

..... OCDE/GD(92)116

Directorate for Food, Agriculture and Fisheries

The Market for Dairy Products
Situation and Outlook
No. 29

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

Paris 1992

>

FOR TECHNICAL REASONS, GRAPHS, TABLES & FACSIMILES ARE NOT AVAILABLE ON OLIS

The Market for Dairy Products
 Situation and Outlook -- First Quarter 1992

A. International Market Developments

During the first quarter of 1992 international dairy markets and prices were strongly influenced by three major factors. The first factor is supply-related, due to the normal seasonal increase in milk output in most OECD member countries. However, this seasonal rise has been less than in the past, due to the effects of supply control measures in several important producing countries. Secondly, important demand-related factors have also had a significant impact on markets for individual products, as can be seen in the paragraphs that follow. Thirdly, movements in relative currency values have continued to be a source of significant short-term price fluctuations. At the beginning of the quarter, the values of major European currencies relative to the US dollar were strong, as the dollar fell to around DM 1.55. The monthly average for January was DM 1.57, compared to an average of DM 1.66 in March, as the dollar strengthened. Such movements affected international market prices, as European export price quotations in US dollars have been adjusted downwards to offset the higher value of the dollar.

The data below, reported to the GATT International Dairy Arrangement (IDA), illustrate the ranges of prices (in dollars per tonne, f.o.b.) during the last quarter of 1991 and the first quarter of 1992. Even though prices generally declined in the first quarter, it should be noted that these still prices remain above minimum levels agreed by the GATT. •

• ••• 4th Quarter 1991•	1st Quarter 1992
Skim milk powder•	1 600 - 1 800 • 1 550 - 1 700
Whole milk powder•	1 650 - 1 800• 1 550 - 1 700
Butter•	1 500 - 1 850• 1 400 - 1 550
Butteroil•	1 750 - 2 250• 1 700 - 1 950
Cheese (Cheddar)•	1 600 - 2 050 • 1 750 - 1 950

As regards individual dairy products, prices for butter weakened in the first quarter in response to weaker international demand, primarily due to the lack of purchases by the former USSR. This situation carried over from 1991, for example under the 1990 GATT derogation, sales of 311 000 tonnes were contracted by four member countries of the GATT International Dairy Arrangement for sale to the USSR. However, primarily due to payment difficulties experienced by the USSR, it was not possible to deliver all of this volume by the 31/12/91 deadline. Total deliveries were about 176 000 tonnes, of which

about 95 000 tonnes were shipped by the European Community and about 70 000 tonnes were shipped by New Zealand. The uncertainty regarding the short-term import situation for in the former USSR as to what proportion of total imports will be commercial and what proportion is likely to be shipped as food aid, is likely to over-shadow the international butter market for several months. Prices may not break out of their current range until this situation becomes more clearly defined. Sales of butter to other destinations during the first quarter were restricted by stagnant demand, particularly in Algeria and Venezuela, which are normally rather stable importers.

On the other hand, the market for skim milk powder (SMP) continued to improve in the first quarter primarily as a result of very large purchases by Mexico, which is traditionally the largest importing country. For example, in January and February the Mexican Government completed purchases of about 150 000 tonnes, enough to cover its import requirements for all of calendar year 1992. Such large purchases have contributed to a tighter supply situation, which has encouraged firmer forward commitments. This has, in turn, contributed to favourable future price expectations, which has provided support for current price levels. The international market for whole milk powder (WPM) has closely followed the market for SMP. Toward the end of the first quarter, market prices were mostly around the upper end of the price range for both products.

The international market situation for cheeses covered by the GATT IDA was steady during the first quarter, and prices are expected to remain around current levels of even increase somewhat during the remainder of 1992.

According to a GATT IDA Council report, the trade outlook for 1992 for dairy products is generally favourable. However, butter is the exception. For example, the continuation of the decline in export volumes in both butter and butteroil that occurred in 1991 is expected in 1992. This is due primarily to the continued uncertainty of imports by the ex-USSR, and to some extent to uncertainties surrounding the domestic political situation in Algeria. In the case of SMP, the outlook is for an increase in trade volumes, due to increased efforts by major producers to reduce their stock levels and renewed interest from traditional importers. Even though export volumes of WPM reached record levels in 1991, a further increase is expected in 1992. Export volumes of cheese rose two per cent in 1991, and are expected to rise by about the same rate in 1992.

B. Developments in national markets and policies

{European Community}

Intervention stocks of butter and SMP continue to decline. The draw-down began in the last quarter of 1991. As of 15/4/92 stocks were 233 850 tonnes and 340 000 tonnes, respectively. The downward trend in butter and SMP production continues. The January output of both products was 10 per cent below the year-earlier level; whereas, the decline for calendar year 1991 is estimated to be about 14 per cent for each product. Cheese output rose by one per cent in 1991. At the same time, EC milk output continues to decline: it is estimated that January's production was 3.4 per cent below the January 1991 level.

{New Zealand}

{1. Market developments and related factors}

In the 1990/91 dairy year real dairy farm gross revenue declined by 25 per cent from the previous season. The level of real farm incomes in 1990/91 was comparable to the economically depressed seasons of 1986/87, 1977/78 and 1970/71.

The 1991/92 dairy production season has been more favourable for dairy farmers. Unusually favourable weather conditions have resulted in above average milk production. There was rain in January and February throughout most of the country. This will ensure continuation of good milk flows over the remainder of the summer through to the end of the season.

Primarily as a result of higher international prices for dairy products which began in late 1991, the average dairy company farmgate payout to dairy farmers is expected to be 25 per cent more than in the last year. The New Zealand Dairy Board initial basic price for 1991/92 was NZ\$3.70 per kg milkfat. This was increased to NZ\$4.10 and NZ\$4.70 through the season. The final basic price to be announced in May is expected to be close to NZ\$5.00 per kg milkfat. Dairy company payouts to farmers are forecast to be about NZ\$5.25 - NZ\$5.50 per kg milkfat. The Dairy Board basic price is an indicative price based on expectations for market returns and is set very conservatively. It is used to set the level of monthly payments to farmers for milk before the products made from that milk are sold.

The gross revenue of the average factory supply dairy farm fell by 25 per cent between 1989/90 and 1990/91. Gross revenue is forecast to increase by 17 per cent to NZ\$148 500 in 1991/92. The increase is a consequence of higher milk production sold at higher prices to dairy factories. Returns from sales of cull cows and young calves are virtually unchanged.

Farm expenditures in 1990/91 and in the early months of 1991/92 were constrained by low income and high interest payments. After the rise in the New Zealand Dairy Board basic price in February, cash flow improved, assisted by reducing interest rates. Farmers began to catch up on deferred spending on maintenance, fertiliser, vehicles and others. Average farm net profit for 1991/92, before deductions for tax, drawings and principal repayments is forecast to lift by about 70 per cent from NZ\$25 383 to NZ\$43 500.

{2. Adjustment measures and policy developments in the dairy sector}

The New Zealand Dairy Board Amendment Bill is currently being considered in parliament. It aims to make the Board more accountable to farmers. The Board will maintain control over exports of dairy products but is able to license private companies to supply particular products to particular markets. The Bill has provisions for a financial and management performance audit to be completed at least once every five years. Other proposed measures would more clearly define the ownership of the Board's assets.

The Milk Act 1988 will expire in April 1993. The integration of liquid (drinking) milk into the larger manufacturing dairy industry is almost

complete. Liquid milk processing has been taken over by the manufacturing co-operatives in most areas. Much of the supply is from seasonal suppliers with only winter supply earning higher prices. After April 1993, milk processors will not be required to operate home deliveries and the price of milk sold at retail outlets will not be controlled.

{Sweden}

{Market developments and related factors}

The number of dairy producers declined by 13.1 per cent in 1991 (to just 21 528), primarily as a result of market orientation measures taken over the past year or so throughout the agricultural sector. Total milk deliveries declined by 8.8 per cent to 3.13 million tonnes.

{United States}

{1. Market developments and related factors}

In early 1992, the USDA estimated that milk output in 1992 will about equal the 1991 level (67.585mt), due in part to the continuation of relatively low net returns to producers. Such conditions are likely to lead to a slight rise in numbers of producers exiting the industry in the first half of 1992. The increase in yields per cow is expected to be below trend during most of the year as a result of milk/feed price ratios that will not promote an increase in concentrate feeding. Such returns averaged \$9.00/cwt/milk in the third quarter of 1991, compared with the 1990 average of \$10.39/cwt/milk. In the case of gross prices received by milk producers, the January 1992 average for "all milk" sold to processing plants was \$13.60/cwt, virtually unchanged from the average received during the last quarter of 1991. However, the January average price for manufacturing milk was \$11.90/cwt, compared with an average of \$12.67/cwt during the last quarter.

{2. Adjustment measures and policy developments in the dairy sector}

In January the USDA revised its support prices for butter, SMP and cheese to better reflect the market value of the milkfat/protein content of milk. The changes were as follows: Butter, a decline from \$2.16/kg to \$1.92/kg; SMP, an increase from \$1.87/kg to \$2.01/kg; Cheese (block Cheddar), a increase from \$2.44/kg to \$2.45/kg. Also, the 1992 regulations for the Dairy Export Incentive Program (DIEP) were announced. Bonuses will be available on 150 800 tonnes of milk powders to 84 countries, 41 800 tonnes of butterfat to 70 countries and 4 700 tonnes of Cheddar to 13 countries.

The Milk and Dairy Products Market in OECD Countries (1)

I. Summary Review of the 1991 Situation

In 1991 the market situation was characterised by a marginal decline in aggregate OECD milk output, an increase in milkfat consumption only slightly above the general rate of population increase, lower prices to producers and, world prices well above GATT minimum levels, in spite of stock levels that were significantly above 1990 ending stocks. World prices rose substantially in 1991, after touching the minimum levels agreed by the GATT during part of the year. Net export availabilities of milkfat in the OECD area declined by 7.5 per cent in 1991 due to a combination of lower milk output and higher consumption. The rise in stocks was primarily related to a decline in imports by the former USSR and the Persian Gulf region, as well as to declines in butter consumption in most OECD countries.

Total OECD milk production (42 per cent of estimated 1991 world output) was estimated at 220.1 million tonnes down by 156 000 tonnes (0.7 per cent) from 1990. This slight decline was directly related to quota cuts and lower prices to producers (Table IX) in OECD-Europe, where production declined by 1.3 per cent, dropping by 1.2 per cent in the EC. In Canada, output declined by 4.8 per cent. Output rose by the following percentages in other selected countries: 0.2 in the United States; 1.1 in Australia; 1.4 in New Zealand; and by 1.3 per cent in Japan. Aggregate dairy cow numbers are estimated to have declined by one per cent over the past year, to 42.4 million, while average yields continued to rise. Producer returns were generally lower in all member countries, markedly so in New Zealand where net revenues to producers were halved in the 1990/91 dairy year.

Milkfat consumption rose by about 0.5 per cent in 1991, primarily due to population increases and in spite of shifts in consumer tastes away from high-fat dairy products. In general, demand for cheese and low fat milk products remained strong with demand for low fat milk particularly strong in North America. The consumption of butter and several other dairy products with a high milkfat content declined in virtually all OECD countries in 1991, but the decline in most countries was less than the strong declines of 1989 and 1990. In general, the demand for cheese remained strong. These consumption patterns imply that significant volumes of "skim-off" milkfat is diverted from the production of butter to other products, having a reduced milkfat content, such as skim milk powder (SMP) and various "fresh" dairy products.

(1) The relevant text and statistical data concerning milk and dairy products in this section were taken from the Secretariat publication {Agricultural Policies, Markets and Trade: Monitoring and Outlook 1992}, which was published in May 1992.

Butter and SMP stocks in OECD countries rose in 1991 particularly in the EC and in the United States (Table X). Ending stocks of intervention butter and SMP in 1991 were estimated at 730 300 and 739 400 tonnes, respectively, up by 7 and 25 per cent, respectively, over year-earlier levels. The total volume of world trade in dairy products (butter, SMP and cheese) in 1991 declined by an estimated 6 per cent. Export volumes of butter and SMP were below 1990 levels due to weak demand. Trade in cheese continued to expand, and whole milk powder (WMP) trade volumes reached record levels, boosted by a 50 000 tonne food aid shipment by the EC to the former USSR. Average world prices for 1991 were well above the depressed levels of 1990, due to significantly higher prices in the last half of 1991; however, a sustained recovery in prices will depend upon the extent to which stock levels continue their decline which began in the last half of 1991. Graphs I and II illustrate dairy product prices in real terms.

II. Medium term outlook for production, consumption and export availabilities

Medium term forecasts are presented in Table XI and in Graph III. The aggregate cow herd in 1996 is expected to be 6.5 per cent below the 1991 level. Average yields per cow are expected to rise by about 1-2 per cent annually. Thus, despite the rather high rate of decline in cow numbers, total OECD milk production in 1996 is expected to be 1.5 per cent above the 1991 level, primarily due to increased output in the United States, New Zealand and Japan. Average yields could be increased further if BST is approved for general usage in Member countries. For example, BST is expected to have an impact on average yields in the United States toward the end of the forecast period, which could further affect aggregate cow numbers in the US.

The current trend in consumption of lower-fat milk and dairy products is likely to continue in the medium term. For example, the decline in demand for butter in most countries is continuing (although the rate of decline appears to have slackened), while demand for low-fat liquid milk and low-fat milk products continues to rise. The demand for cheese is expected to remain strong. In general, per capita consumption of dairy products is expected to change very little over the medium term, with the exception of Japan, where the upward trend is forecast to continue. On the strength of these trends, combined with population increases, aggregate milkfat consumption is forecast to rise by about 7.1 per cent over the medium term, from 7.34 million tonnes in 1991 to 7.92 million tonnes in 1996.

The forecasts of production and consumption suggest that the net export availability of milkfat for the OECD area will decline by 36 per cent in the medium term to 761 000 tonnes, reflecting in particular reduced milkfat balances in the EC, the United States and Japan.

III. Policy Overview and Evaluation

{1. General Policies}

In general, domestic support policies, together with border measures in OECD countries ultimately have a significant impact on the volume of each country's trade (both exports and imports). Such measures tend to lower the

volume of trade in dairy products, while maintaining excessive export availabilities, which in turn, tends to depress world dairy product prices. As recent experience has indicated, changes in these policies can lead to substantial variations in export availabilities, volume of trade, as well as to substantial variations in prices on world markets. For example, the rise in world price levels during the last half of 1991 was primarily related to reductions in milkfat supplies in the EC (since the EC traditionally accounts for about 50 per cent of world dairy exports). Changes in border measures in Japan in 1990 created a new market for ice cream imports.

Most member countries continue to rely on supply management policies, primarily quota programmes, to regulate milk production. The effect of such restrictive measures, as well as the implementation of more market-oriented policies in some countries, has helped to reduce aggregate OECD milkfat output as well as export availabilities. This process continued in 1991, as its necessity was further underlined by (a) reduced world export volumes and depressed prices; (b) rising stocks; and, (c) continued high levels of treasury expenditures to support producers (whose returns declined again), and to subsidise exports. However, as Table XII illustrates, aggregate OECD assistance to the dairy sector, measured by the producer subsidy equivalent (PSE), declined in 1991. The evolution of PSEs varied between countries, for example net percentage PSEs rose slightly in Australia, Canada, Japan, Norway, and Switzerland. The largest percentage decline was in the US, followed closely by the EC. Aggregate assistance to the sector as measured by the net total PSE in US dollars declined by 8.3 per cent to \$54.59 billion, after rising annually since 1987.

- Dairy policies in OECD countries, with few exceptions (e.g. Australia and New Zealand), continue to involve a high level of support to producers, compared with other major commodities. Domestic prices in most countries remain high: this tends to depress consumption and to stimulate output in the absence of production controls, which often results in excess production which is often sold with the aid of export subsidies. In 1991, more restrictive quota systems (Austria, Canada, the EC, Finland and Norway), as well as restrictive producer price policies and cessation/retirement schemes in a number of countries helped to reduce production. For example, in 1991 such measures contributed to reductions in milk output of 10 per cent in Finland, 9 per cent in Sweden, 4.8 per cent in Canada, 1.2 per cent in the EC and 1 per cent in Norway. These policy measures also contributed to lower export availabilities and to reduced export subsidies. Aggregate OECD export availabilities began to decline from their peak levels in late 1991; nevertheless, ending stocks of butter and SMP were 7 per cent and 25 per cent, respectively, above the 1990 volume of ending stocks. The continuation of restrictive production policies, particularly in the EC, should contribute to even lower levels of aggregate OECD export availabilities. In Japan, the major OECD net importer of dairy products, imports continue to rise due to rising per capita consumption as production quotas continue to limit milk deliveries.

{2. Trade-oriented policies}

Import regimes by OECD countries for dairy products were basically unchanged in 1991. In the case of Japan, imports of ice cream and processed cheese increased primarily due to market liberalization measures implemented in

1990; on the other hand, several dairy exporting countries continued to urge the Japanese Government to implement the conclusions of a GATT panel in 1989 which recommends liberalized imports of powdered and condensed milk.

In general, export regimes for dairy products in OECD countries also remained basically unchanged in 1991. A major change was the re-authorization by the United States of the Dairy Export Incentive Program as part of the 1990 Farm Act. As in the past, bonuses continued to be available to individual exporters in the form of commodities from CCC stocks. The Act authorised, during calendar year 1991, exports of up to 139 800 tonnes of milk powder to 70 countries, and 40 800 tonnes of butterfat to 59 countries. During 1991, about 37 000 tonnes of dairy products were sold under this scheme. Bonus values ranged from about \$700 per tonne for SMP to about \$2 000 per tonne for butter oil, while the aggregate value of bonus payments was \$46.4 million. In 1992, bonuses will be available on 150 800 tonnes of milk powders to 84 countries, 41 800 tonnes of butterfat to 70 countries and 4 700 tonnes of Cheddar to 13 countries.

In the case of the EC's export policies, export restitutions in the fourth quarter of 1991 for butter were ECU 1 620 per tonne, down from the year-earlier level of ECU 1 750 per tonne. A rate of ECU 1 950 per tonne was set in mid-1991 for the special derogation sale of butter to the former USSR. Export restitutions for SMP and WMP remained at ECU 700 per tonne and ECU 1 150 per tonne, respectively, unchanged from their levels of late 1990. Primarily as a result of the depressed world market situation and the need to reduce national stock levels, aggregate export assistance by OECD countries for dairy products rose in 1991, although export volumes declined. For example, in the EC, export refunds amounted to ECU 2 477 million in 1991, compared to ECU 2 401 million in the previous year. In Sweden, export subsidies for dairy products were abolished on 1 July 1991, as part of the general de-regulation of the Swedish agricultural policy.

IV. International Trade in Dairy Products

{1. General Trade Environment }

Notwithstanding relatively low world price levels in 1991, the total trade volume for the year (butter, cheese and SMP) was about 6 per cent below the 1990 level, mainly due to lower imports by the former CMEA countries. Net imports of the developing countries declined slightly; and, the aftermath of the Gulf War, including the trade embargo on Iraq, continued to constrain imports by this region. According to USDA estimates (1), total world exports in 1991 were estimated as follows: butter, 659 000 tonnes (down 10 per cent); SMP, 830 000 tonnes (down 3 per cent); and, cheese, 768 000 tonnes (down 6 per cent). Graph IV presents the recent stock levels of dairy products, compared with trade volumes. As regards market shares of main exporters and importers, see Table 5.

(1) USDA, Foreign Agricultural Service, {World Dairy Situation}, Nov. 1991.

The dairy market in calendar year 1991 was again heavily influenced by trade activity of the former CMEA countries. For example, New Zealand and the EC concluded deals to sell 100 000 tonnes and 200 000 tonnes, respectively, of butter to the former USSR under the 1990 GATT derogation, which stipulated that all deliveries were to be made by 31/12/91. However, due to financing problems and the break-up of the former USSR, shipments prior to this date, amounted to only about 95 000 tonnes by the EC, and 70 000 tonnes from New Zealand. Sales such as this could be made more difficult by recent requests for dairy products by the former USSR as emergency food aid. For example, the EC delivered 50 000 tonnes of whole milk powder as food aid in September; and, in early 1992 other shipments of dairy products were included in some multilateral shipments (including shipments originating in some east European countries) as emergency food aid. Other important developments in 1991 stemmed from exports of butter, SMP, at prices below GATT minimum levels, by some east European countries. Continued economic restructuring in this area resulted in some export availabilities in these countries, since declines in domestic demand exceeded the often steep (i.e. 15-20 per cent) declines in milkfat production.

{2. Medium term outlook for trade in dairy products}

Forecasts of the medium term milkfat balance for the OECD area point to the fact that Member countries' efforts toward limiting support to their dairy sectors should allow for a continuing decrease in export availabilities, and this process is expected to continue. This reflects in particular more restrictive quota policies in OECD Europe and Canada, as well as more restrictive price policies in virtually all OECD countries. Consequently, a continuation of restrictive policies is forecast to result in a significant decline of 36 per cent in export availabilities of milkfat in 1996 (to 761 000 tonnes), as stated previously. This level corresponds to a self-sufficiency ratio of 110 per cent. Based on replies to national questionnaires, forecasts of export availabilities for individual dairy products for the OECD during 1991-96 suggest a significant decline for butter (-31 per cent), a smaller decline for SMP (-15 per cent), while export availabilities for cheese and whole milk powder are forecast to rise in response to continued demand increases (+31 and +8 per cent, respectively).

It must be recognized however, that 1991 aggregate OECD ending stocks of butter and SMP remain high, as a result of production increases in some member countries as well as the downturn in export markets. Stock levels began to decline in the last quarter of 1991; however, a significant stock reduction in the short and medium term remains uncertain, especially in the light of medium term expectations for economic recovery in the former CMEA countries. In the light of this situation, together with the fact that such stocks to some extent have a depressing effect on world prices and trade flows, international co-ordination in their disposition for food aid is desirable.

In the case of the developing countries as a group, aggregate commercial imports could rise in the medium term, depending on their production and import policies. However, in the future if major developing country importers on a commercial basis (e.g. Mexico) follow the example of India, the volume of commercial imports in developing countries could actually decline. India is the largest developing country producer and has increased output by 30 per cent over the past five years. A further increase of 20 per cent is forecast by

1995. Thus, the country which was once the largest recipient of food aid in dairy products currently has periodic export availabilities. Mexico is the largest importer of SMP (288 000 tonnes in 1990); however, in January and February 1992, the Government imported 150 000 tonnes, which it considered sufficient to fulfill domestic requirements for the calendar year. The medium term outlook for dairy product imports by the OPEC countries could rise from the current depressed level as the Gulf region recovers from the aftermath of the Gulf war. Prior to the war, Iraq and Kuwait alone imported about 80 000 tonnes of dairy products. In the case of the newly industrialized economies, imports could increase somewhat; however, in Korea, protectionist policies currently constrain dairy product imports in favour of domestic production.

In the medium term, the necessity for a lasting improvement in the level of export availabilities of individual Member countries may be more important than at any time in recent years due to the increased uncertainties surrounding future export markets to the non-OECD area, in particular the former USSR and Eastern/Central Europe. Indeed, the uncertainty surrounding future volumes of commercial exports to this area is greater than at any time in the recent past. It is entirely possible that the total volume of dairy product exports to this region, at commercial rates, may well decline in the medium term. Such a scenario will have extremely important implications for the future orientation of dairy policies in OECD countries, which could provide an additional stimulus for the continued reform of dairy policies. In order to prevent a persistent build-up of stocks, a lasting improvement in the supply and demand balance of individual Member countries in the medium term remains necessary.

The stagnant or declining per capita consumption of milkfat in most OECD countries underlines the need for a better supply/demand balance in both the short and medium term, accentuating the need for policy changes towards more market orientation in both production and marketing. A durable improvement in the OECD aggregate supply/demand balance for dairy products will depend in particular upon a concerted movement toward greater market orientation. This will require the progressive and substantial reduction of support by individual governments to their respective dairy sectors. Regardless of the outcome of the Uruguay Round, any substantial agreements from these negotiations are likely to be implemented over several years. Thus, in the short term a strong argument exists for a continued and strengthened reform of dairy policies. The current uncertainty and fragility of the international market for dairy products further underscores this argument.

END-OF-TEXT