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## POTENTIAL FOR DAIRY PRODUCT EXPORTS

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Good afternoon. The title of this presentation was originally "New" Potential for Dairy Product Exports. It was intended to lay out how a number of supply and demand factors were converging to make U.S. dairy products -- both commodity and value-added -- more competitive in export markets.

One of the favorable supply side factors has been the progress that recent trade agreements, such as NAFTA and the Uruguay Round of GATT, have accomplished in dropping tariff barriers and export subsidies that artificially lower world prices. Constraints on EU dairy subsidies, especially for cheese, are allowing world dairy commodity prices to rise to more accurately reflect true supply and demand. In addition, the joint efforts by the U.S. dairy industry and our government to force compliance with export subsidy rules, as in the current WTO disputes with Canada and the EU, are intended to ensure that supply is determined by the rules of the market rather than programs intended to guarantee incomes for overseas dairy producers.

On the demand side of the equation, the quick service restaurants have had a strongly positive effect. Their successful and increasing investments in overseas markets is driving a more diversified diet in Asia that now includes dairy products in pizza, hamburgers, ice cream and other processed foods.

The most positive demand factor of recent years, however has been the rapid economic growth of the Asian and Latin American economies. The dramatically rising per capita incomes of hundreds of millions of consumers have led them to demand more animal protein in their diets; that means, beef, poultry, pork and dairy products.

All these factors have led to similar conclusions from an unusually wide variety of analysts, such as those from our competitors in New Zealand, Holland, and Denmark, as well as such major buyers as Nestle's and Japan's Snow Brand. They all projected that within the next five to seven years, demand increases were going to severely tax available supplies. These developments have been reflected in both international prices and U.S. export gains.

But, then, came the current economic problems in Asia. Since November, questions -- from processors, producers, Congress, USDA, the press, my wife -- have been constant: Is the growth path for U.S. dairy exports a mirage? Will our dairy products be faced with a depressed world market demand and price, which we will be increasingly unable to address with our own declining level of subsidies?

These questions required a revised focus for this speech. Instead of the medium and long term, I will focus on the next year or so, and how Asia's recent economic problems will affect U.S. dairy exports.

Three issues here are of primary concern: volatile currency fluctuations, retarded economic growth and the strength of the dollar. The first two issues affect demand for any imported dairy products, while the latter affects U.S. competitiveness in the face of that demand.

Currency fluctuation is the key short-term issue since, as with the Mexico devaluation in early 1995, buyers defer purchasing decisions when widely fluctuating currencies obscure what one's final costs will be. Until currency rates settle down and importers can determine what their costs are, paralysis will prevail.

The other issue affecting demand is the stagnant growth and dwindling consumer purchasing power in many of these markets. Finally, the relationship between the Australian and New Zealand dollars with the U.S. dollar goes to U.S. competitiveness. Currently, the Australian and New Zealand currencies are at 10-year lows to the U.S. dollar. In many markets some U.S. dairy products are running 100% higher in price, while Australian and New Zealand products are "only" 60% more expensive.

In our opinion, the higher value products are the most vulnerable.

- Ice cream will be the most affected throughout Asia by the loss of consumer purchasing power; last year about 46% of all U.S. ice cream exports (15,195 MT in first 10 months of 1997) went to Asia. Sales have already been plagued for some time by tightened consumer budgets, and the current economic situation will tighten consumer purchasing further.
- Cheese exports will decline in some markets. South Korea, which accounts for 13% of all U.S. cheese exports (4,051 MT in first 10 months of 1997), and Southeast Asia, which accounts for about 6% of all U.S. cheese exports (1,128 MT in first 10 months of 1997), have taken and will continue to take the biggest immediate hit. However, Japan, which accounts for 16% of all U.S. cheese exports (4,751 MT in first 10 months of 1997), will likely not be affected.

- Skim milk powder will be less affected by the lack of new orders in the near term, due to the fact that the DEIP allocations for Asia have already been used up and new allocations are not set to be announced until July. However, shipment of some contracts has been postponed due to the economic situation.
- Whey products, of which about 58% of total U.S. exports (52,350 MT in first 10 months of 1997) are in Asia, can see greater opportunities once currencies have stabilized since many manufacturers are looking for ways to lower ingredient costs. Similarly, lactose has greater potential in some markets, owing to the increased production of infant formula.

The effect on U.S. exports will differ in each market.

### **Hong Kong/China**

Chinese imports will probably be the least affected due to the relative stability of the Hong Kong and Chinese currencies against the U.S. dollar. But neither Hong Kong nor China consumes large quantities of U.S. dairy products at retail anyway. Generally, most of the end-users of dairy ingredients have expressed a “business as usual” attitude. Therefore, we expect existing export projections to be on target.

### **Japan**

Japan has also not been substantially threatened by the current problems. Despite the prolonged economic stagnation, dairy consumption continues to grow. The fundamental strength in dairy products, which is unchanged, has been its contribution of calcium to the diet, in which Japanese consumers are chronically deficient. Despite continuing economic doldrums of only about 1% economic growth, the upward movements in both the consumption of dairy products and imports are expected continue.

In fact, due in part to continued reductions in EU subsidies and a long-standing market development program, U.S. cheese exports can be expected to increase about 1,000 metric tons this year. In whey products, imports from the U.S. will likely grow, as many Japanese food processors using skim milk powder may look to reduce costs and consider whey as an alternative ingredient. Since most whey products are imported under quota, the growth rate is expected to be moderate at 5-10% over 1997. Ice cream is the only area in which we may see a decline. Our ice cream is in the more expensive premium ice cream category, which is susceptible to tight consumer budgets.

### **South Korea**

In South Korea, currency fluctuations, the strength of the U.S. dollar and liquidity problems have profoundly affected sales of most U.S. dairy products over the last two months and will continue to do so in the short-term. Consumer-ready products have

been the hardest hit. Ice cream in particular has not only been affected by the reduced purchasing powers of consumers, but also by the "Buy Domestic" movement within the country. Importers of cheese, primarily mozzarella, are depleting inventories of imported cheese, most of which will last only until the end of February, placing orders for imitation product and increasingly considering Oceania sources in light of their more favorable currency rate compared to the U.S. dollar. In the medium term, U.S. cheese exports can be expected to resume, but U.S. competitiveness will depend in large part on the strength of the U.S. dollar at that point. Some buyers in the market speculate that once the exchange rate reaches around US\$1:1,300 won (currently at about 1700 won), or at the point when U.S. mozzarella becomes less expensive than the local product, they will resume purchases of U.S. cheese.

Imports of whey and lactose from the U.S. will continue to increase, but at a slower pace than last year. Manufacturers of infant formula, a large user of lactose and whey protein, expect demand to grow over the next quarter as more women enter the workforce with second jobs.

#### **Southeast Asia:**

In Southeast Asia, in spite of currency fluctuations and economic problems, we expect consumption of dairy products to grow throughout the region, especially since market growth is largely fueled by government school milk programs. Sales of sweetened condensed milk will remain flat, while sales of imported premium ice cream are likely to decline in favor of locally produced product. The future of the recent steady growth in yogurt and mozzarella is tied to the pending stabilization of the economies.

Additionally, as manufacturers look for ways to lower ingredient costs, the market for whey products throughout the region should remain strong. The current position of the U.S., as predominately a supplier of dairy ingredients rather than retail products, should largely shield U.S. dairy exporters from adverse effects in the retail and foodservice sectors.

#### **Indonesia**

Indonesia has been one of the hardest hit by the currency crisis. Per capita income has dropped in real dollar amounts over the last few months and concern is rising about political and social unrest. Hoarding of food products has meant that long-life dairy products are sold out. Dairy manufacturers are reducing inventory to raise cash, and difficulty in securing letters of credit and a shortage of dollars are limiting imports. One positive result is the Indonesian government's decision to include agricultural goods in a general program of tariff reductions. As of February 1, all Indonesian tariffs on food items have been cut to a maximum of 5% while local content regulations on dairy products have been completely abolished. Additionally, for U.S. exporters of feed-grade whey, tariffs on non-food agricultural products were reduced by 5% to a

maximum of 10% by 2003. In spite of this increased market access, Indonesia remains the most problematic for the near term.

### **Malaysia**

Malaysia has seen a significant drop in consumption over the last month, in large part resulting from the Muslim period of Ramadan. There are campaigns promoting domestic products over imported food products, but as with all Southeast Asian countries, local dairy production is insufficient to meet consumer demand. Indeed dairy products consumption has not been overly affected, with the exception of imported premium ice cream.

### **The Philippines**

While the Philippines has experienced the devaluation of its peso, dairy consumption remains strong and is likely to continue to increase owing to parental concern over their children's nutrition. Canned milk is a prime commodity and Filipinos are hoarding quantities of sweetened condensed milk. There is not likely to be any growth in the canned milk market this year, but the majority of Philippine dairy manufacturers are still forecasting double-digit growth in all other sectors.

### **Singapore**

Singapore has seen a significant drop in retail sales, although by volume 1997 sales were 4-5% higher than in 1996. Fresh milk sales grew 12% while skim milk powder sales grew 8%. Sales of lower value products such as UHT milk, full-cream powdered milk, and condensed and evaporated milk stayed flat. Similar results are forecast for 1998.

### **Thailand**

Despite Thailand's problems leading to the IMF bailout, its dairy consumption is projected to grow. As part of its agreement, the IMF agreed that the Thai government's school milk program, which underpins demand for dairy products, should continue. As a result of the economic climate, buyers are currently reducing their inventories and profit projections of dairy manufacturers are down. The result is that dairy consumption is now forecast to increase by 10-15% from 1996, which although down from the 20% growth previously forecast, is still ambitious.

## **Conclusion**

In conclusion, let me emphasize a few things. First, as serious as the situation is in Asia, it is temporary. The economic fundamentals are in place to ensure a recovery. The big question, of course, is when? For a testament to the resilience of the economies of developing countries, look at Mexico....

Secondly, regardless of the current situation in Asia, the U.S. dairy economy has little choice but to look towards export markets for its future growth path. The loss of price supports in 22 months, the steady decline in available export subsidies, and the continuing ability of milk production in the western United States to profitably expand at prices considerably below the national average, is setting this future for us. Therefore, it is imperative that our industry continue to identify and invest in those markets and products best suited for export expansion.

Thank you for your attention.