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THE MARKET FOR DAIRY PRODUCTS  
SITUATION AND OUTLOOK

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## The Market for Dairy Products

### Situation and Outlook -- First Quarter 1994

#### A. International Market Developments

World prices for milk powders were slightly lower in the first quarter compared with their levels in late 1993. (see below.) This situation is mostly attributable to seasonally lower demand, as well as to currency movements. The world market situation for butter and butteroil continued in its depressed state, with prices (excluding the derogation sales to the NIS) virtually unchanged for the past three quarters, i.e. they remain at or near the GATT minimum of \$1 350 per tonne. According to the GATT, some sales were reported below the minimum level. Prices for cheese remained firm, on the strength of continued strong world demand; however, the lower end of the price range has fallen below the lower level of the previous six months.

Table 1. Export prices reported to the GATT International Dairy Arrangement (dollars per tonne, f.o.b.)

Product	3rd Qtr. 1993	4th Qtr. 1993	1st Qtr. 1994
Skim milk powder	1 400 - 1 650	1 500 - 1 750	1 450 - 1 600
Whole milk powder	1 355 - 1 650	1 400 - 1 600	1 380 - 1 560
Butter	1 350 - 1 550	1 350 - 1 500	1 350 - 1 480
Butteroil	1 625 - 1 750	1 625 - 1 750	1 625 - 1 780
Cheese (Cheddar)	1 800 - 2 150	1 800 - 1 950	1 650 - 2 000

As regards the GATT butter derogation for the NIS, it was decided at a March meeting of the International Dairy Arrangement to extend the derogation (a) to 31 May 1994 concerning sales contracts, and (b) to 31 August concerning deliveries. In addition, the IDA raised the maximum for total shipments per participating country by an additional 16 500 tonnes - over the original limit of 50 000 tonnes per country. During the first quarter the pace of these sales continued to be rather slow, which was possibly related to questions concerning the solvency and repayment capability of some of the NIS buying agencies. Recently, the range of prices has been around \$1 100 to \$1 250 per tonne. As the first quarter ended, a total of 73 459 tonnes of derogation sales had been notified to the GATT by IDA participating countries.

## **B. Developments in National Markets and Policies**

### **Australia**

#### *- Market developments and related factors*

Recent milk production increases have been due mainly to abnormally mild summer seasonal conditions in most dairy producing regions. The availability of relatively low priced feed grains and the general improvement in both herd genetics and farm management are further factors.

While farm gate prices for manufacturing milk are expected to be 5-10 per cent lower than last season, farm income is expected to be largely unchanged - with the increased milk production offsetting unit returns.

### **New Zealand**

#### *- Market developments and related factors*

As the New Zealand 1993/94 dairy production season drew to an end, 95 per cent of milk production had been achieved by the end of March 1994. Final production of milk and dairy products has to be forecast but with little further production expected these forecasts can confidentially be expected to be close to the final end of season amounts.

The number of dairy cows at the beginning of 1993/94 was 2 734 000 (provisional) about the same as at the beginning of 1992/93 and 1990/91. The dry autumn and the expectations of return to more normal conditions next season with lower milk production and lower farmgate prices could result in a higher culling rate and a decrease in cow numbers by the time of the annual agricultural census at the end of June 1994.

The production season ending 30 May 1994 is expected to be the third consecutive record production year. Milk produced will be about 12 per cent more than in 1992/93 and 18 per cent more than the average for the previous decade.

At the beginning of November dry conditions were affecting many dairy farming areas. However widespread heavy rain fell over most of the country in December 1993 and January 1994. From February sporadic, scattered rain well below average in most districts did not allow the usual autumn flush of grass growth and reduced milk production for March and April. Total milk production for the 1993/94 season will be close to 9.3 million tonnes of which 8.7 million tonnes is used for the manufacture of dairy products.

Butter production will increase by 10 per cent to 300,000 tonnes with casein output expanding by 10 per cent to 81,000 tonnes and skim milk powder by 6 per cent to 133,000 tonnes. Whole milk powder production will be up by 12 per cent to 337,000 tonnes. Two new milk drying facilities, one in the Waikato and one in Southland will begin production in 1994/95. The rate of expansion of WMP production will probably fall as some major markets reduce imports. Cheese production is expected to have increased by season end by 40 per cent to reach 200,000 tonnes, a more significant advance over the decade average of about 120,000 tonnes. Improved world market opportunities continue to boost New Zealand's cheese production.

The New Zealand Dairy Board's initial basic price for 1993/94 was NZ\$ 2.60 per kg milksolids or NZ\$ 4.50 per kg milkfat. In October 1993 this was increased to NZ\$ 2.74 per kg milksolids or NZ\$ 4.77 per kg milkfat. In February 1994 the Board decided not to change the basic price. In May the price was forecast to be revised to NZ\$ 2.80 per kg milkfat or NZ\$ 4.55 per kg milkfat or NZ\$ 0.22 per liter of milk.

The average dairy company payout for 1993/94 is forecast to be NZ\$ 3.20 per kg milksolids or NZ\$ 5.40 per kg milkfat or NZ\$ 0.25 per liter of milk, a reduction of 18 per cent on the previous season. With the increase in the quantity of milk produced average milk income is expected to decline by 5 per cent. Returns from beef were down because of lower prices. Average dairy farm gross farm revenue for 1993/94 is forecast 12 per cent lower than the previous season's NZ\$ 160,000. This is close to the average 1992/93 dairy farm gross farm revenue.

A decline in average milk production is assumed for future dairy seasons. Little change in international prices is forecast for 1994/95. Forward cover of currency values shielded the New Zealand Dairy Board from the full effects of the increase in the US\$/NZ\$ exchange rate in 1993/94. In 1994/95 currency appreciation could reduce the NZ\$ value of dairy exports by up to 6 per cent. Farmgate prices will be 10 per cent lower than in 1993/94. Thus a decline of dairy farm gross revenue in the order of 10 to 15 per cent is forecast.

*- Adjustment measures and policy developments in the dairy sector*

In 1992 the New Zealand Dairy Board decided to change the terminology for describing the value of milk from NZ\$/kg milkfat to NZ\$/kg milksolids to match the practice of dairy companies who pay farmers for milk at a rate based on separate values for the fat and protein components of milk. The term "milksolids", as one word, is now used and means the fat and protein components of milk. Milksolids are all the solid components of milk and are about 13 per cent of the weight of milk. The payment for a liter of milk by the New Zealand Dairy Board to dairy companies or by dairy companies to farmers is not in any way different using either way of expressing milk value. As from April 1994 prices will be expressed in terms of milksolids or quantities of wholemilk.

## Canada

### *- Adjustment measures and policy developments in the dairy sector*

Industrial milk and cream production in the 1993/94 dairy year (August-July) is expected to reach 43.3 MhL at 3.6 kg of butterfat per hectolitre, up from 41.89 MhL in the previous dairy year. Total milk deliveries should increase slightly to 72.5 MhL.

Butter production is expected to remain at the same level as the last dairy year. The industry has been able to control the downward trend with programmes such as the butterfat utilisation programme administered by the Canadian Dairy Commission. The objective of this programme is to increase the domestic utilisation of butter in specific baking goods.

Cheddar cheese and specialty cheeses production and consumption are forecast to increase this dairy year.

## United States

### *- Market developments and related factors*

Dairy markets proved to be considerably tighter than expected during the winter quarter. Recovery in sales of fluid milk and nonfat dry milk and growth in cheese sales generated increased commercial use of skim solids. Milk production has been slightly weaker than expected but markets generally had allowed for even weaker output.

By the end of March, cheese prices had risen about 22 cents per kilogramme and were well above last autumn's seasonal peak. These counterseasonal rises were a combination of somewhat tight market fundamentals and building pipeline stocks. However the BST-related increases in second-half production and expected commercial use make it unlikely that these early price increases can be sustained. Second-half milk prices are expected to average below a year earlier but may be just as volatile as in 1993.

Milk cow numbers continue to be weakened as substantial numbers of farmers exit dairying in some Midwestern States. In addition, moderately unfavorable milk-feed price ratios and feed quality problems have held gains in milk per cow to only about 1 per cent. These sources of production weakness are expected to have less influence as 1994 progresses.

The effects of BST have been quite muted since it became legal for sale in early February. As expected, farmers have been quite cautious about the number of cows treated, although a sizable share of producers in all States are using it. Response to BST has varied greatly by farm and by cow. The initial impact may have been muted by the feed situation, but BST effects generally have been very close to expectations. Despite extensive media coverage, no effects on milk sales were discernable.

Allocations for the 1994 DEIP programme were finally announced on March 11. In general, initial allocations were below 1993 levels. However, most of the reductions were to countries that had not fully used their allocations, and their impact on the volume of 1994 DEIP business is unlikely to be significant.

Conditions on the butter market are changing dramatically, although the effects on milk prices will be quite limited. Surplus removals during December-March (normally accounting for one-half to two-thirds of the annual total) fell 40 per cent from a year earlier. Sales continue to grow from last year's strong level, the largest since 1966. Meanwhile, butter production has been cut by stronger sales of milkfat in other products. By late 1994, butter stocks probably will be small.

### **The European Union**

#### *- Market developments and related factors*

During the first quarter of 1994:

- a) deliveries of milk were below the year-earlier period, which contributed to the improvement of the milk balance;
- b) market prices for butter and SMP were slightly below their levels of the last quarter of 1993;
- c) stocks continued their downward trend. However, the beginning of the spring production season could cause a moderate rise in SMP stocks, if market prices continue to decline in certain Member states.

The ratio between the producer price for milk and the price of feed for dairy cattle has remained within a small range over the past three years.

### **United Kingdom**

#### *- Market developments and related factors*

In practice, the variable silage quality, referred to in the Report No. 36, has caused few problems. Yields have held up well, to the extent that the quota will almost certainly be exceeded.

The quota position also continues to be markedly affected by the exceptionally high butterfat levels which remain more than twelve trigger points above the base level.

Expectations that quota will be exceeded have led to some increase in the number of cull cows being sent for slaughter, with numbers exceeding those for the same period last year. Nevertheless, cull cow prices have continued to hold up, with the export trade having a significant influence.

Conversely, there has been some easing in the price of newly calved cows but prices remain around £ 150 per head above those being paid a year ago, reflecting the continued confidence in the milk production business.

On the marketing front, the delay in the establishment of a free market for milk occasioned by the Government's "hesitations" over some aspects of the MMB's proposals has met with mixed reactions. Many producers who had concluded deals with new buyers are complaining of lost income due to the delay in their receipt of prices negotiated at a higher level than those they expect to be receiving from the Board. On the other hand, the delay has enabled others to take a more leisurely approach to seeking the best deal and a characteristic of this has been a growing interest in producer groups intent on doing their own marketing. One also senses a reaction against the "hard sell" of Milk Marque and it will be interesting to see how many of those who feel they have been pressurised into signing will take advantage of the cooling off period to withdraw.

Soil temperatures are average for the time of year and have been high enough for some weeks in most places to justify the application of fertiliser. On the down side, however, winter rainfall has been so high as to inhibit the use of vehicles on the land for this purpose and unless there is some reasonably dry weather turn-out may also be delayed for the same reason.

The industry approaches the new season in a relatively buoyant state with confidence at a high level and in spite of some apprehension about the impending new marketing arrangements.

## Japan

### *- Adjustment measures and policy developments in the dairy sector*

At the end of March 1994, the Government of Japan revised levels of administrative price and the ceiling quantity for the deficiency payment for fiscal year (FY) 1994.

The guaranteed price for milk for processing (a support price for producers) was lowered by ¥1/Kg to ¥75.75/Kg for FY1994.

The stabilization indicative price for butter was lowered by ¥39/Kg to ¥993/Kg. This reflects the recent weak demand for butter and its stock accumulation. The stabilization indicative prices for skimmed milk powder, condensed whole milk and condensed skimmed milk were unchanged.

The standard transaction price which is derived from stabilization indicative prices for the above-mentioned designated dairy products was lowered by ¥1/Kg to ¥65.26/Kg. This is the price which dairy manufactures pay to milk producers.

As a result of these price changes, the deficiency payment by the Government (the difference between the guaranteed price and the standard transaction price) remains at ¥11.49/Kg.

The government also set the ceiling quantity of milk for processing eligible for the deficiency payment at 2,300,000 tonnes, which is 50,000 tonnes smaller than that of the previous year.

<b>Milk for processing</b>	<b>FY1992</b>	<b>FY1993</b>	<b>FY1994</b>
Guaranteed Price (¥/Kg)	76.75	76.75	75.75
Standard Transaction Price (¥/Kg)	65.40	65.26	64.26
Deficiency Payment (¥/Kg)	11.35	11.49	11.49
Ceiling Quantity for Deficiency Payment ('000 tonnes)	2,400	2,350	2,300

#### **Stabilization Indicative Prices for Designated Dairy Products**

Butter (¥/Kg)	1,051	1,032	993
Skimmed Milk Powder (¥/25 Kg),	12,663	12,841	12,841
Condensed Whole Milk (¥/24.5 Kg)	8,055	8,055	8,055
Condensed Skimmed Milk (¥/25.5 Kg)	7,193	7,193	7,193

#### *- Market developments and related factors*

Raw milk delivery started declining in September 1993. This is considered to reflect measures such as government supports for slaughtering milk cows and for feeding calves on raw milk and a downwards amendment of the production target by the producers' organization.

#### **Mexico**

Since Mexico officially became a member of the OECD in May 1994, the following summary is presented for information.

**Production --** The value of milk production represents 19 per cent of the total value of production in the livestock sector: 98 per cent of milk production in Mexico comes from bovine cattle; goat's milk comprises the remaining 2 per cent.

Dairy cattle in Mexico represents 16 per cent of the total bovine herd. Specialized dairy cattle represents only 13 per cent of the total dairy herd, and produces 54 per cent of volume. The size of the dairy herd has remained relatively constant since 1985, with 54 per cent of it concentrated in six states in the north and central regions.

Domestic production of milk is characterized by a high degree of variability, with shifts of up to 155 per cent in monthly volumes within a single year. Although largely due to shifts in climatic conditions, such variability is partly cyclical: months of high production are July to September, and months of low production are January through May. The lack of a constant supply of milk has discouraged further investments in the dairy processing industry.

Three different types of farms can be distinguished in the Mexican dairy sector:

Intensive, with a share of 25 per cent in domestic production; have an average of 265 cows; an annual yield of 4 to 6 thousand liters per cow; mechanical milking; cooling equipment; and a high degree of integration;

Semi-intensive, with a share of 45 per cent in domestic production. They include medium-scale and family enterprises; have manual milking and no cooling equipment; and depend on poorly developed marketing channels. Medium-scale farms have 25 cows on average, and an annual yield of 1.6 to 2.8 thousand liters per cow. Family enterprises have an average of 5 cows, each yielding 300 to 700 liters annually; and,

Double purpose, mainly in tropical regions, with a share of 30 per cent in domestic production; 40 cows per herd; an annual yield of 610 liters per cow; manual milking, no cooling equipment; and poorly developed marketing channels.

Out of total fresh milk production, 50 per cent is sold for direct consumption, without pasteurization; 50 per cent is sold to dairies for pasteurization, for fresh consumption (20%) and to be processed into dairy products (30%).

The unconstrained use of BST in Mexico has not yet been approved. The product has a "conditional registration" status since July 1990, and only two companies are allowed its distribution. Control over total amounts used is exercised through the requirement of prior authorization of imports by the Mexican veterinary authorities.

Production of pasteurized fresh milk and other dairy products is highly concentrated: the three largest industries produce 45 per cent of the domestic volume of fresh milk; one firm produces 70 per cent of powdered milk and another produces 100 per cent of condensed milk. There is less concentration in the production of cheeses, yogurt and other dairy products.

The social milk supply programme of LICONSA (milk producing and distributing affiliate of CONASUPO) provides reconstituted milk to nearly 7 million urban and rural low-income families at subsidized prices. LICONSA operates mainly through the rehydration of imported dried milk. LICONSA's production has increased by an average annual rate of 13.1 per cent since 1980. Around 3 million liters were distributed daily during 1992 and 1993.

From 1985 to 1989 fluid milk production in Mexico experienced a cumulative decline of 23 per cent. As controlled producer prices increased at rates lower than those of the general economy, and the prices of feed grains and oilseed meals remained high, producers were increasingly unable to cover costs, and at the same time, compete with LICONSA's subsidized milk. However, due to improved marketing systems, deregulated farm prices, and a production development programme, and a narrower targeting of LICONSA's social milk supply programme, growth was renewed since 1990, at an average annual rate of 7.6 per cent. Domestic production of fresh milk was 7,122 million liters in 1992 and reached 7,555 million liters in 1993.

**Consumption** -- Out of total consumption of milk, 53 per cent of volume (fluid milk equivalent) is consumed fresh -- 37 per cent un-pasteurized and 16 per cent pasteurized; 32 per cent is consumed as processed dairy products -- 17 per cent as dried milk, 13 per cent as fluid milk, and 2 per cent as cheese and other products; and the remaining 16 per cent as rehydrated milk produced by LICONSA.

Consumption of milk and dairy products in Mexico has been erratic. The increasing trend since 1980 was reversed in 1986. This downward trend lasted until 1989. Consumption has been growing at annual rates of 5 per cent ever since, reaching 9,569 million liters in 1992, and an estimated 9,811 million liters in 1993.

Current milk prices at producer and consumer levels vary depending on state and city. Prices, previously controlled at the national level are now "concerted" by state governments.

**Trade** -- Out of the total value of imports of dairy products, those of dried milk represent 40 per cent of total, butter and other milk fats represent 40 per cent; and whey and fluid milk represent the remaining 20 per cent.

Mexico is a major importer of dairy products, and the main importer of dried milk in the world, with a 53 per cent share of global imports, followed by Japan, with a share of 25 per cent, and Brazil, with a share of 5 per cent. Exports of dairy products are not significant.

From 1980 to 1989 Mexico relied increasingly on imports of dried milk products to meet domestic demand. The share of imports in total consumption went from 8 per cent to 31 per cent during that period. However, the trend has been reversed since 1990, due both, to a fall in the volume of imports, and a recovery in domestic production. The share of imports in consumption reached 26 per cent in 1992.

Imports of dried milk increased by an average annual rate of 19 per cent from the through of 1984 to 1990; from 100 thousand metric tons (US\$74 million) that year, to 288 thousand metric tons (US\$551 million) in 1990. However, high inventory levels and a recovery of growth in production resulted in an important reduction of imports of dried milk in 1991, to only 58 thousand metric tons (US\$108 million), and in 1992, to 213 thousand metric tons (US\$371 million). Main suppliers are the United States with a 34 per cent share, Ireland with 16 per cent, New Zealand with 13 per cent, France with 12 per cent and Canada with 12 per cent.

While imports of dried milk by the private sector are allowed, the share of CONASUPO in total imports remains high; at 86 per cent in 1992.

**Trade policies** -- As part of a major programme to liberalize its economy, following its accession to the GATT in 1986, Mexico has significantly reduced its tariffs and removed import permit requirements for most products. Furthermore, in December 1988 Mexico went beyond its obligations under GATT, which set overall tariff ceilings at 50 per cent, and unilaterally reduced the maximum tariff rate to 20 per cent -- with the exception of sugar -- from a 1985 maximum of 100 per cent.

Included in the package of elimination of import licensing requirements were agricultural products, which had, up to 1986, been applied to all imports, and are today maintained only for selected commodities. Dairy products still requiring an import license include dried milk; evaporated milk; fresh, founded, and soft cheeses.

The trade policy reforms initiated since 1985 significantly reduced direct and indirect price discrimination against the dairy sector. Import barriers were reduced for major inputs such as machines, pesticides, and other high technology inputs. They were totally eliminated at the beginning of 1993.

While import restrictions that result in high domestic prices for feed grains and, to a smaller degree, oilseeds, still tax the Mexican dairy sector, trade liberalization under the NAFTA, combined with the implementation of PROCAMPO (Mexico's new support programme for the farm sector) will result in the alignment with international prices, of domestic prices for the major feed grains and oilseeds, by the middle of 1995.

The following background statistics were provided by the Ministry of Agriculture.

YEAR	Milk Production (Million Liters)		
	TOTAL	COWS	GOATS
1980	7,021	6,742	280
1981	7,151	6,856	294
1982	7,224	6,924	301
1983	7,057	6,768	289
1984	7,141	6,860	280
1985	7,474	7,173	301
1986	6,539	6,373	165
1987	6,350	6,201	149
1988	6,281	6,159	122
1989	5,704	5,577	127
1990	6,266	6,142	124
1991	6,848	6,717	131
1992	7,122	6,974	148
1993	7,555	7,404	151

**Fluid Milk Consumption**  
(Million Liters)

YEAR	PRODUCTION		IMPORTS	NATIONAL APPARENT CONSUMPTION (4)=(1)+(2)+(3)
	LICONSA <sup>1)</sup> (1)	OTHER <sup>2)</sup> (2)	<sup>3)</sup> (3)	
1980	564	7,021	48*	7,633*
1981	750	7,151	49*	7,949*
1982	788	7,224	49*	8,061*
1983	972	7,057	48*	8,077*
1984	1,179	7,141	49*	8,368*
1985	1,515	7,474	51*	9,040*
1986	1,761	6,539	45*	8,344*
1987	1,513	6,350	43*	7,906*
1988	2,372	6,281	43*	8,695*
1989	2,498	5,704	38	8,240
1990	2,335	6,266	32	8,632
1991	1,994	6,848	52	8,894
1992	2,376	7,122	71	9,569
1993	2,185*	7,555	71*	9,811*

<sup>1)</sup> From imported dried milk; <sup>2)</sup> Includes goat milk; <sup>3)</sup> Does not include condensed or evaporated milk

\* Estimate.

## Hungary

### - *Market developments and related factors*

The Hungarian Agricultural market is regulated by the Law on Agricultural Market Regime, implemented on 2 March 1993. Nevertheless cowmilk belongs to the directly regulated group of products, due to the unsettled ownership situation of the sector, there is a temporary regulation at the moment, according to which the collection of milk is subsidised.

	<b>Collection price</b> (H. Forints per litre)	<b>Subsidy</b> (H. Forints per litre)
Extra quality milk	25	1.50
First quality milk	23	1.00

The export of some of the processed dairy products are also subsidised.

<b>Products</b>	<b>Normative Support</b>
Butter	10 %
Cheese	30 %

### - *Adjustment measures and policy developments in the dairy sector*

There is a declining trend in both production and consumption of dairy products in Hungary at present time. Although there is an increase in price of milk it has hardly been enough to cover the production costs, nevertheless there was a temporary lack on the consumption market.

<b>Years</b>	<b>Milk production prices</b> (H. Forints per litre)
1991	14.40
1992	15.70
1993	19.20

The trade liberalisation procedure has been accelerated during the recent years, what strongly influenced the domestic situation of the Hungarian dairy sector, mainly because of the not very effectively working import tariff and levy system.

## MILK AND DAIRY PRODUCTS MARKET IN OECD COUNTRIES

### MEDIUM TERM FORECASTS TO 1998

#### Introduction

The medium term outlook includes data through the 1998 calendar year; however, it should be noted that these forecasts do not take account of the GATT agreement. Even though data is presented for the 1990-92 base period, for the purposes of comparison, the forecast period is assumed to be the five year period 1993-1998. The projections presented on the following pages were prepared by the Secretariat as part of its annual "monitoring exercise." Much of the text and statistical material for this paper can be found in the Directorate's publication *Agricultural Policies, Markets and Trade - Monitoring and Outlook 1994*, which will be released June 4, 1994. As in the past, data used for the projections are based primarily on Member countries' replies to questionnaires. However in 1994, selected results derived from the Directorate's AGLINK database and modeling procedures were used in some cases to complement the data contained in the questionnaires. One of the main advantages of the Secretariat's AGLINK database and modeling procedures is the ability to present a more balanced, overall view of the OECD-wide situation (production, consumption, trade, prices and stocks) for specific commodities -- in this case, for milk and dairy productions -- than is otherwise the case by a simple evaluation (in isolation) of a series of individual, country contributions. In this manner, the AGLINK modeling procedures is complementary to the existing method of individual country questionnaires. The commodity projections for 1998 do not include the potential effects of the GATT agreement nor the reform measures envisaged under the EC's Common Agricultural Policy, since some aspects of these reforms have not been formally implemented by the EC council of Ministers, e.g. reductions in milk quotas.

#### A. The situation at the end of 1993

According to the FAO, world milk production declined by about one per cent in 1993 to 507 million tonnes. Most of this decline is related to a decrease of 8-9 per cent in Eastern Europe and the ex-USSR. In OECD countries in 1993, the imbalance between supply and demand for milkfat lessened compared with 1992. The 1993 market situation was characterised by marginal increases in total OECD milk production and milkfat consumption and a reduction in stock levels of about one-fifth for butter, while skim milk powder (SMP) stocks declined 3 per cent. Total OECD milk output in 1993 was about 227 million tonnes, virtually unchanged from the 1990-92 average (Table 1), or about 52 per cent of world bovine milk production. World dairy product prices remained largely above the GATT minima, except for butter and butteroil which were around their minima; however prices weakened considerably in the last half of 1993. Butter production, utilisation and stocks continued to decline in most OECD countries. Output of SMP increased marginally, however, stock levels continued to decline due to de-stocking policies (Table 2). Thus, product balances in 1994 are expected to decline significantly compared to 1990-1992 average (Table 3). The total volume of world trade in dairy products declined in 1993 (Graph 1), reflecting primarily lower shipments to the ex-USSR. For example, butter exports by OECD countries to this area declined by about one-third in 1993.

## B. Main policy developments

The OECD countries continued to progressively reduce price support for their dairy sectors, although few new major policy initiatives were undertaken in 1993. Most countries continue to reduce prices as a primary means of decreasing support, and real prices to producers continued to decline (Table 4). For example, support prices for milk and/or dairy products, and direct payments to producers were lowered in Australia, Austria, the EC, Sweden, Switzerland, and the United States. In several countries (Canada, Finland and the United States), methods of calculating support prices for dairy products were altered to respond to changing market conditions, and/or to encourage the production of milk with a higher protein content. Since world prices were relatively strong (except for butter) in the first half of 1993, intervention purchases of dairy products in the EC and the United States were reduced again. Thus, total OECD intervention stocks are substantially below their levels of the 1980s.

As regards quota policies, which are in force in most Member countries, the picture is mixed. In the EC, quotas were increased temporarily for Greece, Italy and Spain, and SLOM quotas were raised by 0.6 per cent in the other nine member states. A general EC-wide one per cent cut in the 1993/94 quota, as agreed in principle by the Council of Ministers, was deferred, pending further discussions. A new structural initiative in the EC, involving a cessation scheme was implemented in early 1994, offering payments to producers who abandon milk production completely. The quotas given up can be redistributed at the discretion of national administrations. New regulations concerning the transfer of quotas in Austria and Switzerland will tend to reduce their national quotas. In Canada, the industrial milk quota was increased by 4.5 per cent for the 1993/94 dairy year, reflecting an expected recovery in domestic butter consumption after several years of reductions. In the case of export assistance, export restitutions per tonne in the EC were reduced in 1993 on two occasions; whereas, in the United States, bonus rates for the Dairy Export Incentive Program were virtually unchanged from the previous year's level.

## C. Medium term outlook

According to OECD baseline forecasts, the medium term outlook for milk and dairy products will be characterised by: lower output growth to 1998; continued slow OECD demand growth for milkfat (primarily related to population growth); sharply lower dairy product balances; lower export volumes; and, an increase of about 20 per cent in world prices.

### (i) Production

In the medium term (Table 3), the traditional export availabilities for dairy products are expected to decline, as total OECD milk production is forecast to rise by only 1-2 per cent over the forecast period to 1997/98). Such a relatively small increase generally reflects continued quota-related reductions in output in Member countries where quota measures are the primary policy instrument to regulate milk production. In OECD-Europe, a decline in production of about one per cent is forecast. On the other hand, increases of about 8 per cent are expected in New Zealand, where dairy production reacts

rapidly to the expected rise in world prices, as well as to the relative prices of other commodities and also in Japan where, in spite of production quotas, dairy output rises in response to domestic demand. A five per cent rise is expected in the United States in response to a growing domestic market and the effects of bovine somatotropine (BST).

(ii) Consumption

Consumption patterns are expected to follow recent trends: i.e. reduced utilisation of butter; continued growth in consumption of fresh products and cheeses; as well as a continuation of the general trend towards lower-fat dairy products. As a consequence, production and utilisation balances for the OECD region are forecast to decline for butter and skim milk powder, and to stabilise in the case of cheese. Consumption of milk and dairy products in Japan and Turkey is expected to continue to rise faster than in other OECD countries, as milkfat in general becomes a more common element of consumer diets in these countries.

(iii) Prices

The forecast of a minimal increase in total OECD milk production and declines in butter and SMP balances represents a change from the situation of the 1980s. Thus, in the 1990s it is likely that stocks will remain below their average levels of the 1980s which, in turn, should favour higher prices on the world market. A price increase for butter and SMP of about 20 per cent (compared to 1993 levels) is forecast whereas, the rise in cheese prices is expected to be around 15 per cent. However, such price increases may be hampered by the uncertainties discussed in the following paragraph.

(iv) Trade

Some major uncertainties overhang world dairy markets in the medium term. For example, the future commercial market for dairy products in the ex-USSR remains extremely uncertain in view of the steep decline in butter imports in 1992-1993 and, the future outlook for financing commercial imports. Other developments which could influence trade volumes/flows include: the potential for exports from the Baltic Republics and Eastern Europe; the volume of imports by the OPEC, the developing and Pacific countries; and dairy-oriented aspects of the GATT agreements.

D. Main conclusions

The following observations emerge from the medium term outlook for dairy products according to the baseline projections:

- lower production growth, lower product balances, and lower exports;
- continued slow demand growth for milkfat in OECD countries;
- continued shift in consumer preferences for lower-fat products;
- higher international dairy product prices; and,
- continued uncertainty concerning ex-USSR dairy product imports.

The fact that total OECD milk production is forecast to rise by only 1-2 per cent over the forecast period (which is actually lower than projected increases in population) and the medium term balances of both butter and SMP are expected to fall by about 10-15 per cent, represents a dramatic change from the situation of the 1980s. This will lead to a situation in which stocks are substantially below their average levels of the past decade which, in turn, will foster higher prices on the world market.

The forecast medium term outlook is, in large measure, due to the fact that over the past few years OECD dairy production policies have gradually attempted to reflect the situation on domestic and international markets, which has contributed to a significant reduction in the rate of increase in total OECD milk production. This has been especially evident in countries which rely primarily on quota systems to regulate output.

#### E. Critical factors in the outlook

There are several uncertainties which could influence the world market in the medium term, in particular as regards the probability of commercial imports of dairy products (especially butter) by the ex-USSR. For example, the production potential of the ex-USSR has been seriously weakened by the drastic decline in dairy cow herds and milk yields. Also, the potential for commercial imports of dairy products remains constrained by a serious shortage of foreign exchange. Herd rebuilding and the availability of foreign exchange are not expected to improve significantly over the medium term, thus the majority of OECD dairy exports to this area are not expected to be commercial undertakings. On the other hand, even though milk and dairy production in Eastern Europe and the Baltics may continue to be affected by the impact of the creation of the ex-USSR, periodic surpluses are forecast to continue in these countries in the medium term. Thus, it is likely that some exports of butter and SMP from these countries will continue in the medium term. However, these exports may not be a cause for concern to OECD exporters in general, since their stock levels will be significantly lower.

On the supply side, other uncertainties which could affect OECD milk production in the medium term are: a) the possibility of world cereal and oilseed prices declining to a level lower than in the baseline, which could stimulate a general rise in milk output; and, b) changes in milk production policies in OECD countries, for example selected quota policies (which are in force in most Member countries), CAP reform; and, the potential impacts of BST. As regards the former, the ultimate impact on milk production from any decrease in feed prices could be relatively minor; however, such a scenario would reduce SMP used for animal feeding in the EC, which could lead to higher exports which, in turn, would contribute to a slower increase in world prices for SMP. Significant changes in quota policies would have a rapid and direct impact on milk output. However, as regards BST, its usage in countries other than the United States is uncertain over the medium term. Commercial usage in the US began in early 1994 and, its potential impact on US production has been taken into account by USDA forecasts, and thus also in the baseline projections.

Table 1

Table 2

Table 3

Table 4

Graph 1

Graph 2

Table 1

Table 2

Table 3

Table 4

Table 5

Table 6

Table 7

Table 8