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Coronavirus & the Dairy Sector: Impacts and Solutions

Current market issues

Coronavirus has caused some severe market disturbance in the dairy sector. The massive shift from food service to retail has created a huge divide in the sector. The businesses serving retail have seen unprecedented demand, whilst those supplying food service have seen their entire market decimated overnight.

The supply chain is too complex to simply redirect all product from food service to retail to match the pace of change. While some milk is being redirected, the uplift in retail has not made up for the loss of the foodservice market, and [AHDB](#) estimate overall demand for dairy products in GB is currently running around 2m litres per day lower than it was before the Covid-19 lockdown.

Those exporting dairy products have also encountered issues. Although borders are still open, there are significant delays and logistics issues being experienced around the world as well as drop in demand. There are many reports of product being stuck in ports or on lorries which given the perishable nature of dairy, means that it may not reach its final destination.

The pre-Coronavirus market

Prior to the outbreak, the dairy market had been stable and trending upwards. Cheese markets have seen a historic period of strong performance and commodities were doing well. For example, the price for milk powder was at its highest for around six years in January 2020. The liquid milk market has faced challenges in the past couple of years, but again was showing signs of recovery. Indeed, a number of processors in the liquid market had announced price increases in February.

Surely people are still consuming the same amount of dairy?

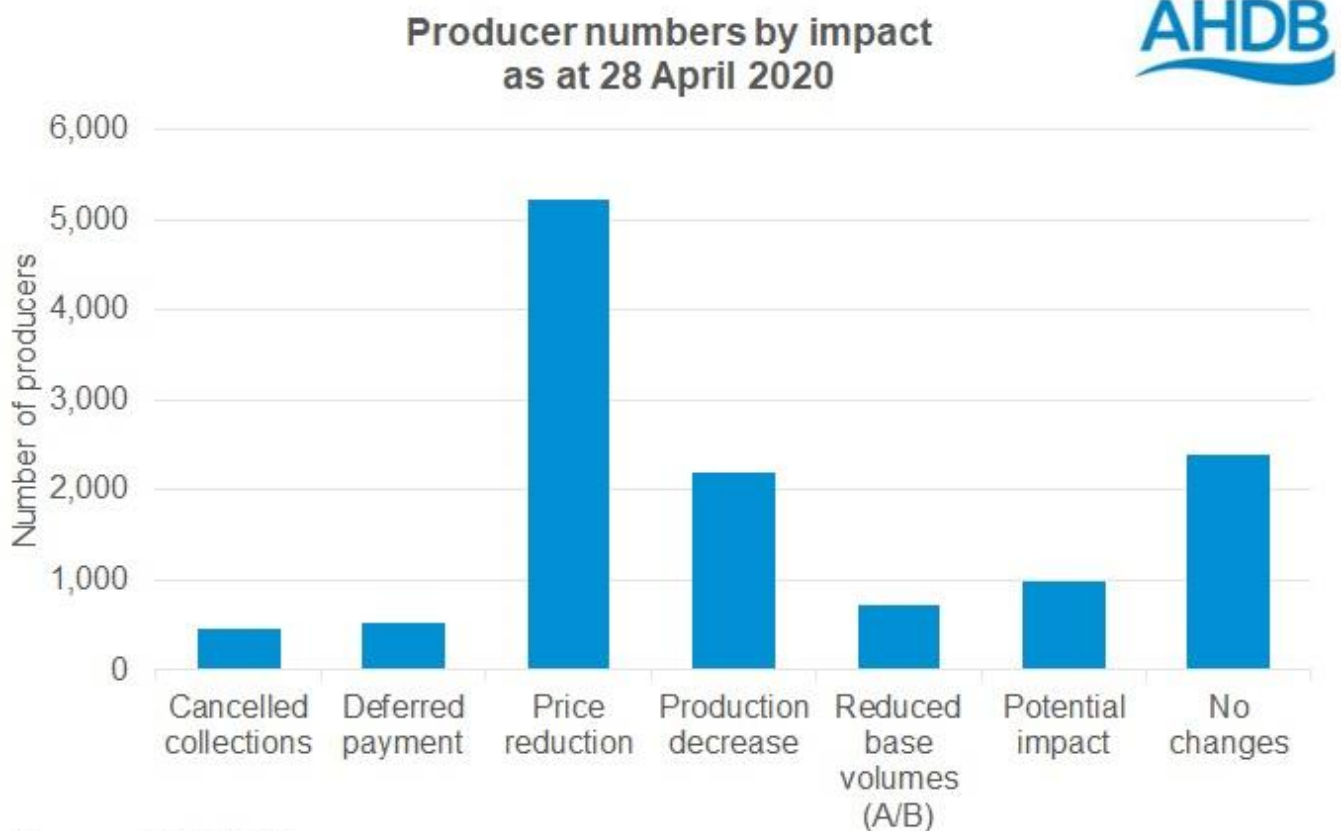
When the outbreak began, there was an initial large uplift in retail sales as waves of panic buying set in and the demand for milk was around 15-20% higher. However, demand has now dropped from this initial peak with many large retailers now reporting that demand is at the same levels as pre outbreak or just 5% above. As such, there is a huge oversupply of milk and other dairy products which have lost markets in the food service sector amounting to [around 2 million litres](#) of milk per day.

Only a matter of weeks ago, all of this milk had a good home, and hopefully in a few months' time, those markets in the food service sector will return. Wales' dairy farmers want to be there to meet that demand, so it is crucial that the industry is not irreversibly damaged by this crisis.

The impact on farmers

- Market issues in the dairy supply chain are often quickly amplified and usually passed rapidly down to farm level. A processor often has the right to vary the price or terms at very short notice however they see fit, so the issues very quickly get pushed on to the farmer, who we believe takes a disproportionate amount of the risk.

- Put simply, it is the farmer who is paying for the loss of markets. In many situations, the timeline is clear. Pubs and restaurants are shut as according to government guidelines, meaning those businesses are unable to pay their bills and as such cannot pay the dairy processor. The processor then cannot then in turn pay the farmer, so the farmers are the ones left with the bill.
- For example, a producer who sells around 1 million litres of milk a year would receive an average milk cheque of around £20,000/month. If payment is delayed until mid-May, the total owed to that farmer would be £40,000 – creating a **massive impact on cash flow**.
- It is not only cash flow that is affected. There has also been a raft of price cuts to farmers on the back of the market disturbances in the dairy sector. Many prices have already dropped 2ppl or more, and some farm-gate prices are now estimated to be in the region of 17-20ppl. The average cost of production for a dairy farmer is around 27-31ppl depending on their system.
- At a milk price of 22ppl **the average dairy farmer may be losing around 6ppl**. This translates to £10,000 per month or £120,000/year and is clearly unsustainable.
- [AHDB](#) have estimated the financial impact and to date, the impact in April alone is put at over £7m. This impact increases to nearly £13m in the month of May when other milk price reductions come into play, putting the **overall impact for price cuts alone at £20m** over the two months.
- Farmers have also been hit with reduced collections of milk, deferred payments or reduced volumes and some are affected by multiple impacts.



Source: AHDB/NFU

How many farmers have been impacted so far?

- Since March, when lockdown restrictions began, a number of milk processors have announced measures to manage the situation, which have had an almost immediate impact on farmers.
- Of the estimated 9,200 farmers in GB, more than 5,200 have suffered a milk price reduction this spring. Those price cuts range from 0.5ppl to 4ppl and higher. In addition, nearly 500 had milk collections cancelled, 500 had payments deferred, 2,200 have been asked to reduce milk output and 700 have had the volume they get paid a full price on reduced.
- Dairy represents some 30% of Welsh Agricultural Output Value, with around 1640 dairy farms in Wales
- Of these 1640 farms, NFU Cymru estimates that around 700 of these have been adversely impacted by the market conditions
- Of these 700, we estimate that around 170 have been severely impacted by not having their milk collected on certain dates, non-payment or deferred payment terms for milk and reduced payment for milk, or payment only being made for a certain level of production with milk in excess of this level only being paid at a spot market price (between 5 and 15 pence per litre)
- However, as the difficulties in the dairy sector continue to intensify, and more and more dairy processors seek to reduce the price they pay, **the number of farmers adversely impacted or severely impacted continues to increase daily.**
- Across GB, AHDB estimate **that around 1,100 farmers have seen a high impact on their business.** It is those farmers that will be struggling the most at the moment, but there is also a risk that those in the medium or low risk category see the impacts worsen over the next few weeks.
- The organic sector has also been hit hard. There are some big contracts for organic milk in the food service sector, for example McDonalds, and there is also a lot of organic produce exported, and domestic demand seems to be dropping fast. This means organic milk may end up being sold into conventional markets.
- The tenanted sector has also been badly hit. Tenant farmers with no land asset value are finding it very difficult to access borrowing on a fast eroding balance sheet which has seen dairy cow values plummet, the milk price crashing, the cost of feed inputs rising and cull cow values falling.
- We know that many Sheep, Goat & Buffalo Milk producers are also dramatically affected by the market forces caused by CV19, they have seen big price cuts and complete loss of markets in some cases. Much of their produce is specialist and essentially has no market at this time.

The impact on the processing sector

- Wales does not have a strong milk processing sector and we estimate that between 55 and 60% of milk is processed outside of Wales. We cannot risk seeing further critical mass lost and our processing capacity further eroded by Covid-19 impacts
- As a result of the current challenges, there is a risk that the UK will lose strategically important dairy processing assets. Given that many of **the foodservice processors also service places like schools, hospitals and prisons** it is crucial that these can still be served in the long term.
- There is also a potential loss of iconic producers/products, especially in the speciality cheese markets. Due to the loss of foodservice and closing deli counters in supermarkets, this particular market has been massively impacted. For some processors this also comes on top of losing valuable export opportunities in the USA due to the Boeing tariff dispute.

- The liquid processing sector has undergone a lot of consolidation recently and is already very tightly matched on capacity. Any loss of major capacity **could leave the UK unable to meet consumer demand for liquid milk.**

Is the market improving?

We have seen some extreme volatility in the dairy markets throughout April. The worst time for the markets was early on in April where the retail demand dropped dramatically, and it resulted in milk being thrown away. Since then, the market has slightly improved which has meant no milk is currently being thrown away, but given the volatile retail demand, that could quickly change.

Just because milk isn't now being thrown away, it doesn't mean the market is performing well. There are still milk products being sent to AD plants for a very small return. The spot price at the end of April had picked up, but only very small volumes are now being traded on spot as those processors who had previously lost markets have sought to contract excess volumes elsewhere. The returns from the market are still extremely poor and commodity prices have dropped around 40% since the start of the CV19 outbreak. This means that returns to farmers from the market are currently falling fast and are at around the equivalent of 18-19ppl (UK Milk Futures equivalent, FCStone)

Why the existing Treasury support package will not help the dairy sector

The Treasury's support package is significant, but NFU Cymru is currently unaware of any farmers or processors that have successfully accessed it. Those businesses who have tried to access it they have reported issues with:

- Falling outside of turnover thresholds
- Credit insurance being withdrawn
- Insufficient credit rating to access the scheme – banks unwilling to lend to businesses
- They are net receivers of VAT so deferred payments are of no help.
- Processors have to keep factories running so can't furlough staff and get Gov. to pay 80% of wages
- Where large chunks of trade have been lost, a loan cannot compensate as it will have to be repaid.
- Dairies have to keep taking milk in and keep making product. If they make a product which can't be stored e.g. liquid milk or short shelf life cheese, then stockpiling is not an option.

A more nuanced approach is required in this scenario that ensures whole supply and value chain integrity. **It is our view that the HMT package is not suitable for the dairy sector and should be amended to make it more applicable for dairy farmers and processors.**

We welcome the changes announced on the 27th April from the Chancellor about the bounce back loans. They may benefit some smaller dairy farmers, but for many more the losses will exceed £50,000.

Action needs to be taken urgently to help restore confidence in the dairy market and avert a spiral of decline that has already seen raw milk being dumped.

What we need is a surgical and precise government intervention in the market that prioritises activity on the most affected businesses and ensures market stability through the supply and value chain.

NFU Cymru and dairy industry proposals to government include:

- A targeted grant scheme for affected farmers.

- A novel cow furloughing scheme run by government to help reduce production on a voluntary basis.

NFU Cymru do not believe that **one single measure will be sufficient to tackle this issue** and that a combination of measures should be implemented by UK and Welsh Government and the supply chain to try and address the issue. We are clear that we want to work collaboratively with Defra and Welsh Government and will work through any actions which may not have been previously considered to help us through this crisis.

Summary:

- The current situation is clearly unprecedented and extremely fast moving and therefore urgent action is needed to support the sector.
- We are just days away from the seasonal peak of milk production, where we will see an even greater volume of milk on the market.
- If no steps are taken to support dairy farmers, there is a real potential for unsustainable returns which will result in many farmers having to cease milk production. A huge number of dairy farmers have already been affected, but this situation could quickly escalate and affect the entire industry.
- This is not a 'typical' dairy crisis like those we have seen in the past. Up until a matter of weeks ago, markets were balanced, and supply and demand matched to provide for the UK consumer.
- In these unprecedented times we will need some unprecedented support to ensure the long-term sustainability of the Welsh dairy sector.