

TRADE AND AGRICULTURE DIRECTORATE
COMMITTEE FOR AGRICULTURE

Cancels & replaces the same document of 20 March 2009

Group on Commodity Markets
Working Party on Agricultural Policies and Markets

OECD-FAO AGRICULTURAL OUTLOOK 2009-2018: REVIEW OF BASELINE PROJECTIONS
DAIRY PRODUCTS MARKET OUTLOOK

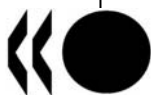
6-7 April 2009

This document is presented to the Group on Commodity Markets for DISCUSSION under item 2 of the draft agenda. The tables are presented in document [TAD/CA/APM/CFS/MD/RD(2009)1/ANN1].

Please note that Figure numbers have been corrected on page 4.

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JT03261822



(Note by the Secretariat)

The attached room document contains the highlights of the main trends and issues in dairy products' markets which will be further worked out and edited for inclusion in the forthcoming version of the OECD-FAO Agricultural Outlook. This document is intended to stimulate discussion during the meeting of the Group on Commodity Markets under item 2 of its draft agenda. This discussion should help the OECD and FAO Secretariats to make any required revisions to the baseline projections and in drafting the final version of the Outlook report.

Milk and dairy products projections at a glance: 2009-2018

International prices to rebound but to remain far from recent record levels

- The spectacular increase in international dairy prices in 2007 was followed by an equally spectacular tumble with prices falling by half or two-thirds from their record high levels of mid-2007. The prices fell particularly in the second half of 2008, undermined by weaker demand - resulting from the global economic slump - and increased exportable surpluses mainly from New Zealand, the EU and the United States. In the same period, melamine contamination in China may have further weakened demand and dented consumer confidence in products containing dairy ingredients. The reintroduction of export refunds by the EU at the onset of 2009 has exacerbated the downward pressures on international prices.
- Stimulated by a return to global economic growth and continuing population growth, world dairy prices are expected to rebound from 2011 but would not attain the exceptional levels of 2007/08 (Figure 1). When compared to the decade preceding the 2007/08 peak, prices in nominal terms are expected to be 30-40% higher on average (Figure 2). The long term upward shift in world dairy prices in real terms anticipated in buoyant “peak” years is to recede considerably, but not entirely. The prices in real terms are expected to stay slightly above the 1997-2006 average. Real butter prices are likely to enjoy the strongest gains, staying on average 15% higher, pushed by high energy and vegetable oil prices (Figure 3).

The milk production growth potential receiving a renewed interest

- The extremely high prices and low dairy global stocks have refocused the attention towards supply growth. Several governments have announced plans to boost domestic milk production through improved cattle breeding and milk yield gains. The EU has decided to put an end to its long standing milk production quota system and thus allow efficient milk producers to expand. The United States has confirmed milk producer’s support in its 2008 US Farm Bill.
- Spurred by high milk prices, world milk production rose strongly by 2.2% in 2008. On average, the annual growth rate over the Outlook period is expected lower at 1.7% as lower international prices filter through to domestic markets and moderate supply response.
- *Oceania*– after a strong supply response to high international price situation, milk production in *New Zealand* is projected to increase by 2.16% annually tempered by increasing on farm costs and environmental concerns. Cow inventories in *Australia* are expected to increase in 2009 for the first time in seven years. The anticipation of continuing slow rebuilding of the herd should result in annual growth of 1.8% on average, a growth rate that remains sensitive to water availability (Figure 4).
- *European Union* - the Health Check of the CAP abolished the EU milk quota from 2015 and provided soft-landing via milk quota increases - five times by 1% between 2009 and 2013 with Italy receiving the full 5% increase in 2009. Restrained by relatively low milk prices throughout the projection period, EU milk production is expected to increase by less than 2%, which is 0.3% annually. With a steady decrease in subsistence production milk supply is to fall in EU-12 by more than 3% over the projection period although milk deliveries are to rebound by nearly 6%.

Figure 1. World dairy prices

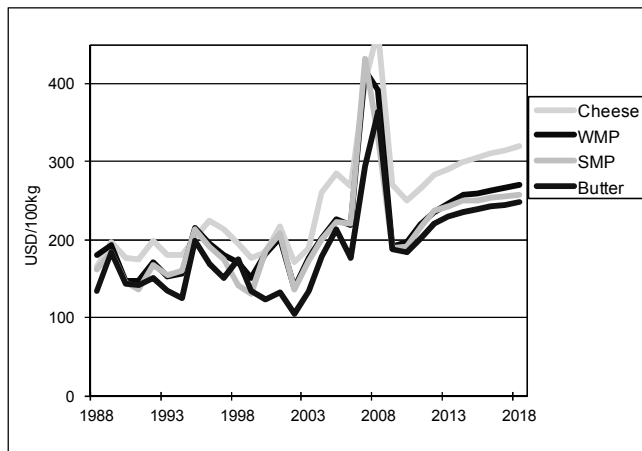


Figure 2. Average growth of world dairy prices (prices in nominal terms)

Figure 3. Average growth of world dairy prices (prices in real terms)

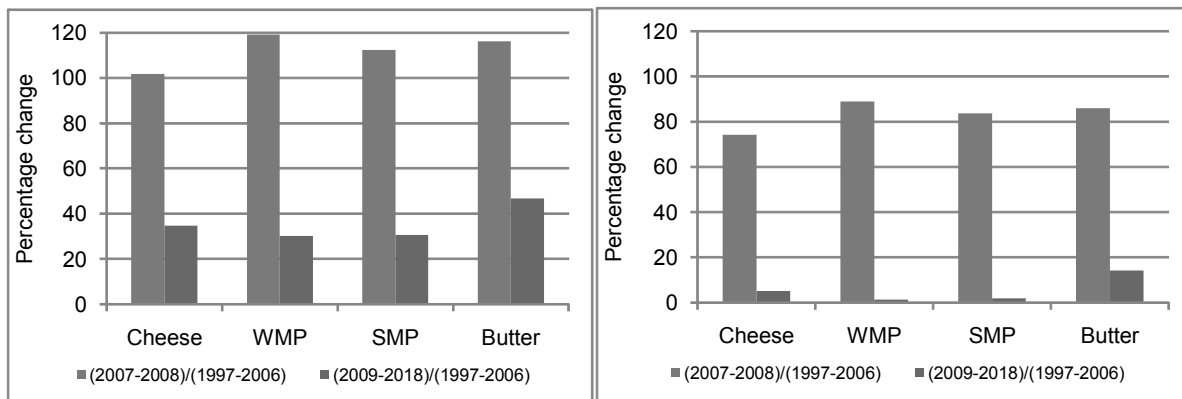
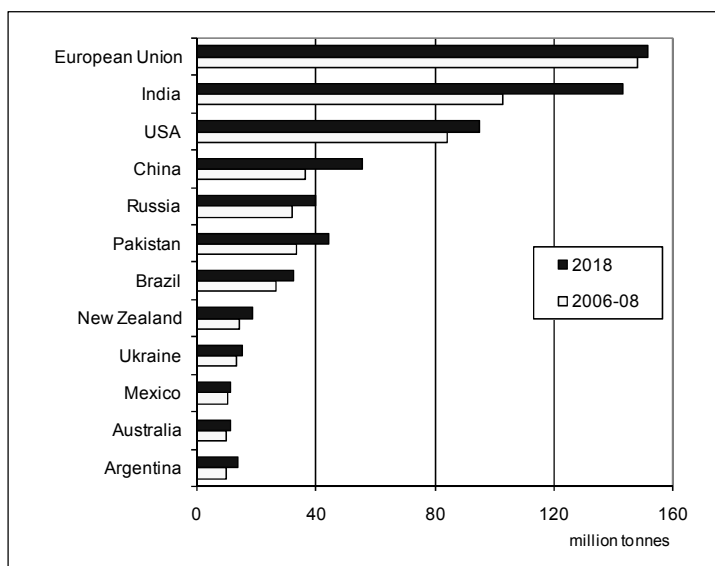


Figure 4. Milk production growth from 2006-08 to 2018



- *United States* – the recent strong growth in milk production of more than 2% per year is expected to recede with lower milk prices and return to a declining cow numbers trend. Production is expected to grow by 1% annually – a growth that provide 7% of additional global milk supply and covers more than 40% of additional milk production in the OECD area over the Outlook.
- *Russia* – after falling for more than a decade, milk production has been increasing since 2005 partly due to government efforts to revive Russia milk production with plans to improve the quality of cattle breeding (*i.e.* subsidies for purchase of pedigree bulls). Stimulated by increasing cow numbers and improving yields, milk production is expected to continue growing over the projection period at annual rate of 1.6%.
- Milk yields are projected to continue strong growth globally, but high differences remain a feature of the milk production landscape. Yields are highest, by far, in feed intensive North America, followed by Europe, Oceania, then Latin America (Figure 5).

Production and trade to increase mainly for butter and WMP

- From the 2006-08 average levels, world production of WMP and butter is expected to grow by around 30%, production of cheese by 22%, and that of SMP by 12% over the outlook period. Production is expected to increase mainly outside the OECD area, reflecting investment into processing capacities which enable transformation of the milk production gains.
- In the OECD area, butter production remains flat as gains are offset by fall in the EU. On the other hand, 70% of additional cheese production comes from the OECD countries, mainly from the EU (32%) and the United States (30%). The strongest growth in WMP production is expected in emerging markets such as China and Brazil, which will provide 33 and 24% of additional WMP production respectively. Oceania (25%), the United States (20%), Brazil (20%) and China (15%) are responsible for nearly all the additional production of SMP over the projection period.

World exports to increase but market shares of majority of traditional exporters to shrink

- Global dairy exports (in milk equivalents) are expected to increase at higher pace than global milk production with the exception of 2009 and 2010 which are affected by the severe economic slowdown (Figure 6).
- World exports are expected to grow mainly for WMP and cheese. SMP and particularly butter exports would lag behind considerably. New Zealand's share of the international butter markets is expected to increase from 43% to 55% as emerging exporters concentrate more on milk powder exports and as exports from the EU are anticipated to decline in the projection period.
- Despite the EU quota increases and quota abolition in 2015, the EU exports of dairy products stay relatively stable as production gains are offset by consumption gains for value added products, and as production is falling at similar rates as consumption for bulk intervention products (Figure 7).
- Argentina is emerging as an important player on the WMP market. Similarly, Brazil, which was in the past regarded as net importer, is set to increase its presence on the international markets. The WMP exports from Brazil, Argentina and Uruguay are expected to surpass the EU WMP exports by 2018 (Figure 8).

Figure 5. Milk yields by region 2008, 2018

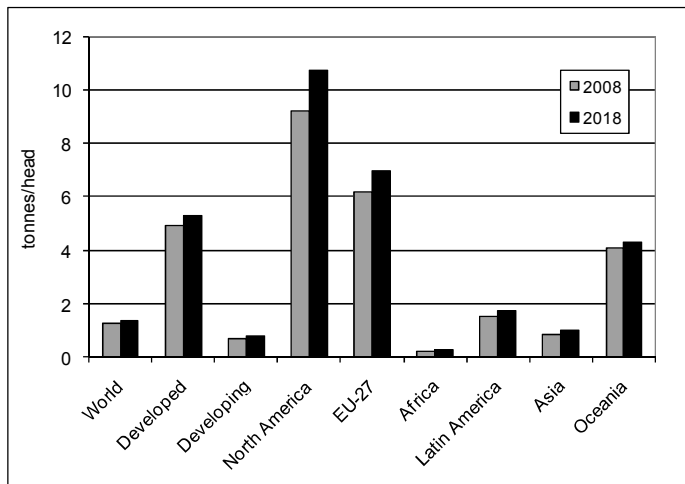


Figure 6. Dairy trade (in milk equivalent) outpacing production

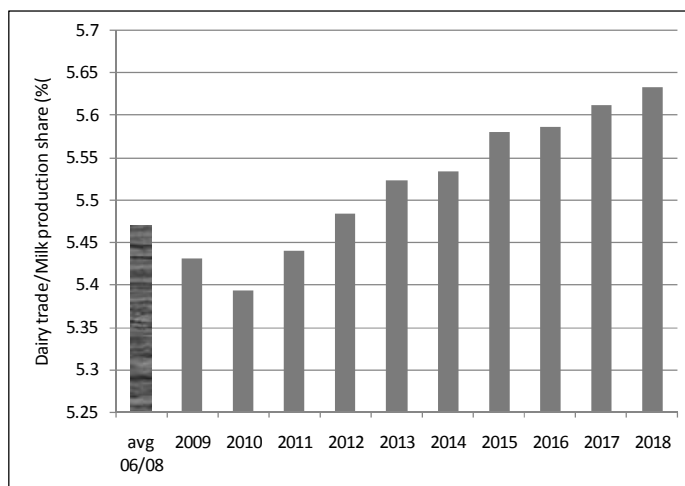
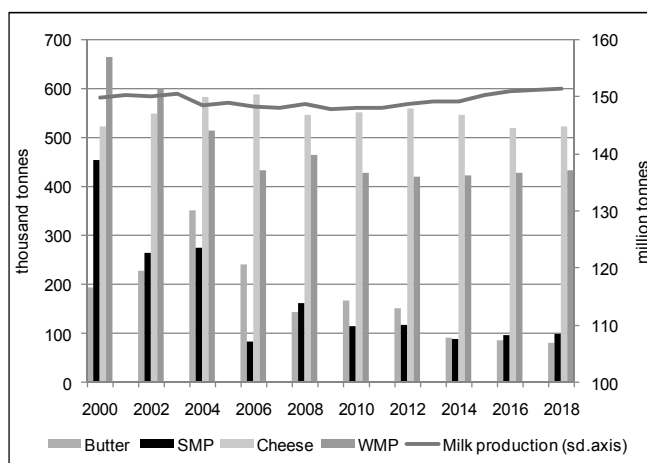


Figure 7. EU milk production and dairy product exports



- The evolution of global dairy exports (in milk equivalents) indicates that out of the big four traditional dairy exporters only New Zealand is able to increase its world markets share while the EU, the United States and Australia shares are expected to decline (Figure 9).

Imports to remain region specific

- Developing countries account for 94% of world imports of WMP, and 90% of SMP, but only for 51% of butter and 40% of cheese imports. By 2018, these shares will increase to 96% (WMP), 92% (SMP), 57% (butter) and 44% (cheese).
- Russia remains one of the most important importing countries, especially for butter and cheese, although butter imports are projected to decline in the Outlook as a result of increased domestic production (Figure 10). Japan and the US will continue to be important cheese importers and would account, along with Russia, for 40% of global cheese imports.
- Mexico will increase substantially its SMP imports, and the Middle East and North Africa are to remain key importers WMP. Algeria is expected to remain the most important WMP importer with 8% share (Figure 11).

Consumption of dairy products remains affected by income profiles and product attributes

- Demand for milk and milk products is expected to continue growing strongly in developing countries at 1.2% per year on a per capita basis (in milk equivalents). In developed countries, milk consumption is projected to increase at half that rate annually, but from a much higher base than for developing countries (Figure 12).
- OECD countries continue to dominate cheese consumption maintaining their three quarter share of the world total while other countries consume more than 80% of global WMP consumption and this share is expected to grow to 85%. OECD cheese consumption is expected to increase by nearly 20% over the Outlook period while that for butter remains relatively stable as a drop in the EU and Japan is compensated by increases in the US.
- In countries outside the OECD area, while demand growth is expected for all dairy products with WMP and butter consumption growing the strongest, fresh fluid milk will remain by far the main product for consumption. (Figure 13).
- Dairy products remain among the agricultural commodities for which consumption exhibit the highest growth rates. Such demand growth, mainly due to changing diets and preferences, as well as growing incomes in developing countries, is supporting higher prices for international milk products and trade over the medium term.

Will the spectacular price peak be repeated?

- As export shares of market suppliers anticipated over the next 10 years are likely to become more equally spread, markets may be able to handle better the regional production shortfalls. The exception may be a situation of New Zealand that is expected to considerably strengthen its dominant position on the world dairy markets and where any major production tumble would likely have considerable repercussions on the market and level of the potential price spike.

Figure 8. Major dairy product exporters

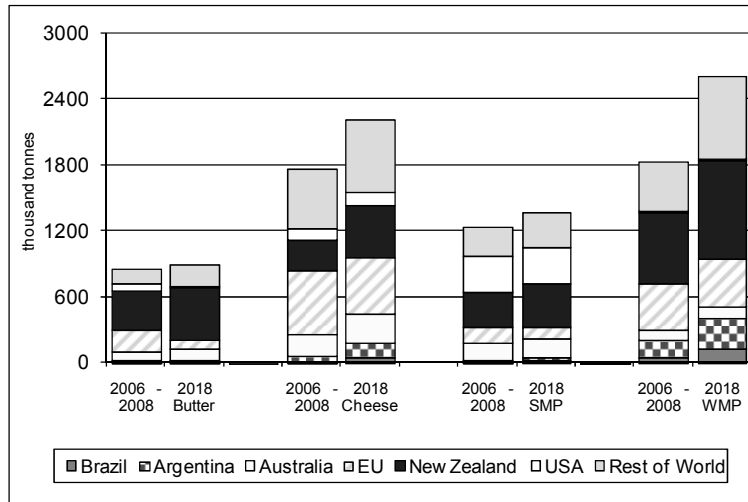


Figure 9. With the exception of New Zealand traditional exporters losing market shares

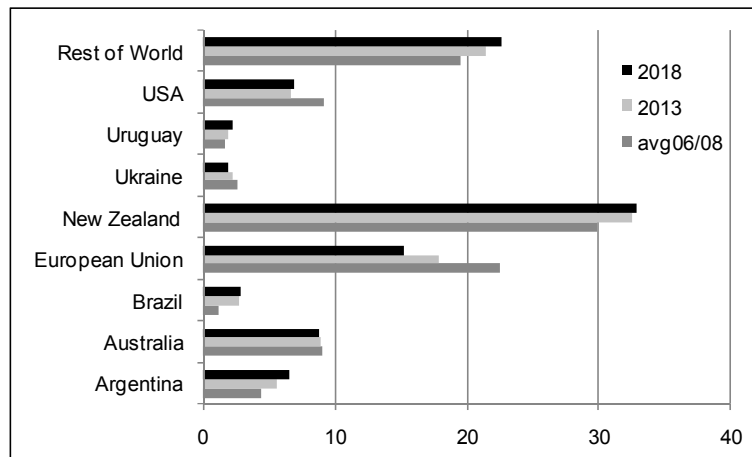


Figure 10. Russia milk production and dairy imports

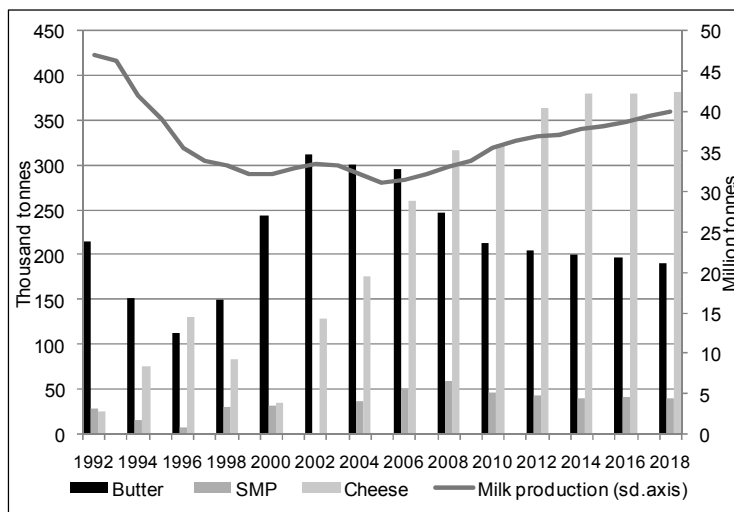


Figure 11. Major dairy product importers

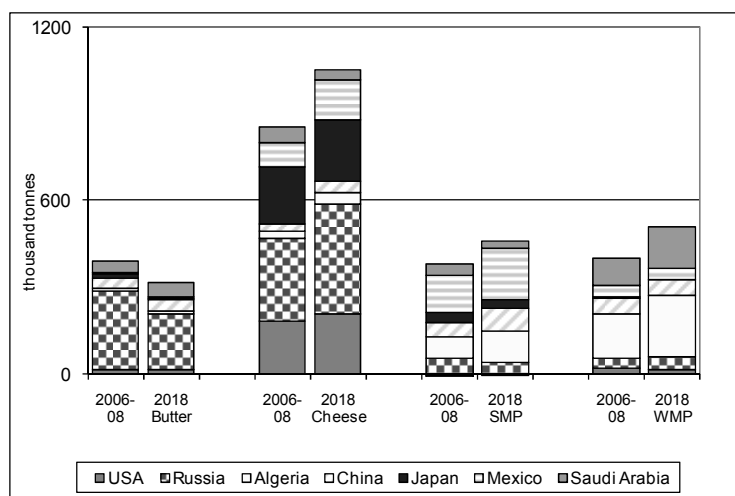


Figure 12. Per capita milk consumption growth by region (in milk equivalent)

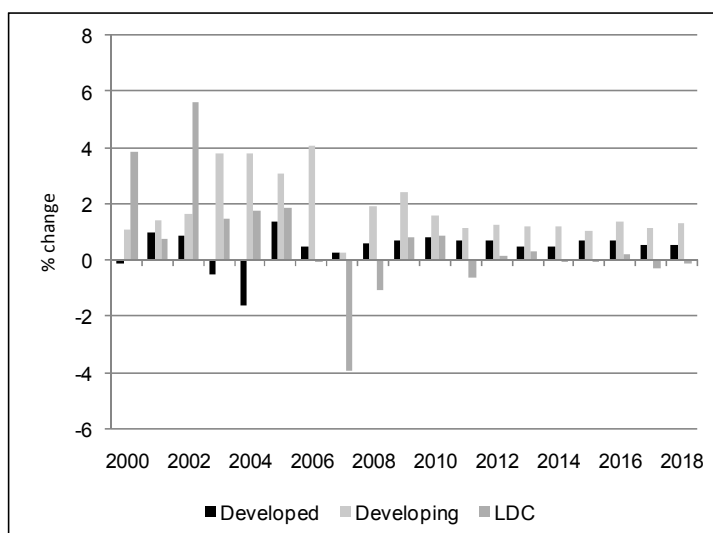


Figure 13. Outlook for dairy products

