (25%) than the peak in January 2011.

The Dairy price Index is 3.3% up from November 2019. Cheese prices surged with 8% in December 2019 once again underpinned by strong global import demand with tight export availability from the EU and Oceania. Skimmed milk powder prices pointed higher in December 2019 while in contrast weak global demand for butter and full cream milk powder resulted in softer prices in December 2019. The overall index level indicates marked buoyancy in the dairy market that was present from January 2019 mainly due to limited export availability while demand is holding steady. World economic growth in the fourth quarter of 2019 slowed down marginally while demand for food was maintained. Export availability from the major export
countries and regions was tight (lower supply) providing momentum for the dairy index to point north. Growth in milk production in Western Europe was less than expected due to low feed quality and quantity, a result of adverse weather the previous year. Milk production in Australia continues to struggle due to the nationwide fire crisis and adverse climate conditions. Fires started burning in Australia last year in May and very few people expected they would continue into January 2020. Estimates are that 70 000 dairy cows were killed due to the fires. In New Zealand agricultural lenders are increasingly concerned about dairy producer debt. This has led to conservative lending practices that could have curtailed milk production growth in 2019. In 2019 milk production in South America began very slowly in the first half of 2019, picking up in the second half but not reaching the same levels as in 2018. Unfavourable weather conditions in the first half of 2019 being the culprit. Growth in milk production in the US was subdued mainly due to the restructuring of the industry on the back of a period of low producer prices resulting in small dairy farmers exiting the industry.

![Monthly FAO food price indexes](source)

The Global Dairy Trade platform is an online auction through which large volumes of dairy products can be sold or bought. There are two trading events per month where people across the globe can enter bids or offers.

Figure 13 shows the movement of the Global Dairy Trade (GDT) price index inclusive of December 2019. There is a clear price support level at 900 index points and a price resistance level at 1100 index points. The December price slowed down once again confirming the 1100 resistance level.
Figure 14 shows international prices for milk powders, butter and cheddar cheese as reported by USDA in Rand/ton inclusive of December 2019. The upward trend for dairy product prices since the beginning of 2019 was led by cheese with butter providing further momentum. This trend reversed in June and July with all product prices reducing but maintaining levels higher than in July 2018 with the exception of butter which is lower. In August 2019 prices for all dairy products increased in both US Dollar and Rand terms.

In September 2019, both butter and SMP (skimmed milk powder) prices strengthened in Dollar terms while the prices for full cream milk powder (FMP) and cheddar softened. In October SMP prices strengthened with a further 8% in Dollar terms, full cream milk powder with 2%, butter stayed the same while cheddar prices decreased with 6%. In Rand terms, price behaviour in October 2019 was similar due to the R/$ exchange rate being stable between September and October.

Although December 2019 prices for all the monitored dairy products decreased in dollar terms except for cheese, prices remain at high levels (excluding FMP). This is mainly due to the poor growth in unprocessed milk production in the major dairy exporting countries that is creating uncertainty in the world market regarding product availability.

In dollar terms year on year butter is up by 4%, SMP 50% and cheese 22%. FMP in a counter cycle reduced by 23%.
In Rand terms all prices increased year on year butter is up by 5%, SMP 51%, cheese 24% and FMP by 24%.

1.12 Import parity and producer prices

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.

The current difference in import parity and SA producer prices reduced from the extreme level registered in May 2019 but is still very high.
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. Changes in cumulative unprocessed milk production in the major dairy exporting countries

Changes (%) in cumulative unprocessed milk production in the major dairy exporting countries and South Africa 2015 – 2019 (2019 only first 11 months). SA first 12 months, last two preliminary.

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Milk production at farm level is down for all the major exporting countries. This provides illumination on the strong increases in international dairy product prices for 2019 and the current nervousness on the Global Dairy Trade Index.

3. Economic overview

3.1 International economic outlook

Global growth is projected to rise from an estimated 2.9 percent in 2019 to 3.3 percent in 2020 and 3.4 percent for 2021—a downward revision of 0.1 percentage point for 2019 and 2020 and 0.2 for 2021 compared to those in the October World Economic Outlook (WEO). The downward revision primarily reflects negative surprises to economic activity in a few emerging market economies, notably India, which led to a reassessment of growth prospects over the next two years. In a few cases, this reassessment also reflects the impact of increased social unrest. Intensifying social unrest in several countries posed new challenges, as did weather-related disasters—from hurricanes in the Caribbean, to drought and bushfires in Australia, floods in eastern Africa, and drought in southern Africa.

Despite these headwinds, some indications emerged toward year-end that global growth may be bottoming out. Moreover, monetary policy easing continued into the second half of 2019 in several economies.

In the third quarter of 2019, growth across emerging market economies (including India, Mexico, and South Africa) was weaker than expected at the time of the October WEO, largely due to country-specific shocks weighing on domestic demand. The global growth trajectory reflects a sharp decline followed by a return closer to historical norms for a group of underperforming and stressed emerging market and developing economies (including Brazil, India, Mexico, Russia, and Turkey).

In sub-Saharan Africa, growth is expected to strengthen to 3.5 percent in 2020–21 (from 3.3 percent in 2019). The projection is 0.1 percentage point lower than in the October WEO for 2020 and 0.2 percentage point weaker for 2021. This reflects downward revisions for South Africa (where structural constraints and deteriorating public finances are holding back business confidence and private investment) and for Ethiopia (where public sector consolidation, needed to contain debt vulnerabilities, is expected to weigh on growth).

The SA 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.
3.2 South African economy

3.2.1 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.

Figure 18 shows the quarterly growth rate of the SA gross domestic product. The SA economy contracted with 3.2% in the first quarter of 2019, in the second quarter a growth rate of 3.1% was achieved and in the third quarter contracted once again with 0.6%. The SA economy is set for marginal growth of less than 0.5%. The continued struggle between the factions in the ANC regarding the role of government in the economy leaves investors out in the cold. The magnitude of the decay in government departments and parastatals has been under estimated and will take longer to fix.
**Indicators of economic activity**

The coincident indicator of economic activity show whether the economy is in an upwards or downwards phase of the business cycle. The current slow downwards trend indicates a slowdown in economic activity. The leading indicator shows possible changes in economic activity in future. The decreasing trend points towards still lower economic growth in future.
3.2.2 Household debt and income

Household debt at current prices as a percentage of household income has been on a steady decline since the first quarter of 2008. Household debt decreased from 87.8 to 71.3 in the third quarter of 2019.

3.2.3 Inflation

The consumer price index and monthly inflation rate are reflected in Figure 19.

Annual consumer price inflation was 4.0% in December 2019, up from 3.6% in November 2019. The consumer price index increased by 0.3% month-on-month in December 2019. The main contributors to the 4.0% annual inflation rate were food and non-alcoholic beverages; housing and utilities; transport; and miscellaneous goods and services.
**Consumer price index (CPI) and inflation**
The CPI is the value of a basket of goods and services on retail price level. The change in the value of this basket compared to the same period a year ago is called the rate of inflation. The Reserve Bank tries to keep the rate of inflation between 3% and 6%.

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![Graph of Consumer price index and CPI %](image)

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

*Source: Stats SA*

### 4. Ruling factors

- The apparent inability of the dairy market to recognise the inadequate distribution of income in the value chain, with specific reference to the unrealistic low level of producer prices, is indicative of a lacklustre approach by some role players in the value chain. It seems that the future availability of raw product is of no concern and neither the direct and indirect labour force of the primary sector.
- The primary sector will have to consider available options.
- Unprocessed milk is likely to become one of the most volatile agricultural commodities in future (Outcome at the 2019 International Farm Comparative Network (IFCN) conference).
- This is because of:
1. the strong influence that small changes in the quantities available internationally have on world market prices;

2. the length of time before there are increases in milk production as a result of price changes; and

3. delayed reaction of demand to changing dairy commodity prices. The key challenges to making a reliable forecast of world market prices for milk are the nature of consumer reaction to rising milk prices and the response of dairy farmers with regard to supply, especially in low-cost dairy regions. The last part of this sentence is very applicable in SA.

- 50% of milk is sold as liquid products – retailers claim it a low margin product line limiting upward mobility in unprocessed milk producer prices.

- Production will increasingly be a function of comparative advantage. Geographical niches will exist especially near semi-urban areas and smaller cities as will certain product niches and milk types.

- Land values and competing enterprise dynamics will be at play especially as the optimization of the production factors are more exact and dairy farming squeezed on capital yields

- Farmers have been and are still being squeezed on optimisation while the same is not as amplified outside the farm gate. The model will have to be reviewed.

- Although UHT imports expressed as a percentage of production is negligible, it changes the mood in the market and negotiation tactics between retailers, processors and farmers. The balance of power from the milk farmer’s perspective seems to tilt even more towards the processors and other role players further down the value chain once UHT imports start to arrive. This will continue to frustrate farmers.