Directorate for Food, Agriculture and Fisheries

The Market for Dairy Products
Situation and Outlook
No. 28

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT
Paris 1991

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The Market for Dairy Products
Situation and Outlook -- Fourth Quarter 1991

A. International market developments

International market conditions for most dairy products continued to show modest but nevertheless solid improvement during the fourth quarter, continuing the trend which first developed following the peak production period in the northern hemisphere. Year-end prices in US dollars were about 20 per cent above their mid-year levels. On the other hand, much of the gain in prices was related to a decline in the parity of the dollar against major currencies. For example, the dollar/deutschmark exchange rate on 31/12/91 was 17 per cent below the average rate for the month of June. During the same period, dollar/ECU exchange rate declined by 15 per cent. According to GATT data, the following ranges of prices (in dollars per tonne, f.o.b.) were reported to the GATT International Arrangement (IDA) during the fourth quarter:

- Skim milk powder ...... 1 600 -- 1 800 (for human consumption)
- Whole milk powder ..... 1 650 -- 1 800
- Butter ................. 1 500 -- 1 850
- Butteroil ............. 1 750 -- 2 250
- Cheese (Cheddar) ...... 1 600 -- 2 050

It should be noted that these prices are well above minimum levels agreed by the IDA.

Aside from the influence of currency fluctuations, the improved world market situation in the fourth quarter was also linked to improvements in the market balance in the European Community (since the EC is the predominant single exporter). For example, the combined effects of (a) the stabilisation of internal prices: (b) the more stable internal market during the last half of 1991: and, (c) higher volumes of EC exports contributed to higher EC export prices. Since EC export prices heavily influence world levels, world market prices for dairy products also rose.

The main short term influence on international dairy market demand for 1992 remains the uncertainty concerning the future trading patterns and relationships with the individual Republics of the former USSR. Indeed, import demand (both commercial and concessional) from this region provided a stimulus to the international market during the latter months of 1991. However, short term uncertainty is likely to continue concerning selected Arab markets (which have traditionally been large importers of dairy products), such as Iran, Iraq, Kuwait and, to a certain extent Algeria.
B. Developments in national markets and policies

(Australia)

1. Market developments and related factors

National milk production for the September quarter of 1991 of 1 462 million litres was down slightly (0.3 per cent) on the corresponding period of 1990. However, there were significant divergences in production trends between regions. Production was down in the major manufacturing milk states of Victoria and Tasmania but up in Western Australia and New South Wales. On a national basis, preliminary production estimates for the five months to end-November suggest that the national production forecast for 1991/92 of 6 300 million litres will be met. This represents a decline of about 2 per cent from 1990/91 production levels (6 401 million litres).

As regards prices, the firming of international product prices in recent months has enabled major manufacturers to raise the farm gate price paid for manufacturing milk. There have been increases in the retail prices for market milk in some states to reflect the higher cost of production under the current dry seasonal conditions.

As regards utilisation, despite the slight reduction in overall milk supplies, sales of drinking milk in recent months have been almost 4 per cent above those for the corresponding period of 1990. Much of this increase is a result of the impact on consumption of the hot dry weather in Queensland and New South Wales, where quarterly milk sales were up by over 5 per cent.

The seasonal production of manufactured products such as butter and SMP fell as a result of increased utilisation of milk supplies for drinking milk during the spring quarter. However, the turn-round in Victorian milk supplies since October has alleviated manufacturer concerns regarding product availability.

The fall in fresh product supplies did not affect September quarter exports of butter and butteroil. Sales of both these products were up substantially reflecting the increased demand from major Asian Markets. Butter exports during the first nine months of 1991 totalled almost 30 000 tonnes, an increase of over 60 per cent on the same period of 1990. Domestic consumption of butter and butteroil during the September quarter was relatively static. However, there has been a decline in domestic sales of butter and butter blends to the domestic food processing and food service sectors as a result of the general slow down of the Australian economy. Local stocks of butter and butteroil fell sharply during the September quarter. Commercial stocks at the end of September of 7 900 tonnes were around half 1990 levels and well below normal commercial holdings for this time of year.

Export sales of SMP during the September quarter were down by almost 20 per cent down on 1990 levels. However, aggregate export sales during the first nine months of 1991 of 84 300 tonnes remain almost 30 per cent above 1990 shipments. More recently, there has been renewed buyer interest in SMP from major Asian markets. While commercial SMP stocks increased slowly during the September quarter to 17 200 tonnes, they remain well below normal levels for
this time of year. Dairy companies’ stocks as of the end of September were less than 60 per cent of their 1990 holdings.

Production of WMP in the September quarter rose sharply from 1990 levels. There has been some shift towards increased WMP production in 1991, in spite of the relatively slow start-up of WMP production in the Spring of 1990. Overall production of WMP for 1991/92 is expected to be slightly below the 1990/91 total of 59 700 tonnes. One factor behind the recent increase in WMP production has been the improved demand and returns in both domestic and export markets. Despite a strong increase in world prices, export sales of WMP during the September quarter reached 10 700 tonnes, an increase of 55 per cent on the same period of 1990. Overall, export sales during the first nine months of 1991 are 15 per cent above 1990 levels. The major factors contributing to these improvements have been increased demand from buyers in major Asian markets and the diversion of EC product supplies to Eastern European markets.

National cheese production in the September quarter of 1991 was 40 400 tonnes (2.5 per cent above the corresponding period in 1990, but slightly below 1989 levels). Production trends varied across the major varietal categories with increased output recorded for cheddar types, fresh and hard grating cheeses, while production of other types was lower. These trends reflect the ongoing strength in demand for cheddar and cream cheeses in major export markets such as Japan and Saudi Arabia. Export sales for the September quarter of 12 400 tonnes were 10 per cent above the previous year, while sales during the first three quarters of 1991 were up by 25 per cent over 1990.

Domestic demand for cheese has also been firm with September quarter sales up by over 2 per cent. This principally reflects the growth in retail sales of reduced/low fat cheddar cheeses and shredded cheeses. Sales of these products rose by 21 and 40 per cent respectively during the September quarter. Other cheese lines to experience increased demand included fresh cream cheeses and mold ripened cheeses. The share of domestic consumption accounted for by local cheese supplies has fallen recently from 85 to 83 per cent. This shift principally reflects an increase in imports from New Zealand particularly mozzarella cheese for industrial food processing usage. The strength of export demand and domestic consumption has held down local stock levels and no significant increases are expected in these over the coming months.

2. Adjustment measures and policy developments in the dairy sector

Federal marketing arrangements for manufactured dairy products have been under review by the Industry Commission since 1990. The final findings and recommendations of this review were presented to the Government in November; and, the Government’s official response is pending. New legislation covering the marketing of manufactured products is required by 30 June 1992 when the current legislation expires.

The Australian Dairy Corporation has also reviewed market support rates for manufactured dairy exports in light of recent international market trends and government underwriting contributions. As a result, market support
payments (MSP) were reduced by an average 4.5 per cent from 8 November 1991. The MSP rates applying to exports of major dairy products from this date are:

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<th>Product</th>
<th>MSP Rate</th>
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<td>Butter</td>
<td>432</td>
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<tr>
<td>Butteroil</td>
<td>533</td>
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<tr>
<td>SMP</td>
<td>413</td>
</tr>
<tr>
<td>WMP</td>
<td>437</td>
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<tr>
<td>Casein</td>
<td>1231</td>
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<tr>
<td>Milkfat</td>
<td>534</td>
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<tr>
<td>Solids non Fat</td>
<td>436</td>
</tr>
<tr>
<td>Cheese</td>
<td>238 -- 578 depending on cheese type</td>
</tr>
<tr>
<td>Whey Powder</td>
<td>93</td>
</tr>
</tbody>
</table>

{New Zealand}

{Market developments and related factors}

The previous season was favourable for grass harvesting for hay and silage. This provided for adequate dairy cow nutrition over the winter. Milk production at the beginning of the 1991/92 season was better than average but by November (i.e. summer), cold and wet conditions had restricted milk output to around year-earlier volumes. In New Zealand, where the dairy production is mainly based on grass, most of the annual fluctuations in output between years is a primarily a consequence of the amount of rainfall over the summer and early autumn. Widespread heavy rain throughout most dairy farming areas in January 1992 ensured continuing grass growth for the remainder of the summer. Expectations are that last season’s milk production levels will be equalled or exceeded.

In response to improved farm gate prices for milk in 1989/90 farmers reduced cow culling. In June 1990 milking cow numbers were 3.5 per cent above the June 1989 number. Preliminary results from the June 1991 agricultural census show a decline in cow numbers of 3.9 per cent back to the average of the last 10 years. With the lowest real farm gate prices for milk on record in 1990/91 the usual pattern of herd replacement has resumed.

There has been a cautious move by dairy manufacturing companies to increase whole milk powder production, while reducing the output of butter and SMP. Notwithstanding the marketing difficulties for butter, especially in relation to the former USSR, production of butter in the first half of the season has declined only marginally. When milk volumes reduce later in the season and there is unused manufacturing capacity, a greater proportion of milk will be directed to WMP production.
The average farm gate price for milk for the 1990/91 was NZ$ 4.24/kg milkfat or NZ$ 0.21 per litre of milk. Expectations for the present season are about NZ$ 5.00/kg milkfat or NZ$ 0.28 per litre of milk. Real net farm profit in 1990/91 was the lowest on record and caused extensive disruption throughout the dairy industry and more generally in rural areas. The forecast real net farm profit for the current season based on the expected farm gate price will be substantially below the average of the last 10 years.

As a result of such financial stress, the average farm size and average herd size have continued to increase each year. The search for economies of scale has led to a steady decline in the number of dairy companies as a result of amalgamations.

{Canada}

1. Market developments and related factors

Industrial milk and cream production in the 1990/91 dairy year (August-July) was 44.45 million hectolitres (mhL), down from 45.58 mhL from the previous year. During the 1991-92 dairy year, fluid milk output is expected to continue its upward trend at about the same pace as last year. 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.

2. Adjustment measures and policy developments in the dairy sector

Effective August 1, 1991, the Market Sharing Quota (MSQ) was reduced by 4.7 per cent to 42.6 mhL (41 mhL for the domestic market, plus a 1.6 mhL allowance for exports). The blended in-quota levy and the over-quota levy are C$ 3.37/hl and C$ 37.53/hl, respectively.

{Iceland}

1. Market developments and related factors

The economic situation in Iceland has been stable and therefore farmers’ incomes remain relatively good. However, due to international competition, it is unlikely that producer returns will increase substantially in the future.

2. Adjustment measures and policy developments in the dairy sector

In an effort to limit milk production, the Government recently offered to pay dairy farmers IKr 35/liter (about $0.65) for not producing milk in the 1991/92 season. The objective is to reduce output by 5 million liters, which the Government expects will be cheaper than subsidizing exports of surplus
production. If the objective is attained, the Government hopes to raise the aggregate production quota by about 5 per cent for the 1992/93 season.

{United States}

{Market developments and related factors}

Economic conditions facing the domestic market at the end of 1991 were considerably different than those at the beginning of the year. Milk supplies were smaller; wholesale dairy products prices were relatively strong; average farm milk prices were above a year earlier for the first time in a year; commercial use started to recover from recession-weakened levels; and surpluses removed from the market-place by the price support program were dramatically smaller.

Assuming the dairy provisions of the 1990 Farm Bill prevail and the economy recovers, 1992 is expected to be characterized by little expansion in milk production, slightly higher producer prices for milk, and improved commercial sales of dairy products. On the domestic front, in 1992, the dairy sector could face challenges associated with possible changes in Federal Milk Marketing Orders. Beyond 1992, new domestic food labeling rules may provide incentives for the increased production of lower fat versions of high milkfat-content products, such as Cheddar cheese, butter, and ice cream. One final unresolved issue on the near-term horizon is the approval of BST, and it’s ultimate usage by producers.

Low milk prices from late 1990 until mid-1991 and strong prices for cull dairy cows eroded expansion in milk output very quickly in 1991. For example, production during the third quarter declined almost 1 per cent. Producer prices for milk increased during the second half of the year and helped to slow the decline in production during the fourth quarter. Producer prices for milk in the fourth quarter were considerably higher than earlier in the year and were 10 per cent above the fourth-quarter 1990. Total 1991 milk production is projected to be about 67.36 million tonnes, similar to 1990; while milk cow numbers will average about 1 per cent below 1990’s 10.1 million. Milk yields per cow rose about 1 per cent over 1990.

In early 1992, continued high concentrate feed prices and declining milk prices will erode most of the improvement in milk-feed price relationships expected for fourth-quarter 1991. The milk-feed ratio is expected to average 1.6 down from 1.7 during the fourth quarter. Producer returns over concentrate costs are projected to drop almost 10 per cent. The relatively low returns expected in the first half of 1992 may result in larger numbers of farms exiting the industry than was typical during the 1980s. 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. The milk-feed ratio could decline to about 1.5. This ratio is associated with a growth rate in concentrate feeding and milk per cow which is well below trend levels.

Producer prices for milk will in 1991 will average above those prices of a year ago. The 1991 price of all milk is expected to average about $12.25 per cwt, down about 10 per cent from 1990 and 1989, but basically unchanged from
1988. Late 1991 increases will not be enough to outweigh the very large year-to-year declines posted during the first three quarters of the year. Increases in wholesale dairy products prices between May and early October were translated into sizable increases in farm milk prices. The Minnesota-Wisconsin (M-W) price of manufacturing grade milk was $12.50 per cwt in October, $2.48 above the March low level and $2.02 above a year ago. The average price of all milk received by farmers was $13.20 per cwt in October, $1.90 above the $11.30 level in April, and 10 cents above a year earlier. October marked the first time in 12 months that farm milk prices were above their year-earlier levels.

At the beginning of 1992, total dairy product stocks, milk equivalent (milkfat basis), are expected to be below a year earlier. Projected increases in commercial sales and smaller milk supplies for the second half of 1991 will result in a more normal seasonal draw-down of available stocks. Given the forecasts for increases in commercial use of 2-3 per cent for 1992, and little change in milk production from 1991, total stocks during 1992 will finish the year below year-earlier levels.

In calendar 1992, the milk surplus is expected to decline. Net removals by the CCC, milk equivalent (milkfat basis), of dairy products under the price support program are forecast at 2.7-3.6 million tonnes. A relatively healthier economy is expected to stimulate commercial use, while the milk supply is forecast to increase little.

After increasing 30 per cent from a year earlier during the first 6 months of 1991, CCC net removals fell sharply during the third quarter. Removals during the last quarter were very small and made up solely of butter. The quantities removed from the market include amounts exported through the Dairy Export Incentive Program (DEIP). For all of 1991, net removals of dairy products are forecast to be about 4.5 million tonnes, milk equivalent, up from 4.1 million a year earlier.
The Dairy Market Situation in the
Czech and Slovak Federal Republic, Hungary and Poland

A. Highlights of the current situation

The fundamental political and economic changes taking place in the Czech and Slovak Federal Republic (CSFR), Hungary and Poland have contributed in large measure to the current recession in each of these countries. The economic changes underway, which differ in pace and intensity between the three countries, are expected to result in some disruption in virtually all sectors of the economy, including the respective agricultural sectors of these countries during their transition to a more market-oriented agricultural economy. In fact, significant impacts have already been felt in the short term as regards the production, consumption and trade of several major agricultural commodities, including milk and dairy products.

In the case of production, primarily due to inflationary pressures and lower supplies, farmers’ prices paid for virtually all inputs have risen in excess of prices paid by dairies to producers for their milk. Caught in the midst of such a cost-price squeeze, producers have subsequently reduced their usage of purchased inputs (including credit), which has affected output. For example, primarily as a result of significant declines in profitability, milk production declined by about 20 per cent in both the CSFR and Poland during the first half of 1991, and by about 10 per cent in Hungary. In addition, producers have reacted to the effects of lower consumer demand, together with drought conditions in some parts to this region in 1990 and 1991, which fostered increased cow slaughter. In addition to lower output of milk and dairy products, the combination of the above factors has resulted in substantially reduced dairy herds in all three countries. The output of milk and dairy products in the three countries continued to decline during the last half of 1991; and, aggregate output in 1992 will continue to be constrained by the drastically reduced cow herd. (See Table 1).

Higher inflation has adversely affected consumer incomes, causing a serious decline in real wages. The per capita consumption of milk and dairy products has dropped significantly in all three countries as a result of lower disposable incomes, coupled with retail price increases following the abolition of consumer subsidies and most price controls. Since the supply response of milk in 1991 did not keep pace with the lower demand (in spite of the recent implementation of herd buy-out schemes in two of the three countries) on both domestic and international markets, surpluses of dairy products resulted, and in many cases were sold on world markets with the aid of export subsidies. Such "distress sales" in 1991 placed additional strains on national treasuries during their "high stress" period of economic transition.
As a consequence of the fall in consumption due to increased retail prices, all three countries had exportable surpluses of dairy products in 1990, and in 1991. In many cases, these products have been exported with the aid of export subsidies. In the case of SMP, some sales were made below the GATT International Dairy Arrangement minimum price level (especially when the quality was below average), which caused some concern among major exporting countries. Other sales have been made at low prices under special derogations by the IDA. The current trade situation remains rather volatile, for example, due to excessive exports of butter in 1990, Poland was forced to return to its status as an importer in early 1991 in order to satisfy domestic demand. In the case of Hungary, it was necessary to provide additional funds for export subsidies in 1991 in order to lower its stocks of dairy products.

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B. Medium term developments

In general, one of the most important factors in the return to stability in the consumption of dairy products (and thus contributing to the stability of production) will be the degree to which governments are successful in bringing down (and controlling) the rate of inflation. Given the importance of dairy products in the Polish diet (for example), inflation rates, through their impact on the consumer price index, will continue to have an impact on the ultimate consumption level of milk and dairy products. Among the three countries, inflation rates have been the highest in Poland, but the annual rate of increase is expected to decline substantially in the medium term.

The introduction of a more market oriented economy in general can provide a large stimulus to more efficient production methods. However, for a stable, progressive development of the dairy sector in the medium term, a balanced dairy policy is preferred which will concentrate on the stimulation of productivity and, provide a reasonable supply/demand balance, as well as equitable prices for both producers and consumers. Such a policy, however, may
lead to surpluses, thus requiring the implementation of supply management measures for some time: such measures have already been introduced to some extent by the CSFR, Hungary and Poland. In general, milk production has been declining over the past two or three years in all three countries, particularly in Poland. Within the next two to three years, output in Poland could begin to rise again, as a result of re-structuring measures among the smaller farms. Both the CSFR and Hungary are attempting to lower milk output by about 10 -- 20 per cent in the medium term. The average herd size is likely to rise in the future in the three countries, which (through increased efficiency) could contribute to higher average yields per cow. Such increases are likely to be largest in Poland, due to the fact that currently small herds prevail, with a resulting lower average yield per cow than in the CSFR and Hungary.

The medium term trend for consumption is uncertain, given the uncertainty concerning disposable income over this period. It may take some time for per capita consumption to approach the levels existing prior to the removal of consumer subsidies. As stated previously, the pace of reform varies between countries, thus the effect on per capita consumption of milk and dairy products also varies between countries. In the case of Poland, where retail price changes have been the greatest, projections by the World Bank indicate only slight growth by the end of the decade. Since consumer subsidies were removed in the CSFR only at the beginning of 1991, the full impact on consumption has yet to be felt. In any case, it must be recognised that per capita consumption levels in both the CSFR and Poland remain among the highest in Europe: levels in Hungary are about equal to those of Western Europe.

In the past, exports of milk and dairy products have been an important contributor to the agricultural trade balance. According to the results of a recent forecasting model, net exports of butter, cheese and skim milk powder from Eastern Europe are expected to decline in the medium term, with the greatest decline expected in butter exports. These data (Table 2) include the whole of Eastern Europe; however, since in the past the CSFR, Hungary and Poland have accounted for the bulk of dairy product exports from this region, it is reasonable to assume that such a trend will continue in the medium term. However, depending on the success of supply management programmes in the three countries concerned, export volumes in the medium term could be considerably below those predicted by the FAPRI model above. For example, since all three countries are interested in eventual economic affiliation with the EC, it is likely that their dairy production policies in the medium term will be patterned after those in the EC (i.e., quotas), which could contribute to lower output in the medium term.

A very important element in the medium term development of the agricultural sectors of the Central/Eastern European countries (including the dairy production and processing sub-sectors), will be access to markets. This aspect is probably as important as economic aid to this region, since the continuing need to subsidise exports could prove disastrous to national treasuries in the medium term and could contribute to the preservation of inefficient production structures and methods. As an indication of the importance which these countries attach to market access, a five-year association agreement was recently signed with the EC which will provide for significant increases in EC imports of various agricultural products from the PIT countries. Import quotas remain for dairy products; however, the maximum levels were increased, while import levies were significantly reduced.
Table 2. Net Exports of Dairy Products from Eastern Europe.

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<td>butter</td>
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-- 000 tonnes --

Butter•  45 19 19 19 18 17 16 13
Cheese• 21 21 21 21 20 20 19 18
SMP• 82 72 71 71 70 69 68 66

(Source: Food and Agricultural Policy Research Institute, {FAPRI 1991 World }
{Agricultural Outlook}, Staff Report No. 2-91, March 1991, Center for
Agricultural and Rural Development, Iowa State University, Ames Iowa,
March 1991)

In a similar example, agricultural exports from the CSFR to Austria
have, since 1 July 1991, benefited from a 50 per cent reduction in import
duties. Another new initiative in 1991 was the emergence of "triangular" trade
arrangements as part of the European community aid package for the former USSR.
The EC agreed under these arrangements that 25 per cent of its 500 million ECU
food aid allocation for the former USSR may be used for purchases from Eastern
Europe (Hungary, Poland, CSFR, Romania, Bulgaria and the Baltic States). It is
expected that this will involve 400 000 tonnes of grain, 50 000 tonnes of meat,
10 000 tonnes of whole milk powder and 30 000 tonnes of vegetable oil. This
agreement was with the intention of helping the former USSR with its food
supply problems while at the same time also helping to relieve the East
European countries of some of their agricultural surpluses.

All three countries have actively participated in the current GATT
negotiations in the anticipation of more open markets, and Hungary is a member
of the Cairns Group. Both Hungary and Poland actively participate in the
International Dairy Arrangement of the GATT, which sets minimum export prices
for dairy products. The ultimate result of the GATT negotiations could result
in some reductions in dairy support policies in all three countries;
nevertheless, their respective agricultural sectors have much to gain through
increased market access, which may ultimately result from the current
negotiations.

END-OF-TEXT