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The Market for Dairy Products
Situation and Outlook
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THE MARKET FOR DAIRY PRODUCTS
Situation and Outlook -- Second Quarter 1992 (1)

A. International Market Developments

1. During the first half of 1992 international dairy markets and prices were strongly influenced by three major factors. The first factor was supply-related, due to the normal seasonal increase in milk output in most OECD countries. Secondly, stronger international demand led to declining stocks of dairy products in OECD countries (Graph 1). Thirdly, movements in relative currency values continued to be a source of significant short-term price fluctuations. In early 1991, the values of major European currencies relative to the US dollar were strong, e.g. the dollar was around DM 1.55. The dollar strengthened in March to an average rate of DM 1.66. During July the dollar weakened again, to around DM 1.48-1.50 at the end of the month. Such movements affected international market prices and trade flows, as exporting countries made downwards adjustments in their price quotations in US dollars.

2. Table 1 illustrates the ranges of dairy product prices during the last quarter of 1991 and the first two quarters of 1992. (See also Graph 2.) In general, prices have strengthened considerably since the end of 1991. As a result of stronger prices, a proposal to increase the minimum export prices under the GATT International Dairy Arrangement (IDA) was on the agenda for the Group’s September 1992 meeting.

<table>
<thead>
<tr>
<th>Product</th>
<th>4th Qtr. 1991</th>
<th>1st Qtr. 1992</th>
<th>2nd Qtr. 1992</th>
</tr>
</thead>
<tbody>
<tr>
<td>Skim milk powder</td>
<td>1 600 - 1 800</td>
<td>1 550 - 1 700</td>
<td>1 600 - 1 900</td>
</tr>
<tr>
<td>Whole milk powder</td>
<td>1 600 - 1 800</td>
<td>1 550 - 1 700</td>
<td>1 550 - 1 900</td>
</tr>
<tr>
<td>Butter</td>
<td>1 500 - 1 850</td>
<td>1 400 - 1 550</td>
<td>1 350 - 1 600</td>
</tr>
<tr>
<td>Butteroil</td>
<td>1 750 - 2 250</td>
<td>1 700 - 1 950</td>
<td>1 625 - 1 950</td>
</tr>
<tr>
<td>Cheese (Cheddar)</td>
<td>1 600 - 2 050</td>
<td>1 750 - 1 950</td>
<td>1 750 - 2 100</td>
</tr>
</tbody>
</table>

3. In the case of individual products, sales of butter remained stagnant. The market for skim milk powder (SMP) during the first half continued to improve as several importers in Latin America made very large purchases (e.g. about 200 000 tonnes by Mexico), which continued to support market prices. If such demand continues, some problems of supply could emerge by end-1992: for example, Australia and New Zealand have already committed all their supplies for the current season. In the EC, current production levels are scarcely able to meet demand. The world market for whole milk powder (WMP) has, in general followed the market for SMP: Venezuela continues to be the major market. The international market situation for cheese remained strong in the first half: prices advanced steadily in response to strong demand. Cheese prices are expected to remain strong over the short term.

(1) Exceptionally, the standard tables concerning production and stocks are not included in this issue. They will be continued in the next issue.
4. As regards trade flows, world trade in dairy products continues to be heavily dependent on demand in the former USSR (almost 50 per cent of world butter trade), Eastern Europe, OPEC, and to a lesser extent, in selected developing countries. According to the USDA(2), butter imports by the former USSR and Eastern Europe in 1992 are expected to rise to 345 000 tonnes, up from 284 000 in 1991, primarily due to substantial volumes of food aid from OECD countries. Food aid in dairy products to this area by the EC and the US in 1991/92 was about 100 000 tonnes of SMP and about 50 000 tonnes of butter. As of mid-1992, there were industry reports of inquiries concerning purchases of butter from the CIS countries; however, actual deals usually failed to be finalised due to the shortage of hard currency and the perception by the potential customers that international prices were too high. Poland and the CSFR are likely to continue to export SMP in 1992, however, total volumes may not equal their levels of recent years. In early 1992, Lithuania entered the export market, with small shipments of food quality SMP to Japan. As regards other regions, after-effects of the Gulf War continued to constrain dairy product imports by some countries in this region. Meanwhile, Central and Latin American countries (e.g. Mexico and Venezuela) continue to import large quantities of milk powders. Imports of dairy products by other emerging economies and developing countries (e.g. Northern Africa, Nigeria) continue to be affected by economic and/or political unrest.

5. During the past year, even more so during the first half of 1992, significant changes have occurred in the stock situation in OECD countries. This has resulted from a combination of factors. Firstly, declining milk and butter production in some producing countries, e.g. in the EC and Canada, where butter output in the second quarter was estimated to be about 12 per cent below the year-earlier period. Also, in the EC, SMP production declined by 28 per cent in the first half compared to the year-earlier period. Secondly, export demand for dairy products (combined food aid and commercial sales), has risen especially for milk powders and butter. Thus, a larger proportion of this demand was met through existing stocks. The Secretariat estimated that in September 1992, OECD intervention stocks of butter were about 620 000 tonnes, down from a level of 730 000 tonnes on 1/1/92; while aggregate SMP stocks were expected to be about 635 000 tonnes, compared with 739 000 tonnes at beginning of the year. Virtually all of the major producing countries have experienced declines in stock levels. However, it should be noted that some of the decline in intervention butter stocks in the European Community has been related to (a) significantly lower purchases as a result of improved market prices and, (b) its policy of shifting some of the burden of stock-holding to the private sector.

6. Sweeping changes in Austrian milk policies were agreed in 1992, with the twin objectives of reducing production and bringing milk policies more into line with those on the EC, prior to Austria’s ultimate adhesion to the Treaty of Rome. Briefly, these changes concern the Milk Board, the regional marketing system, target prices, milk quality and the quota system.

   - Milk Board: As of 1/1/93, the systems of transport equalisation and price pooling will be progressively abandoned. By 1/1/94, the funds spent for these purposes must be reduced by 75 per cent to AS 850 million.

   - The regional marketing system: By 31/12/93 this system, which forbids dairies to purchase milk and market milk products outside well-defined regions, will be abolished.

   - Target Prices: As of 1993, these prices will be based on the level of the previous year, rather than by a process of negotiations between the Government and producer organisations as in the past. Depending on supply conditions, dairies will be allowed to pay producers up to 3 per cent less than the target price in 1993, and by up to -4 per cent in 1994.

   - Milk Quality: The criteria will be the same as in the EC, beginning on 1/1/93.

   - The Quota System: Several changes have been made in the administrative rules. For example in the past, when quotas were transferred, 15 per cent of the total quota volume was forfeited to the Government, and no new quotas were made available on a priority basis to those farmers desiring to enter the industry. This regulation was declared unconstitutional. Current regulations still require that 15 per cent of all transfers be forfeited; however, a portion of the forfeited quotas must be held in reserve by the Government to be sold to newcomers.

AUSTRALIA

7. According to recent ABARE data, total milk production in the 1991/92 dairy year is expected to be about 6.81 million tonnes, the highest level since 1973/74, and about 3 per cent above the 1990/91 volume. This is primarily due to exceptionally favourable seasonal production conditions, beginning around November 1991. The average producer price of manufacturing milk rose by one cent to A$ 0.223, due to the fact that most of the increase in production was exported, in response to higher international prices. As a result, the aggregate value of dairy exports is estimated to rise by about 7 per cent to A$ 819 million in 1991/92. Producer returns to market (drinking) milk also rose -
from A$ 0.409 to A$ 0.432, in response to increased domestic consumption. Increased returns from both international and domestic sales are expected to result in a substantial rise in aggregate producer incomes for the 1991/92 production season. However, unless the exceptionally favourable production conditions continue, milk production, exports and returns to producers for the 1992/93 season (which began 1/7/92) are expected to be lower. For example, estimates by the ABARE in June predicted a decline of about 5 per cent in the aggregate value of dairy exports in 1992/93.

Adjustment measures and policy developments in the dairy sector

Federal marketing arrangements for manufactured dairy products were reviewed by the Industry Commission in 1990 and 1991. The final findings and recommendations of this review were presented to the Government in November 1991; and, the Government announced its official response in mid-1992. The strategy falls short of the once anticipated major de-regulation. It took effect on 1/7/92. The most important changes are as follows:

- a one year moratorium on reductions in market support assistance to producers in recognition of difficult circumstances facing many producers;

- a reduction in the market support payments for manufactured dairy exports beginning with the 1992/93 milk year, in equal steps to 10% above the export parity prices by the year 2000;

- no further legislated support to the dairy industry after 2000, at which time it will be treated the same as other industries;

- as of 30/6/92, the termination of minimum pricing arrangements by which the government underwrites dairy prices against fluctuations in world prices;

- an increase in industry promotion levies and expanded usage of this promotional fund.

NEW ZEALAND

Market developments and related factors

The quantity of milk produced in the New Zealand dairy season that ended on 30 May 1992, at 8.2 million tonnes, was a record owing to higher than average rainfall in late summer and early autumn. Dairy cow numbers in that season, at 2.6 million, were three per cent lower than in 1990/91. The amount of milk processed for manufacturing dairy products was 7.7 million tonnes of milkfat. The quantity of skim milk powder manufactured was down by seven per cent but there were significant increases in the amounts of other dairy products manufactured.

Most dairy cows calve in August, at the end of the winter. The winter in many dairy districts was cold and wet with inadequate feed. Early milk production is expected to be lower than in previous seasons. At the opening
stages of the June 1992 to May 1993 dairy production season only average levels of milk production can be forecast.

11. Dairy farm net profit returned to average levels in the 1991/92 season, after being severely depressed in 1990/91. Improving international dairy product prices are expected to lift dairy farm incomes further in 1992/93.

CANADA

{Market developments and related factors}

12. Industrial milk and cream production in the 1991/92 dairy year (August-July) was 49.18 million hectolitres (hl), down from 50.19 mlh from the previous season. It appears that commercial sales of low-fat milk have stabilized this year but the demand for standard milk continues its downward trend. Fluid cream sales have shown an increase. Butter production is expected to decline in the current dairy year, and could fall further in the following year. Skim milk powder is also declining and is expected to fall to 75 million kg this dairy year and to fall to 70 million kg. next dairy year. Cheddar cheese production and consumption are forecast to increase during the current dairy year. Such patterns of production are reflected in international trade flows, for example, forecasts by Canada Agriculture (3) point to a 2 per cent decline in the value of dairy product exports in calendar 1992, to around C$ 177 million.

13. According to recent estimates, consumption of milk for liquid purposes is expected to rise slightly in 1991/92. Most of this increase will come from the continued popularity of low-fat drinking milk with a milkfat content of only 1 per cent. After 10 months in the dairy year, sales of this product rose by about one-third. At the same time, sales of skim milk rose slightly, while sales of standard (whole) milk declined by 8 per cent. In the case of butter, consumption is forecast to decline by 4 per cent in 1991/92 and by 3 per cent during the next dairy year. Cheese consumption is expected to rise by about 1 per cent in 1991/92 and by another 1 per cent in 1992/93. During the first half of the dairy year, demand for this product rose by about one-third. At the same time, sales of regular skim milk rose only slightly, while sales of standard (whole) milk declined by 7 per cent. Sales of liquid (drinking) milk are expected to rise by 2 per cent over the next 2 years. In the case of butter, consumption is forecast to decline by 4.5 per cent in 1990/91, and by 3 per cent during the next dairy year. The consumption of cheddar cheese is expected to rise by about 1.5 per cent annually over this period.

{Adjustment measures and policy developments in the dairy sector}

14. Producer prices for the 1991/92 season are estimated by Agriculture Canada at C$ 49.92/ml, an increase of 2.5 per cent over the past season. Prices are forecast to rise to C$ 51.00/ml for the 1992/93 season. The shift in consumer tastes has been partially responsible for a shift in the emphasis on support prices between butter and SMP. Currently, for example, one-third of any increase in the target price is applied to butter, while two-thirds is (3)

applied to SMP. Another pricing change related to consumer consumption patterns, has been the introduction of multiple component pricing in the fluid milk market to give a higher economic value to the solids-not-fat (snf) component. This system was applied in January 1992 in Ontario and in Quebec in August 1992.

15. Target return to producers for industrial milk for the 1992/93 dairy year was maintained at C$ 49.76/hL for milk containing 3.6 kilograms of butterfat. Last year, a C$0.16 was included on top of the target return; C$0.14 to assist in financing the carrying charges associated with the marketing of butter and C$0.02 as processor contribution to a rebate fund for food manufacturers using dairy ingredients. This year, the butter carrying charged were reduced to C$0.08 because of a reduction in necessary stocks to meet domestic market and a reduction in interest rates. The final target price will be C$49.86 a reduction of C$0.06 compared to the last dairy year. The support price of butter will be reduced by C$0.014 to 5.317 per kilo because of the reduction in carrying charges. Another pricing change related to consumption patterns, has been the introduction of multiple component pricing. The new multiple component pricing will price raw milk based on its content of butterfat, protein and other solids. This system was applied in January 1992 in Ontario and in August 1992 in Quebec.

UNITED STATES

{Market developments and related factors}

16. According to the June 1992 USDA {Agricultural Outlook}, total milk production in 1992 is expected to rise 1.2 per cent, i.e. to 68.18 million tonnes, compared to the 1991 level of 67.36 million tonnes. At the same time, dairy cow numbers are forecast to decline by 1.5-2.0 per cent. The decline in cow numbers, the largest since the mid-1970s (except for buy-out programmes), is related to relatively high slaughter cow prices and the relatively low returns to dairying during the last quarter of 1991, and to the increased number of producers abandoning milk production. However, the exit rate is not expected to be as large as during early 1991, when low prices following 2 years of high prices precipitated substantial exit. For all of 1992, returns over concentrate costs are expected to be similar to 1991. During the first half of 1992, producer prices were about 10-12 per cent above the 1991 monthly average of $12.23/cwt. The USDA estimates that milk prices in 1992 will average $0.50-1.00/cwt above the 1991 level.

{Adjustment measures and policy developments in the dairy sector}

17. In January, the 1992 allocations for the Dairy Export Incentive Program (DEIP) were announced. Bonuses will be available on 177 700 tonnes of milk powders to 84 countries, 51 800 tonnes of butterfat to 70 countries and 4 700
tonnes of Cheddar to 13 countries. In June, this list was expanded to include several drought-affected African countries (19,000 tonnes of SMP), as well as India (10,000 tonnes of SMP). The total volume of shipments in 1992 is likely to be significantly above the 1991 level. For example, by mid-1992, shipments had already reached almost 50,000 tonnes of SMP, and several contracts for butter and butteroil had been signed. Such increased DEIP activity is likely to be a factor in the rise in producer prices mentioned above. Since November 1991, bonuses have been paid to exporters in cash rather than in commodity certificates from CCC stocks. In 1991, total export sales under the DEIP of dairy products were about 140,000 tonnes of SMP and about 40,000 tonnes of butter and butteroil.

18. The 1990 Farm Bill allows two revisions in the CCC purchase price of dairy products. These prices were revised in January and again in May in order to better reflect the market value of milkfat and nonfat components for milk in an effort to encourage producers to produce milk with a higher proportion of nonfat solids and to promote greater commercial usage of milkfat. For example, the total changes for the two revisions were as follows: butter, a decline from $2.16/kg to $1.68/kg; SMP, an increase from $1.87/kg to $2.14/kg; block Cheddar cheese, an increase from $2.44/kg to $2.45/kg. Producer support prices remain at $10.10/cwt ($222.65/tonne), as defined by the Farm Bill. A producer programme service levy of $0.05/cwt ($1.10/tonne) remains in effect as part of a national budget deficit reduction agreement.

EUROPEAN COMMUNITY

{Market developments and related factors}

19. Intervention stocks of butter and SMP continue to decline. The drawdown began in the last quarter of 1991. As of 30/7/92, intervention butter stocks were 175,700 tonnes, compared with carry-over stocks of about 300,000 tonnes at the beginning of 1992. However, the volume of butter in private storage was about 176,200 tonnes, more than double the year-earlier level. For comparison, the average level of private stocks at mid-year during 1988-1990 was 145,000 tonnes. During the first half of 1992, one of the largest releases of butter from intervention was the 25,000 tonne food aid consignment to major cities of the former USSR. Also, during this period, relatively small quantities of butter were sold into intervention storage, (from Spain and Portugal). Stocks are expected to decline further over the next few months. It is likely that butter output as from about mid-year will about equal the requirements of internal demand and commercial exports. Should exports to third countries (food aid included) about equal 1991, which remains to be seen, 1992 carry-over stocks could be as low as 150,000 tonnes.

20. Due to the significantly increased world demand for SMP, intervention stocks as of 30/7/92 were about 124,500 tonnes, less than one-third their level of 1/1/92. If the current rate of reduction in SMP stocks continues, due to exports and the continued subsidized demand from the EC compound feed industry, supplies could become tight in late 1992. For example, the seasonal peak in EC milk output has passed, and as of mid-year, there was relatively little fresh milk powder available for the feed industry. Thus, a larger percentage to the
demand from the feed industry may be met from intervention stocks. As of mid-year, no SMP had been taken into intervention storage

{Adjustment measures and policy developments in the dairy sector}•

21. Highlights of the dairy aspects of the 1992/93 Agreement of EC farm ministers concerning the reform of the common agricultural policy are as follows:

-- The quota system will continue to the year 2000. For the 1992/93 marketing year there will be no reduction in quotas. At the beginning of each of the following two marketing years, the Commission will report to the Council an outline of the current situation, with any relevant proposals. The aim of the Commission is a reduction of one per cent in both 1993/94 and 1994/95.

-- Quotas were increased by 100 000 tonnes for Greece. The increase for Spain was 500 000 tonnes, combined with a buy-out scheme. Changes in quota volume for Italy was undecided as of mid-1992. After an analysis of the application of the quota scheme in these member states in 1992/93, certain changes in the global guaranteed quantities will be agreed as from 1993/94.

-- The target price for milk will be decreased by 1.275 per cent annually in both 1993/94 and 1994/95. The intervention price for butter will be reduced by 2.5 per cent in the 1993/94 and 1994/95 marketing years, compared with the 1992/93 levels. The prices for SMP remain unchanged. These decisions can be revised annually in the light of market developments. Thus, the following prices will prevail (in ECU/100 kg):

1993/94: target price (-1.25%) = 26.47
• butter price (-2.5%) = 285.46
• SMP price = 172.43
• SMP price Portugal = 195.48

1994/95: target price (-1.25%) = 26.13
• butter price (-2.5%) = 278.14
• SMP price = 172.43
• SMP price Portugal = 183.95

-- The co-responsibility will be maintained for 1992/93, but will be abolished as from 1993/94.

-- The proposed dairy cow premium has been abandoned.

-- The final date for the leasing of quotas shall be 31 December, instead of 31 July. The dairy marketing year will begin on 1 June.
22. In 1991, milk production was about 8.60 million tonnes, compared to 8.57 million tonnes in 1990. Total output in 1992 is expected to vary little from the past two seasons. The Government continues to offer several kinds of support for livestock producers. For example, a subsidy of 25 per cent of the investment of the producer’s own capital in a new livestock project is provided by the State. This ratio is 30 per cent in under-developed regions. In the case of dairy farmers, incentive payments are available if they sell their milk to modern dairy processing plants. In 1991, this rate was TL 55-70 per litre: the rate for 1992 is expected to be near the upper end of this range. Total payments by the Government under this incentive programme were TL 106 billion in 1990 and were TL 115 billion in 1991. Since 1987, Government subsidies have been available for the importation of high-yielding dairy cattle. Currently, this subsidy is about TL 450,000 per cow, and rises to TL one million per animal in the under-developed regions of Turkey. As regards trade measures, an import surcharge of $60/tonne is applied to margarine imports, while margarine exports benefit from a subsidy of $50/tonne. (Note: The average dollar-lira exchange rate in 1991 was TL 4,169 per US dollar. As of mid-1992, it was about TL 6,900 per dollar.)