SUMMARY OF THE KEY MARKET SIGNALS FOR THE DAIRY INDUSTRY

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SYNOPSIS

Following the major changes in the world due to Covid, the situation in the world changed dramatically at the end of February 2022, due to the invasion of Ukraine by Russia and the reactions of other countries to the invasion. These developments and other developments like the increased tension between the Western world and China:

- *Dramatically increased the level of uncertainty about future developments in the world; and*
- *Impacted negatively on economic growth in the world, prices of food, other products and energy, international trade and trade relations between countries.*

The duration and outcome of the conflict created by Russia is unknown, and further escalation of the conflict and the negative impact of the conflict on economic growth in the world, is possible. It is known that even when the conflict comes to an end, some of the negative consequences of the conflict, will continue in the medium term and most likely also in the long term.

The price index for dairy products of the Food and Agricultural Organisation (FAO), which measures the price movements of a basket of dairy products in the international market, increased in 2021 to levels higher than in the previous seven years. This increase continued in the first half of 2022, but from June 2022 to May 2023, it decreased by 20.97 percent to a level 17.68 percent lower than May 2022, 1.98 percent lower than in May 2021 and 25.74 percent higher than in May 2020.

According to the FAO, the reduction in the price index of dairy products, is "principally due to ample export availabilities, including from inventories, amid seasonal high milk production in the northern hemisphere".

The prices of unprocessed milk in the EU, increased sharply in 2022 and in the USA, it increased sharply in the first half of 2022. Following these increases, the prices of unprocessed milk in the EU and the USA, decreased sharply. In May 2023, the average price of unprocessed milk in the EU was 2.91 percent lower than in May 2022.

The performance of the South African economy in recent years, was disappointing and the Gross Domestic Product (GDP) in 2022, was only 0.26 percent higher than the GDP in 2019. If the GDP grows by 0.3 percent in 2023, as expected by the Reserve Bank, the GDP in 2023 will only be 0.56 percent higher than in 2019. This position and the high unemployment rate in South Africa, does not support optimistic views about the demand for consumer products, including dairy products, in the immediate future.

In 2020, in the situation created by COVID and the lockdown measures of Government, the performance (in terms of sales quantity and retail price), in the South African retail market of specific dairy products namely, UHT (long life) milk, yoghurt, maas, pre-packaged cheese, cream cheese, butter and cream, were higher than in 2019, while the opposite was true in respect of fresh and flavoured milk.

SYNOPSIS (Continued)

In the February 2021 edition of the "Summary of the Key Market Signals for the Dairy Industry", it was stated that it should not be assumed that the good performance of most dairy products as achieved in 2020, will continue as, amongst other, "the lower level in South Africa of economic activity resulting from COVID, and of which the full extent will only be known later", can impact negatively "on the demand for food products including dairy products".

The good performance of dairy products in the South African retail market in 2020, did not continue in 2021, in 2022 and in the first quarter of 2023 (the latest available information is in respect of March 2023).

In 2021, the retail sales quantities of eight of the nine dairy products, of which the retail sales are monitored, were lower than in 2020.

In 2022, the retail sales quantities of six of the nine dairy products, namely fresh milk, flavoured milk, yoghurt, cream cheese, butter and cream, were from 2.1 to 7.7 percent lower than in 2021, while the retail sales quantities of three of the dairy products, namely UHT milk, maas and pre-packaged cheese, were from 0.05 to 1.2 percent, higher. The retail sales prices of the nine dairy products increased in the year which ended in December 2022, with from 6.7 percent to 13.2 percent. The price increases of eight of the nine dairy products were higher than the inflation rate of 7.2 percent in the year which ended in December 2022, but lower than the inflation rate of processed food of 15.7 percent in the same period.

The retail sales quantities in the year which ended in March 2023, of eight of the nine dairy products, namely fresh milk, UHT milk, flavoured milk, yoghurt, pre-packaged cheese, cream cheese, butter and cream, were from 0.02 percent to 6.4 percent lower than in the previous year, while the retail sales quantity of maas, was 0.3 percent higher. The retail sales prices of the nine dairy products increased in the year which ended in March 2023, with from 10.9 percent to 24.1 percent. The price increases of four of the nine dairy products, were higher than the inflation rate of processed food of 16.2 percent in the year which ended in March 2023.

The decrease in the retail sales quantities of most dairy products in South Africa, is linked to the erosion of the purchasing power of consumers by widespread increases in the prices of consumer goods and services (including high increases of the prices of dairy products), poor service delivery by the public sector and weak economic growth during the last five years.

The producer price index of dairy products as published by Statistics SA, fluctuated from month to month and:

- *In the year which ended in December 2020, it increased by 1.60 percent;*
- *In the year which ended in December 2021, it increased by 10.66 percent;*

SYNOPSIS *(Continued)*

- *In the year which ended in December 2022, it increased by 12.12 percent; and*
- *From December 2022 to April 2023 (the latest information is in respect of April 2023), the producer price index of dairy products, increased with 7.3 percent to a level:*
  - *15.7 percent higher than in April 2022;*
  - *26.7 percent higher than in April 2021; and*
  - *30.3 percent higher than in April 2020.*

According to Milk SA, the mass of production in South Africa of unprocessed milk in 2021, was 0.71 percent lower than in 2020, 0.86 percent lower than in 2019 and 0.21 percent lower than in 2018. The decrease from 2020 to 2021, was due to lower production in seven of the first eight months of 2021. The production in the last four months of 2021, was respectively 1.3 percent, 1.9 percent, 2.8 percent and 1.4 percent higher than in the same months of 2020.

The lower production in South Africa of unprocessed milk in 2021, relative to the production in 2020, should be considered, taking into account:

- *The retail sales quantities in 2021, of most dairy products, were lower than in 2020 and thus the demand for unprocessed milk for the production of these dairy products, was also lower; and*
- *The sharp rise in the prices of feed for dairy cattle in the second half of 2020, of which the impact was limited by the increase in the price of unprocessed milk in the last quarter of 2020 and in the first half of 2021.*

The mass of the production of unprocessed milk in South Africa in 2022, was 1.56 percent lower than in 2021, 2.26 percent lower than in 2020 and 2.41 percent lower than in 2019.

The lower production of unprocessed milk in 2022, relative to 2021, is due to lower production in nine months and only the production in January, July and August 2022, being higher than in the same months of 2021.

In the first five months of 2023, the estimated mass of the production of unprocessed milk, was 1.88 percent lower than in the first five months of 2022, due to lower production in four of the five months (the latest available information is in respect of May 2023).

The lower production of unprocessed milk in 2022 and in the first five months of 2023, is linked to the lower demand for dairy products which determines the demand for unprocessed milk, the high costs of inputs required for the production of unprocessed milk and unfavourable weather in particular periods in major production regions.

SYNOPSIS (Continued)

The production of unprocessed milk in South Africa and in other countries, is seasonal. In South Africa, the highest production per day occurs in October or November and the lowest in April, May or June. The average difference between the highest and lowest production per day in the fourteen years from 2008 to 2022, was 34.4 percent.

The extent of the seasonal decrease in the production of unprocessed milk in South Africa from October 2021 to June 2022, of 30.5 percent, was higher than the average decrease of 23.6 percent in the same periods of the years 2008/2009 to 2021/2022, and also higher than the previous highest decrease of 27.7 percent, which was recorded in the period October 2020 to June 2021.

The seasonal decrease in the production of unprocessed milk, from October 2022 to April 2023, is according to estimated figures 35.4 percent, which is 60.90 percent higher than the average decrease of 22.0 percent in the same periods of the previous fourteen years and 24.1 percent higher than the previous record high decrease of 27.7 percent, which was recorded in the same months of 2021/2022.

The extent of the seasonal increase in the production of unprocessed milk in South Africa, in the fifteen years from 2008 to 2022, from July to October, varied from 24.2 percent in 2010, to 35.8 percent in 2021, while the average increase in the years 2008 to 2021, was 29.2 percent. According to figures of Milk SA, the increase from July to October 2022, was 31.9 percent, which is the fourth highest increase in the fifteen years from 2008 to 2022.

The producer price index of unprocessed milk, as published by Statistics SA, fluctuated from month to month and:

- *In the year which ended in December 2020, it increased by 10.57 percent;*
- *In the year which ended in December 2021, it increased by 10.32 percent;*
- *In the year which ended in December 2022, it increased by 16.39 percent; and*
- *From December 2022 to April 2023 (the latest available information is in respect of April 2023), the producer price index of unprocessed milk increased with 15.4 percent to a level:*
  - *17.1 percent higher than in April 2022;*
  - *32.1 percent higher than in April 2021; and*
  - *51.3 percent higher than in April 2020.*

The relationship between the producer price index of unprocessed milk and the index of the feed price indicator (feed for dairy cattle), is an important indicator at a macro level, of the level of encouragement for the production of unprocessed milk.

SYNOPSIS (Continued)

In 2022, the index of the feed price indicator moved close to the producer price index of unprocessed milk, but in January 2022 as well as from September 2022 to December 2022, the first mentioned was higher. This position, together with the sharp increases in the prices of other inputs such as fertilizers, fuel and electricity, offers less encouragement for the production of unprocessed milk, than in 2021 and in especially 2017, 2018 and 2019.

In the first four months of 2023, the relationship between the producer price index of unprocessed milk and the index of the feed price indicator, improved significantly due to the following:

- *The sharp decreases of the prices of maize and soya, which commenced in the last quarter of 2022; and*
- *The sharp increase of the price of unprocessed milk in the first four months of 2023.*

In April 2023, the relationship between the producer price index of unprocessed milk and the index of the feed price indicator, was much more favourable than in the previous three months of 2023 as well as in 2022, 2021, 2020 and 2019.

The future prices of yellow maize and soya, achieved in South Africa on 26 May 2023, for delivery from July 2023 to December 2023, indicate slight upward movement of the prices of yellow maize and soya.

In 2018, 2019, and 2020, the producer price index of unprocessed milk was at lower levels than the producer price index of dairy products. In 2021 and 2022, the producer price index of unprocessed milk was, respectively in nine and in ten months higher than the producer price index of dairy products. From January 2023 to April 2023 (the latest available information is in respect of April 2023), the producer price index of unprocessed milk was higher than that of dairy products.

The producer price index of unprocessed milk was, in the eight years from January 2015 to December 2022 and in the first quarter of 2023:

- *With the exception of one month in 2015, higher than the retail price index of UHT milk;*
- *Moved in 2016 and 2017, close to the retail price index of fresh milk, in nine months of 2018, in 2019, in 2020 and in seven months of 2021 it was lower, but from March 2022 to March 2023, the producer price index of unprocessed milk was higher than the retail price index of fresh milk;*
- *Higher than the retail price indices of pre-packaged cheese and maas; and*
- *With the exception of the period August 2018 to September 2018 and in the period November 2018 to February 2019, higher than the retail price index of yoghurt.*

SYNOPSIS (Continued)

The sharp increases in the prices of unprocessed milk and dairy products, should be considered taking into account the following:

> *Production costs do not determine prices, as prices are determined by the interaction between supply and demand, but production costs determine the quantity which will be supplied at a given price. The sharp price increases in respect of unprocessed milk and dairy products, as described above, were not intended to meet additional demand, as the demand for dairy products, which determine the demand for unprocessed milk, did not increase. Amidst sharp increases in the production costs of unprocessed milk and dairy products, the price increases were motivated by the need to maintain supply at a level close to the demand, which did not increase, as shown by the retail sales quantities for dairy products. It is highly likely that these price increases prevented significant decline in the production capacity of the South African dairy industry. Due to the demanding and complex nature of the dairy industry, it is very difficult to regain production capacity previously lost.*

The factual position that the South African dairy industry is confronted with, as shown by the information available up to 19 June 2023, corresponds to a large extent, with the factual position described in the November 2022 and February 2023 editions of "Summary of the Key Market Signals for the Dairy Industry". Key aspects of the reality in which the South African dairy industry has to operate in the rest of 2023, are:

- *High levels of uncertainty about future economic growth and political developments internationally and in South Africa;*
- *Interrupted supply of electricity which creates higher costs and other disruptions;*
- *Consumer purchasing power eroded by the widespread increases of the prices of consumer goods and services, poor service delivery by the public sector and lack of economic growth;*
- *Lower demand for most dairy products in terms of quantity and the expected growth of the Gross Domestic Product in 2023, does not support optimistic views about the demand for consumer goods, including dairy products, in the immediate future;*
- *Uncertainty about the extent of the negative impact in the next few months of the recent increases of the prices of dairy products, on the demand, in terms of quantity, for dairy products and thus, on the demand for unprocessed milk;*
- *Lower production of unprocessed milk in 2022, than in 2019, 2020 and 2021 and lower production in the first five months of 2023, than in the same months of 2022;*

SYNOPSIS ***(Continued)***

- *In 2022, the relationship between the index of the feed price indicator and the index of the producer price index of unprocessed milk, was very unfavourable. In the first four months of 2023, due to the significant increase of the index of the price of unprocessed milk and the significant decrease of prices of maize and soya, the extent to which the index of the producer price of unprocessed milk exceeded the index of the feed price indicator increased. In April 2023, the extent to which the producer price index of unprocessed milk exceeded the index of the feed price indicator, was higher than in the previous three months of 2023, as well as in 2022, 2021, 2020 and 2019;*
- *The seasonal increase in production of unprocessed milk, from July to October in the last fifteen years, varied from 24.6 percent to 35.8 percent. The seasonal increase from July 2023 to October 2023 of the production of unprocessed milk and thus the increase in the production of dairy products can, amidst the expected weak consumer demand, put downward pressure on the prices of dairy products and unprocessed milk in the coming months.*