

USDA Foreign Agricultural Service

# GAIN Report

Global Agricultural Information Network

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## **Mexico**

### **Dairy and Products Semi-annual**

#### **New Trade Agreements with the Potential to Diversify Dairy**

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**Report Highlights:**

Fluid milk production in Mexico is forecast at 12.4 million MT for 2018, continuing growth and supplying fluid milk for processed and added-value dairy products. However, a dairy deficit remains. The dairy processing industry competes for inputs, and closes the gap between demand and production with imports. Import diversification is on the horizon given the Mexico-European Union FTA modernization and the Comprehensive and Progressive Agreement for Trans-Pacific Partnership. Industry continues to watch NAFTA negotiations closely.

**Commodities:**

Dairy, Milk, Fluid

Dairy, Cheese

Dairy, Butter

Dairy, Milk, Nonfat Dry

Dairy, Dry Whole Milk Powder

**Executive Summary**

Despite recent steady growth of fluid milk production, the dairy sector struggles to meet demand from the processing sector, and supplements that demand through imports. Despite relatively low priced feed, the high cost of milk production in Mexico constrains growth and keeps Mexican exports from being competitive in the global market. Internally, Mexico looks to improve the quality of dairy products through publishing draft regulations for three dairy products, importing improved genetics, as well as supporting small-scale producers through government programs and public-private partnerships. To make small-scale producers more economically competitive, the dairy industry is promoting the formation of cooperatives.

Diversification in dairy sector imports is expected in the medium-term. While seeking to protect domestic industry to some extent, Mexico's recent trade negotiations with the European Union and the Comprehensive and Progressive Agreement for Trans-Pacific Partnership will expand dairy trade, including several new tariff-rate quotas for dairy imports. Together these agreements have the potential to shift market shares in the processed dairy sector (currently dominated by the United States), particularly for cheese and milk powder. However, transport costs may restrict large volumes of trade from shifting, and the United States maintains a geographical advantage.

In the meantime, industry continues to watch the North American Free Trade Agreement (NAFTA) negotiations closely, with Mexico seeking to further open the U.S. and Canadian markets to Mexican dairy products. Further uncertainty may impact the market due to the Mexican presidential and congressional elections July 1, 2018.

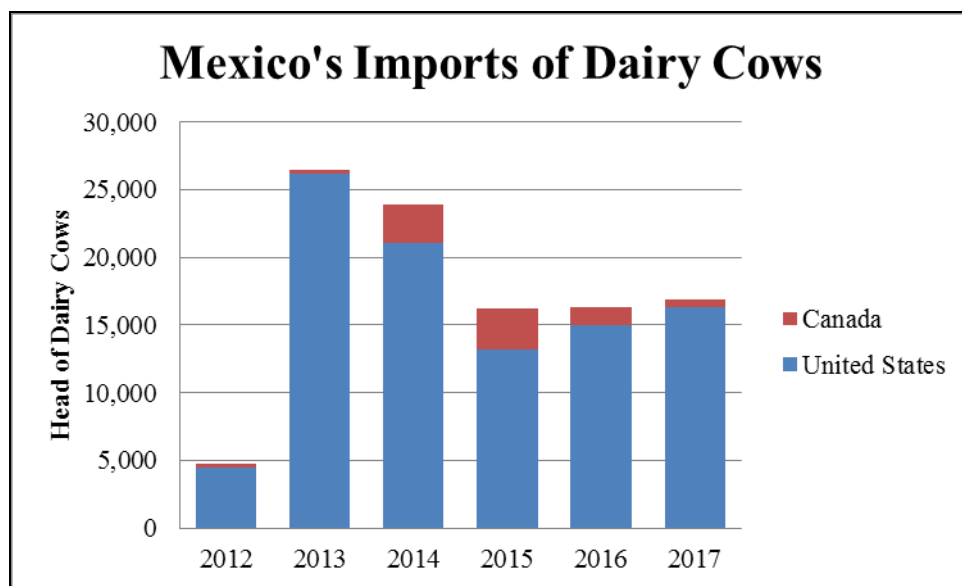
## Dairy, Milk, Fluid

### Production:

#### Steady increases in production but room to grow

The forecast for total fluid commercial milk production in 2018 is 12.4 million metric tons (MT).<sup>1</sup> This small but steady growth continues to be driven by on-farm management, relatively low feed costs, and genetic improvements. On-farm management improvements include strict sanitary and animal health programs, improved milking, handling, and storage practices, as well as technology such as electronic ear tags to assist in traceability. Mexico seeks through these methods to increase the breeding rate, improve milk quality, and raise the production per cow which varies widely across regions and farm size. However, relatively high production costs versus milk pricing still constrains growth. Figures for 2017 production were adjusted to reflect official data.

Genetic improvement is supported by both imported breeding cows and purchases of sexed semen for artificial insemination. Trade in dairy cows is led by the United States, followed at a distance by Canada.



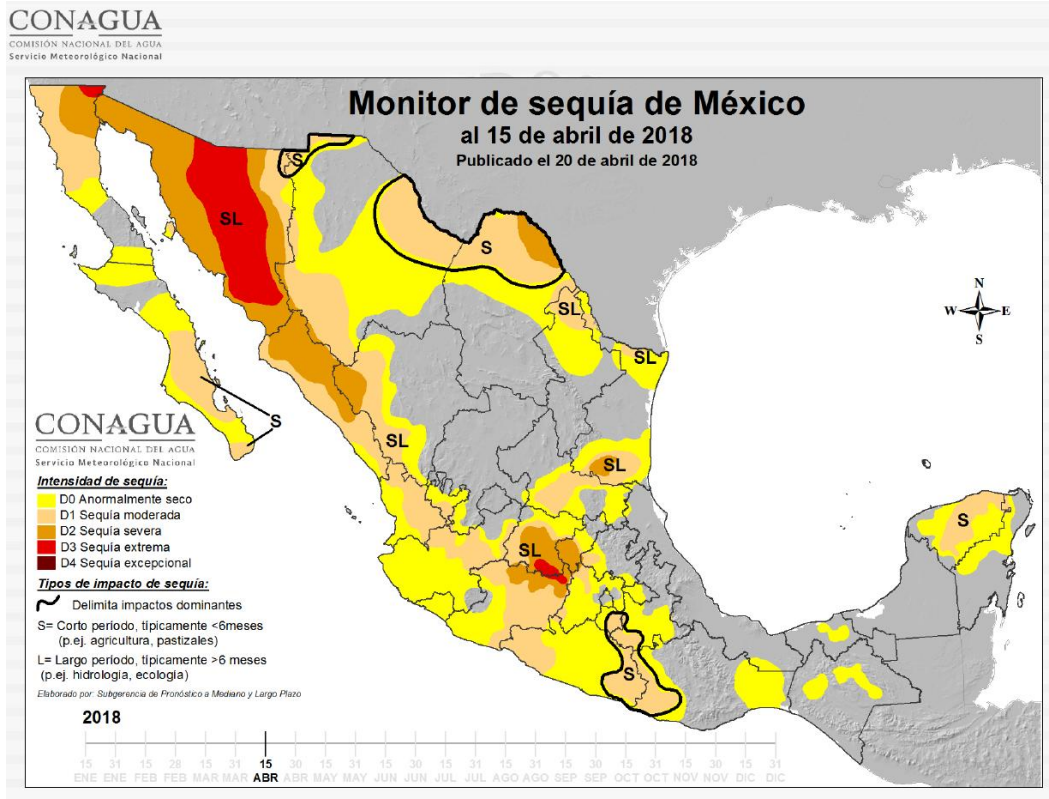
Source: National Institute of Statistics and Geography (INEGI), through Global Trade Atlas (GTA) (HS Code: 01022901)

#### Longer than usual dry season potentially concerning for northern producers

For 2018, Mexico's National Water Commission (CONAGUA) in cooperation with the National Oceanic and Atmospheric Administration (NOAA), forecasts 9 to 40 percent precipitation compared to historical levels. Drought potential persists from late March until early July due to the interaction of *la Niña* and *el Niño*. The Northern and Lagunera Mexico regions, the most important producing regions,

<sup>1</sup> In Mexico, the category "Other Milk," principally refers to goat milk.

are among the most affected. Nevertheless, normal rainfall conditions, which are expected to reassert themselves in August, along with expected low feed prices in the meantime, may offset adverse conditions. Further, specialized commercial farmers in these areas may fully or partially stable their cows. As previously reported, fluid milk production in Mexico is seasonal, peaking during rainy season (summer to early fall) each year.



Source: Comisión Nacional del Agua (CONAGUA), Monitor de Sequía en México.

## Production systems in Mexico

In Mexico, fluid milk is produced under several different types of systems. In the Northern and Lagunera regions commercial production is widespread, often with thousands of head of cattle per farm. As such, the State of Jalisco continues to lead fluid milk production, followed by Coahuila, Durango, and Chihuahua. In other regions, and particularly Southern Mexico, small farms of 1-30 head dominate production. INEGI estimates that more than half of all dairy farms in Mexico are small-scale (30 head or under), while less than one percent of farms have more than 1,000 head (but produce more than 20 percent of fluid milk nationally). The National Council of Balanced Feed Producers and Animal Nutrition (CONAFAB) estimates that 16 percent of feed nationally goes to dairy cows.

## Improving milk quality and supporting small producers

Both the Mexican government and private sector emphasize the importance of improving the dairy sector. Specifically, supporting small scale producers through forming cooperatives, improving milk quality, and addressing the lack of cold chain, are top priorities. A few government programs which seek to support dairy producers include Mexico's government livestock strengthening program

(PROGAN) which saw a budget increase for 2018, and LICONSA, which committed to support small scale producers through purchases of fluid milk.<sup>2</sup> See the Policy section and [MX7047](#) for more details on these programs.

## Consumption

### The trend continues, moving from fluid milk to dairy products

Fluid milk domestic consumption is forecast flat in 2018, while factory use continues to rise, with an overall forecast of 12.4 million MT. Industry groups such as the *Cámara Nacional de Industriales de la Leche* (CANILEC) believe there is room to increase per capita consumption of fluid milk, which remains below FAO recommended levels. However, consumption is held back by low cost beverage alternatives, such as soft drinks, alongside a lack of refrigeration in rural and low income households.

On the other hand, consumption of fluid milk by processors sees sustained growth as consumers demand specialized dairy products from sweetened milk to greek-style yogurt. Building on this trend, many large dairy producers are looking at niche markets, particularly for consumers looking for healthy alternatives. For example, Grupo LALA recently pioneered organic milk in the Mexican market.<sup>3</sup> LICONSA continues to play an important role in domestic fluid milk purchases.

### Consumers prefer Ultra-high temperature processed milk (UHT) despite higher cost

Consumption of commercially produced fluid milk in Mexico can generally be divided into two segments: fresh pasteurized milk and UHT milk. Shifting responsibilities in medium and high income households where more families are dual income means than purchasing patterns have changed. These consumers more likely purchase milk weekly at chain stores rather than a daily purchase at the local market. Low income households prefer the shelf stable UHT (often in tetra packs) due to easy storage and lack of a need for refrigeration. Industry estimates that fresh pasteurized milk accounts for 20 percent of sales, while UHT accounts for 80 percent.

Month	Pasteurized Milk						UHT Milk					
	At Chain Stores (Self-service)			At Local Stores			At Chain Stores (Self-service)			At Local Stores		
	2017	2018	% Change 17/18	2017	2018	% Change 17/18	2017	2018	% Change 17/18	2017	2018	% Change 17/18
January	15.53	16.37	5.41%	15.59	16.50	5.84%	16.69	18.11	8.51%	16.61	18.02	8.49%

<sup>2</sup> Leche Industrializada Conasupo S.A. de C.V. (LICONSA) is a state-owned enterprise, whose goal is to distribute high quality milk at a subsidized price to disadvantaged families.

<sup>3</sup> <https://www.merca20.com/lala-organica-la-nueva-leche-con-alma-de-rancho/>

<sup>4</sup> <http://www.economia-sniim.gob.mx/2010prueba/LecheMes.asp?Cons=M&prod=T&dest=9&dqMesMes=12&dqAnioMes=2017&Formato=XI&sbmit=Ver+Resultados>

<b>February</b>	15.6 5	16.3 7	4.60%	16.0 0	16.5 0	3.13%	16.6 5	18.2	9.31%	17.0 2	18.0 2	5.88%
<b>March</b>	15.7 3	16.4 3	4.45%	16.0 0	16.5 5	3.44%	16.9 9	18.2	7.12%	17.1 9	18.0 3	4.89%
<b>April</b>	16.0 9	17.0 0	5.66%	16.1 3	17.0 0	5.39%	17.5 8	18.2 2	3.64%	17.6 3	18.0 2	2.21%
<b>May</b>	16.3 5	N/a	-	16.5 0	N/a	-	17.7 8	N/a	-	18.0 0	N/a	-
<b>June</b>	16.3 5	N/a	-	16.5 0	N/a	-	17.7 5	N/a	-	18.0 0	N/a	-
<b>July</b>	16.3 5	N/a	-	16.5 0	N/a	-	17.7 5	N/a	-	18.0 0	N/a	-
<b>August</b>	16.3 5	N/a	-	16.5 0	N/a	-	17.7 5	N/a	-	18.0 0	N/a	-
<b>September</b>	16.3 5	N/a	-	16.5 0	N/a	-	17.8 7	N/a	-	18.3 0	N/a	-
<b>October</b>	16.3 7	N/a	-	16.5 0	N/a	-	17.9 2	N/a	-	18.0 0	N/a	-
<b>November</b>	16.3 7	N/a	-	16.5 0	N/a	-	18.0 3	N/a	-	18.0 2	N/a	-
<b>December</b>	16.3 7	N/a	-	16.5 0	N/a	-	18.0 3	N/a	-	18.0 2	N/a	-
<b>Annual Avg.</b>	16.1 6	N/a	-	16.3 1	N/a	-	17.5 7	N/a	-	17.7 3	N/a	-

Source: Market Information National Service (SNIIM), Secretariat of Economy (SE).

## Trade

### Imports remain low

The forecast for fluid milk imports in 2018 remains at 45,000 MT. While demand for dairy products has risen, this is met by an increase in domestic production of fluid milk, as well as production and trade of other inputs such as milk powder. As in previous years, the United States provided 99 percent of fluid milk imports in 2017. Imports remain marginal (less than one percent) compared to production of fluid milk.

### Mexico continues to look for fluid milk markets

Although Mexico is still in the search of new markets, exports for 2018 are kept unchanged at 10,000 MT. Latest final official figures show that exports in 2017 slowed to 6,000 MT. Exports principally flow to the United States (almost 70 percent in 2017), followed by Guatemala, Cuba, and Belize. In general fluid milk exports from Mexico are limited due to the high demand from domestic processors. As previously reported, two of Mexico's medium-term goals are to export Grade A milk to the United States, as well as to access to the Canadian market.

## Policy

### LICONSA strengthens its domestic milk purchase program

In 2017 LICONSA purchased 500 million liters (515 million MT) from 8,086 producers as part of the domestic purchases program. The largest purchases were made from the States of Jalisco and Chihuahua.<sup>5</sup> Purchases by LICONSA are expected to continue in 2018, and to build on the FEMELECHE-LICONSA partnership initiated in early 2017 dedicated to integrating small and medium milk producers into LICONSA's domestic milk purchasing program.<sup>6</sup>

This year, LICONSA is spreading the strategy "A peso el litro," or one peso per liter of milk to 400 municipalities considered by the United Nations Development Program as those with the lowest human development indicators.<sup>7</sup> LICONSA prices in other regions range from MX \$4.50 to MX \$5.50.<sup>8</sup> In March of 2018, LICONSA announced that the cost of fluid milk distributed will be maintained in 2018.<sup>9</sup>

Dairy, Milk, Fluid Market Begin Year	2016		2017		2018	
	Jan 2016		Jan 2017		Jan 2018	
Mexico	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
<b>Cows In Milk</b>	6450	6450	6500	6500	6550	6550
<b>Cows Milk Production</b>	11956	11956	12100	12162	12230	12230
<b>Other Milk Production</b>	165	166	170	167	172	170
<b>Total Production</b>	12121	12122	12270	12329	12402	12400
<b>Other Imports</b>	48	48	45	42	45	45
<b>Total Imports</b>	48	48	45	42	45	45
<b>Total Supply</b>	12169	12170	12315	12371	12447	12445
<b>Other Exports</b>	12	12	7	6	10	10
<b>Total Exports</b>	12	12	7	6	10	10
<b>Fluid Use Dom. Consum.</b>	4183	4183	4184	4184	4185	4183
<b>Factory Use Consum.</b>	7974	7975	8124	8181	8252	8252
<b>Feed Use Dom. Consum.</b>	0	0	0	0	0	0
<b>Total Dom. Consumption</b>	12157	12158	12308	12365	12437	12435
<b>Total Distribution</b>	12169	12170	12315	12371	12447	12445

(1000 HEAD), (1000 MT)

Not Official USDA Data

<sup>5</sup> <https://www.gob.mx/liconsa/articulos/en-2017-liconsa-compro-500-millones-de-litros-de-leche-a-productores-mexicanos?idiom=es>

<sup>6</sup> FEMELECHE (or La Federación Mexicana de Lechería) is one of the major dairy industry and producer organizations in Mexico.

<sup>7</sup> <https://www.gob.mx/liconsa/articulos/en-2018-liconsa-invertira-mas-de-147-mdp-en-a-peso-el-litro?idiom=es>

<sup>8</sup> On May 15, 2018, MX \$5.50 equated to slightly more than a U.S. quarter (US \$0.28).

<sup>9</sup> <https://www.gob.mx/liconsa/articulos/liconsa-mantendra-su-precio-por-litro-de-leche-durante-2018-abelardo-manzo?idiom=es>

## Dairy, Cheese

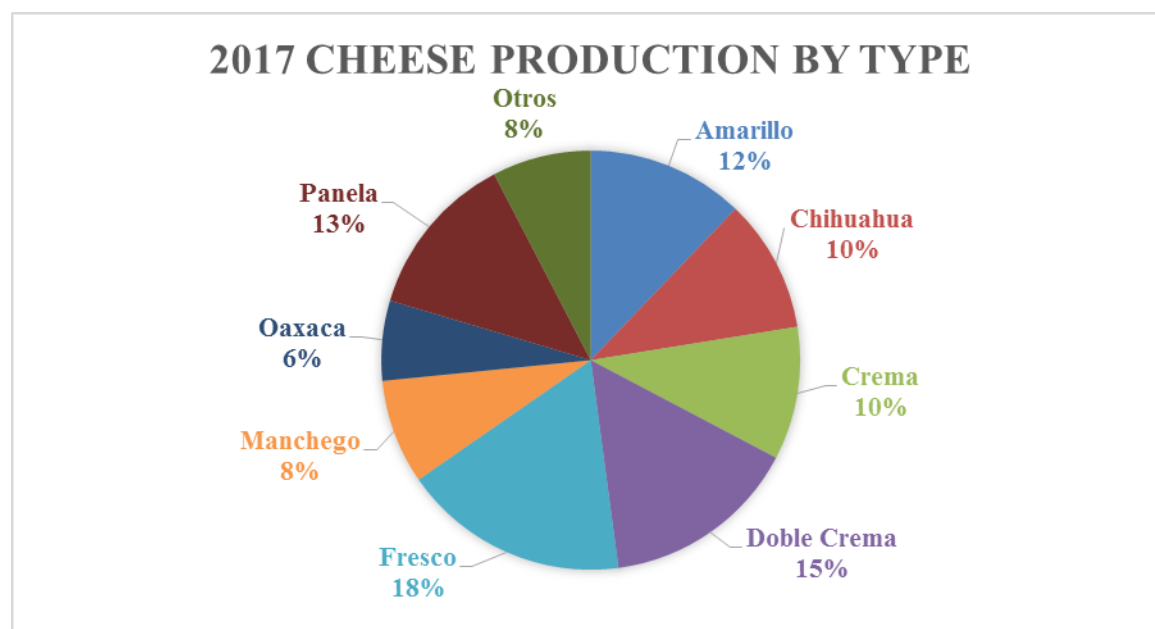
### Production

#### Cheese production continues to blossom

The forecast for Mexico's cheese production in 2018 is revised up to 405,000 MT to reflect expected expansion in the sector and continue an upward trend. Other contributing factors include sustained demand from all income sectors, and an increase in fluid milk production. Cheese production competes with other dairy value-added sectors for high quality milk, and seems to be winning the battle for inputs. The figure for 2017 is revised upward based on official data and demonstrates record production levels. Production between 2016 and 2017 rose by more than 20,000 MT.

#### Four cheeses continue to dominate production

The four traditional cheeses of Fresco, Panela, Doble Crema, and Amarillo continued to dominate production in 2017. The overall production jump in 2017 production was seen principally in Crema and Doble Crema. As previously reported, while traditional fresh white cheeses lead production, commercial cheese producers are branching out into the niche markets of regional cheeses such as Requeson and Jocoque, as well as higher-value international cheeses such as Cottage Cheese, Edam, and Mozzarella.



*Data Source: SIAP (Boletín de Leche: Enero – Marzo de 2018)*

Cheese production also takes place at the local and household level,<sup>10</sup> particularly in rural and southern Mexico. These cheeses are also generally fresh, soft, white cheeses, but may be made with unpasteurized milk. A well-known example is “queso Chiapas.”

<sup>10</sup> This cheese production may not be included in official estimates.



## Consumption

### “Grater” plans for cheese in Mexico

The forecast for 2018 consumption is revised up to 527,000 MT, as demand from all income sectors is sustained, and reflecting a continuation of strong consumption from 2017. Mexico consumes almost all of the cheese produced domestically and uses imports to meet increased demand. A staple ingredient in daily meals such as tacos and tortas, cheese is an important source of fat and protein for the general population. Still, Mexico’s per capita consumption of cheese is well below the United States, Canada, and most of Europe. Domestic industry views per capita consumption of cheese as having a high potential to increase, particularly as income levels rise.

### Type of cheese consumed still determined by income level

The Annual Dairy Report ([MX7047](#)) described how high income Mexicans are moving along the “tasting wheel,” from fresh soft white cheeses to hard aged cheeses, and thereby increasing consumption of “gourmet” cheeses. Chain grocery stores sell a wide variety of cheeses, including significant amounts of imported “gourmet” cheese. The low and middle income population continues to consume the fresh soft white cheeses in traditional wet markets and local convenience stores, principally produced domestically.

### Niche markets

Aside from building on traditional uses of cheeses, the dairy industry in Mexico is reaching out to Millennials and niche markets. For example, specialty cheeses are highlighted in restaurant-made omelets, to cream cheese in sushi, and takeout pizza. Italian style cheeses such as Mozzarella have done well in Mexico, particularly in light of their similarity to traditional domestic cheeses. Large dairy and processed food companies such as Grupo Lala tailor products to reach specific groups, including a new range of lactose-free cheese.<sup>11</sup>

## Trade

### Cheese imports recover from a small 2017 dip

Cheese imports for 2018 are forecast at 130,000 MT, showing growth after a slight dip in 2017. The revised 2017 figure is based on official data, and reflects inflation, a disadvantageous peso-dollar exchange rate, as well as uncertainty in the market due to various trade negotiations. As these negotiations conclude, and the peso strengthens, cheese imports are expected to continue their long-term rise. Imported cheese plays an important role, both supplementing domestic production, and bringing a wide variety of cheeses not traditionally produced in Mexico such as Cheddar and Parmesan. Mexico is a significant importer of cheese globally, although it trails behind countries such as Japan and Russia.

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<sup>11</sup> Source: Euromonitor

U.S. market share rebounded to 75 percent in 2017 after a lull in 2016. As previously reported, Mexico imports more than 25 cheese varieties from the United States. These cheeses run the gamut, from Mozzarella to Monterey Jack, Havarti, and Gorgonzola. The remaining market share is spread out between the Netherlands, Uruguay, Chile, and New Zealand, with a few other European countries rounding out the group. These imported cheeses are principally sold in the HRI sector and at retail.

### **Small growth in exports**

Exports of cheese are forecast at 8,000 MT in 2018, showing growth over 2017 and continuing the recent trend, but remaining low as domestic demand claims the majority of production. In the first two months of 2018, cheese exports are up 6 percent compared with 2017. The 2017 figure was adjusted based on official data.

Demand is sustained from the United States, along with attractive prices due to the exchange rate. However, Mexico was able to diversify their export market, sending more than 1,000 MT to both Chile and Guatemala. Other growth markets include Peru and the Central American countries. In many of these countries, Mexico caters to a niche market which consumes similar soft white cheeses as to the domestic market in Mexico.

### **Policy**

#### **Three new regulations under development**

In early 2018, Mexico published three draft regulations for cheese, milk powder, and yogurt in the *Diario Oficial* (Mexico's Federal Register). The three draft regulations were published jointly by the Ministry of Economy (SE) and the Ministry of Agriculture, Livestock, Rural Development, Fish, and Food (SAGARPA). For additional details see [MX8012](#).

#### **High tariffs for cheese**

For countries with which Mexico does not have a free trade agreement (FTA) or other agreement which covers cheese, duties are from 20 to 45 percent depending on the variety.<sup>12</sup> For example, Blue Cheese and Roquefort face 20 percent duties (HS Code: 040640), while fresh cheeses can face up to 45 percent in duties (HS Code: 040610).

#### **The Europeans are coming**

On Saturday, April 21, 2018, Mexico and the European Union announced an agreement in principle in the renegotiation of their free trade agreement (known in Mexico as the TLCUEM).<sup>13</sup> The agreement expands market access for agricultural products from both sides. While dairy trade was liberalized under the agreement in principle, there are several carve-outs. For example, tariff-rate quotas (TRQs)

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<sup>12</sup> The most recent rates can be found here: <http://www.economia-snci.gob.mx/>. Note: A few varieties may face up to 125 percent duties.

<sup>13</sup> <http://trade.ec.europa.eu/doclib/press/index.cfm?id=1833>

will be established for EU exports of certain cheeses, milk powder, and dairy preparation.<sup>14</sup> Technical negotiations will continue, and once a final document is agreed upon, it will need to be endorsed in Mexico by the Chamber of Senators, and then signed by the President. In other words, enforcement may take several years. Apart from the TLCUEM negotiations, more dairy products from the European Union are expected across the board in Mexico, particularly in the cheese and milk powder sectors.

Specifically, the European Union received a 20,000 MT tariff-rate quota (TRQ) without duties for mature cheeses, and a 5,000 MT TRQ without duties for fresh cheeses. These TRQs will be implemented over 5 years once the agreement goes into effect. Although only slightly higher than current E.U. cheese exports to Mexico currently, it opens the door to future expansion. Reports also indicate that E.U. blue cheese will have unfettered access to the Mexican market.<sup>15</sup>

### **The battle for names**

Within the TLCUEM negotiations, geographical indicators (GIs) emerged as one of the most contentious issues. GIs stipulate that production of a specifically named product is linked to a geographical location. Early during the negotiations, the European Union put forward a list of more than 340 terms to be recognized as GIs. Included in the list are cheeses, meat, wine, beer, and fruit. See GAIN Report [MX7032](#). As such, the final TLCUEM is expected to include GI provisions which will negatively impact cheese exports from the United States.

Of particular interest to the Mexican industry was the term Manchego, widely produced in Mexico. Various sources reported Mexico and the European Union agreed to free use of the term Manchego in Mexico as long as the cheese is made from cow's milk (as opposed to sheep's milk), and that there is no consumer confusion with Manchego from Spain.

### **The Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP)**

Similarly closing a trade agreement in the first half of 2018, On March 8, 2018, 11 countries, including Mexico signed the CPTPP, and the agreement is now in the process of ratification. Mexico ratified the agreement in April, 2018. Other countries include Australia, Brunei, Canada, Chile, Japan, Malaysia, New Zealand, Peru, Singapore, and Vietnam. Included in the agreement are dairy import TRQs that Mexico will implement over time (11 years) for milk and cream (375,000 liters), milk powder (42,000 MT), cheese (6,500 MT), dairy preparations (2,500 MT), other milk related products not specified (2,000 MT), butter (2,000 MT), condensed milk (1,500 MT), and evaporated milk (750 MT).<sup>16</sup> The TRQs will apply to various combinations of the signatory countries. Phased-in duty relief is expected generally for yogurt and milk powder whey, among others.

Of the countries<sup>17</sup> which benefit from the TRQ for cheese, New Zealand is the only one with current market share. In 2017, Mexico imported 4,076 MT of cheese from New Zealand.

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<sup>14</sup> Specific TRQs identified are discussed in the various product sections below.

<sup>15</sup> <http://ec.europa.eu/trade/policy/in-focus/eu-mexico-trade-agreement/agreement-explained/>

<sup>16</sup> CPTPP Annex 2-D. Mexico Appendix a-1 Tariff Rate Quotas of Mexico and Appendix A-2 Country-Specific Allocation for Sugar of Mexico

<sup>17</sup> The TRQ will apply to Brunei, Canada, Japan, Malaysia, Singapore, Vietnam, New Zealand, and Australia.

Dairy, Cheese Market Begin Year	2016		2017		2018	
	Jan 2016		Jan 2017		Jan 2018	
	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Mexico						
<b>Beginning Stocks</b>	0	0	0	0	0	0
<b>Production</b>	375	375	380	396	390	405
<b>Other Imports</b>	126	126	129	122	135	130
<b>Total Imports</b>	126	126	129	122	135	130
<b>Total Supply</b>	501	501	509	518	525	535
<b>Other Exports</b>	5	5	6	7	5	8
<b>Total Exports</b>	5	5	6	7	5	8
<b>Human Dom. Consumption</b>	496	496	503	511	520	527
<b>Other Use, Losses</b>	0	0	0	0	0	0
<b>Total Dom. Consumption</b>	496	496	503	511	520	527
<b>Total Use</b>	501	501	509	518	525	535
<b>Ending Stocks</b>	0	0	0	0	0	0
<b>Total Distribution</b>	501	501	509	518	525	535

(1000 MT)

Not Official USDA Data

## **Dairy, Butter**

### **Production**

#### **Production supported by the bakery and HRI sectors**

Butter and butterfat production in 2018 is forecast at 225,000 MT, up from revised numbers for 2017 and continuing the trend of increasing production. Production in 2017 was revised up based on updated official data, and showing a three percent increase over 2016. In 2017, both butter and butterfat production saw the increase.<sup>18</sup> While production still faces competition for inputs (fluid milk) from other dairy processing sectors, demand from the bakery, confectionary, and Hotel Restaurant Institutional (HRI) sectors is expected to continue to increase in the medium to long term, stimulating production.

### **Consumption**

#### **Spreading the butter**

Consumption for 2018 is forecast at 270,000 MT, as the demand from the bakery, confectionary, and HRI sectors continues. Household butter consumption, although minor, is also expected to increase in the medium term. The 2017 figure is revised down to reflect higher international prices and the resulting trade impact. Nevertheless, at the household level, it is expected that medium to high income consumers will continue demanding butter due to the perceived health benefits compared with margarine. Current Mexican per capita consumption is below the levels of Europe or the United States.

### **Trade**

#### **Butter trade reflective of the global market**

Imports are forecast at 55,000 MT for 2018, regaining some ground after a dip in trade (both imports and exports) in 2017. Imports for 2017 were revised down based on official data, but still comprised 19 percent of consumption. Despite this, in 2017 Mexico was one of the top ten importers of butter globally (top five if the European Union is counted as a single block), as they were in 2016. The dip in butter trade overall is reflective of the global market for butter (high prices and increased domestic consumption in the major producing countries).

#### **A Pacific region stronghold**

New Zealand continues to hold the biggest share in the Mexican import market at 81 percent in 2017 (down from 2016), but saw a challenge from the United States and the Netherlands, which grew to six percent and six percent in 2017, respectively. Chile and Australia also hold small market share. In the CPTPP agreement, Mexico will allow for a 2,000 MT TRQ implemented over 11 years.<sup>19</sup>

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<sup>18</sup> Butterfat in Mexico is known as “Crema o Grasa Butirica,” and is considered to be the same as anhydrous milk fat (AMF) and butteroil in the United States.

<sup>19</sup> The TRQ will apply to Brunei, Canada, Japan, Malaysia, Singapore, Vietnam, New Zealand, and Australia

Exports for 2018 are forecast at 10,000, similarly regaining some ground after a dip in 2017. The United States remained the primary destination for Mexico's butter exports (91 percent) in 2017, but as a decline from 2016. Cuba on the other hand, grew to 8 percent in 2017. Other export destinations are negligible.

Dairy, Butter Market Begin Year Mexico	2016		2017		2018	
	Jan 2016		Jan 2017		Jan 2018	
	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
<b>Beginning Stocks</b>	0	0	0	0	0	0
<b>Production</b>	217	217	218	223	220	225
<b>Other Imports</b>	65	65	55	49	60	55
<b>Total Imports</b>	65	65	55	49	60	55
<b>Total Supply</b>	282	282	273	272	280	280
<b>Other Exports</b>	15	15	8	8	8	10
<b>Total Exports</b>	15	15	8	8	8	10
<b>Domestic Consumption</b>	267	267	265	264	272	270
<b>Total Use</b>	282	282	273	272	280	280
<b>Ending Stocks</b>	0	0	0	0	0	0
<b>Total Distribution</b>	282	282	273	272	280	280

(1000 MT)

Not Official USDA Data

## **Dairy, Skim Milk Powder (SMP)**

### **Production**

#### **SMP production not meeting demand**

The forecast for 2018 production of SMP is maintained at 50,000 MT, showing small growth, but dwarfed by demand. According to industry, Mexico seeks to expand production of SMP (as it has for several years). However, production continues to be constrained by competition for fluid milk as a raw material in other value-added processing sectors. As a general rule, between the milk powders, fluid milk principally goes to whole milk powder (WMP) as an input, with surplus for SMP. The production figure for 2017 was revised marginally up due to updated official data.

#### **Questions of capacity at drying facilities for milk powder**

Several reports in 2018 indicate that capacity at drying facilities is not sufficient for the fluid milk produced. While federal certification through TIF (Federally Inspected Type)<sup>20</sup> is an option for processing facilities/dryers, obtaining certification can be difficult, and not many facilities carry the certification. Previous GAIN reports highlighted two new drying facilities in Jalisco and Aguascalientes intended to increase capacity. News reports indicate that the project in Aguascalientes was canceled, but could be revived in 2018.<sup>21</sup> The facility Jalisco has begun to function.<sup>22</sup> Other reports indicate projects in southern Chihuahua.<sup>23</sup>

#### **Chihuahua takes heat for lack of capacity**

In April 2018, reports hit the press of a lack of capacity in Chihuahua to dry fluid milk. Stories highlighted amounts from 30,000<sup>24</sup> to 800,000 liters<sup>25</sup> with the potential to be wasted, and one report claimed that preference was initially given to commercial producers, rather than small producers under LICONSA contracts. The situation was reportedly resolved; however the reports indicate an underlying need for expanded drying facilities. With a limited number of drying facilities overall, any delay or lack of capacity impacts milk producers, particularly those with a limited cold chain (i.e. small producers).

### **Consumption**

Consumption is forecast for 2018 at 355,000 MT, continuing an upward trend, despite recent high levels of exports to Venezuela. More so than other dairy sectors, the SMP market depends on imports almost entirely (94 percent of consumption in 2017 and 88 percent in 2016). Demand continues for SMP as an input in processed products, or to be reconstituted into specialty milk. LICONSA's consumption of SMP remains almost negligible. For 2017, the consumption figure was revised up based on official data

<sup>20</sup> <https://www.gob.mx/senasica/documentos/directorio-de-establecimientos-tif>

<sup>21</sup> <https://www.inforural.com.mx/sera-2018-cuando-se-consolide-la-planta-deshidratadora-leche-sedrae/>

<sup>22</sup> [http://www.milenio.com/negocios/secadora-leche-tepatitlan\\_de\\_morelos-productores-seder-milenio\\_noticias\\_0\\_873512928.html](http://www.milenio.com/negocios/secadora-leche-tepatitlan_de_morelos-productores-seder-milenio_noticias_0_873512928.html)

<sup>23</sup> <https://www.reportecuaahquemoc.com/single-post/2018/02/24/Destaca-SAGARPA-apoyos-a-productores-de-leche>

<sup>24</sup> <http://www.tierrafertil.com.mx/detenidos-300-mil-litros-de-leche-en-chihuahua/>

<sup>25</sup> <https://www.pressreader.com/mexico/reforma/20180412/282278140913137>

as an increased production and imports provided the sector with ample supplies despite increased exports.

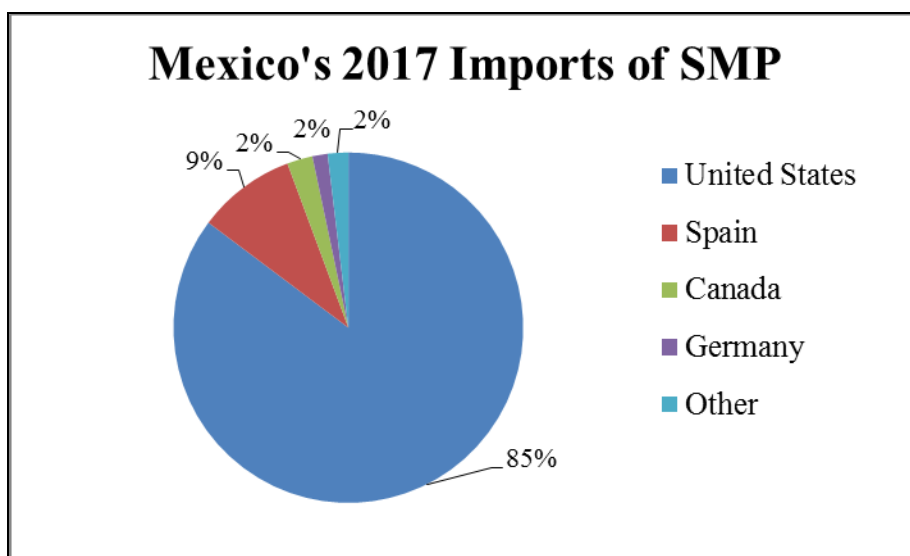
## Trade

### Mexico, the number one importer of SMP

Imports of SMP for 2018 are forecast at 340,000 MT, up three percent from the revised 2017 figure, and continuing the upward trend. In the first two months of 2018, imports came in nine percent higher than the same period in 2017. The estimate for 2017 was revised up to reflect updated official data, and shows a significant jump from 2016. Mexico is a net SMP importer as competition for fluid milk as an input and dryer capacity has driven the sector to look for product abroad. Fluid milk is prioritized for used in other added-value dairy products such as WMP. Mexico is also the number one importer of SMP globally, and this is not expected to change in the near future.

### Low global prices attract trade

Attractive prices for SMP globally spur trade in Mexico. Mexico primarily imports SMP from the United States, with an 85 percent market share in 2017. However Spain jumped to 9 percent of the market in 2017 (from 2 percent in 2016, and 3 percent in 2015) reflecting an advantageous market situation and low prices. Canada maintained its market share in 2017 at 2 percent, while small amounts of imports came from other European countries and New Zealand. With Mexico's efforts to diversify trade, an agreement in principle for the TLCUEM, and the recent uptick in imports from Spain, Europe is poised to grow their market share in the medium-term.



Source: INEGI (through Global Trade Atlas)

### Favorite ports for traders in 2017

In 2017, with a geographical advantage, U.S. SMP continued to enter Mexico through all of the land border ports (Tijuana, Mexicali, Nogales, Ciudad Juarez, Colombia, Nuevo Laredo, Reynosa and Matamoros). Canadian traders favored Ciudad Juarez, Nuevo Laredo, Colombia, Matamoros, and



Altamira. On the other hand, all European traders, including Spain, favored the port at Veracruz on Mexico’s eastern shore, while New Zealand shipped to Manzanillo on Mexico’s western shore.

**Exports continue rapid expansion**

The new forecast for Mexico’s SMP exports in 2018 is 35,000 MT. This shows gains from 2017. Although a net importer, Mexico’s exports of SMP skyrocketed from 2,566 MT in 2016 to 28,874 MT in 2017, principally due to a meteoric rise in exports to Venezuela. Prior to that, exports had been negligible. In 2017, Venezuela comprised 98 percent of the export market. In the first two months of 2018, Mexico had already exported 9,666 MT (9,643 MT to Venezuela), three times the amount during the same period in 2017. Other export destinations include the United States, Panama, Honduras, and Belize. While the exports to Venezuela were viewed as a one-off due to their economic crisis, this continuation of trade suggests a longer trend.

**Policy**

**The TRQ for milk powder imports continues**

In 2012, Mexico established a TRQ for WTO countries of 80,000 MT of powder milk imports (HS Codes: 04021001 for SMP, and 04022101 for WMP). TRQ allocates 40,000 MT for use by LICONSA, with the remainder to be allocated among the private sector.<sup>26</sup>

As previously reported, under the Import and Export General Tax Law (the duty applied to imports from third countries for SMP (HS code: 04021001) is 45 percent *ad valorem*. All U.S. milk powder under NAFTA is duty-free and free of any TRQ.

**The European Union and Pacific Countries poised to gain market share**

Under the TLCUEM agreement in principle, the European Union gained a TRQ for 50,000 MT of SMP, further positioning itself as the secondary market of choice after the United States, with growth potential. In comparison with the total SMP imports in Mexico, and current imports from the European Union, this TRQ alone does not represent an immediate market shift.

However, when the TRQ for the European Union is combined with the general TRQ Mexico established in 2012, along with another new TRQ of 42,000 MT<sup>27</sup> for milk powder (both SMP and WMP) under the CPTPP, market shares could begin to shift. Factors which may influence any shift are the global price for SMP (currently low), transport costs, and exchange rates.

Dairy, Dry Skim Milk Powder	2016		2017		2018	
	Jan 2016		Jan 2017		Jan 2018	
Market Begin Year						
Mexico	USDA	New	USDA	New	USDA	New

<sup>26</sup> <http://www.siicex.gob.mx/portalsiicex/Transparencia/HistoricoCupos/ArchivoHistorico/infespec-Alimentosybebidas-Historico.htm>

<sup>27</sup> This TRQ will apply to Australia, Brunei, Canada, Japan, Malaysia, New Zealand, Singapore, and Vietnam.

	<b>Official</b>	<b>Post</b>	<b>Official</b>	<b>Post</b>	<b>Official</b>	<b>Post</b>
<b>Beginning Stocks</b>	0	0	0	0	0	0
<b>Production</b>	42	42	45	49	50	50
<b>Other Imports</b>	286	286	310	331	330	340
<b>Total Imports</b>	286	286	310	331	330	340
<b>Total Supply</b>	328	328	355	380	380	390
<b>Other Exports</b>	3	3	20	29	22	35
<b>Total Exports</b>	3	3	20	29	22	35
<b>Human Dom. Consumption</b>	325	325	335	351	358	355
<b>Other Use, Losses</b>	0	0	0	0	0	0
<b>Total Dom. Consumption</b>	325	325	335	351	358	355
<b>Total Use</b>	328	328	355	380	380	390
<b>Ending Stocks</b>	0	0	0	0	0	0
<b>Total Distribution</b>	328	328	355	380	380	390
(1000 MT)						

Not Official USDA Data

## **Dairy, Whole Milk Powder (WMP)**

### **Production**

#### **Production to stabilize after slow fourth quarter in 2017**

The forecast for 2018 WMP production in Mexico is revised back, but stabilizing at 140,000 MT. As previously reported, Mexico focuses their milk powder production on WMP instead of SMP. This trend is not expected to change in the near future, and WMP continues to compete with other processed dairy sectors for use of high quality fluid milk. The figure for 2017 was revised down based on official data and due to lower than expected production in the October to December period. In 2018, production is expected to remain relatively flat. While competition with other dairy sectors for milk persists, the capacity of dryers in Mexico also plays a role in constricting growth (see the SMP section).

#### **Infant formula production slightly up**

Mexico's Agricultural and Fisheries Statistical Institute (SIAP), reports that aside from SMP and WMP, Mexico produced 74,611 MT of "leche en polvo para lactantes."<sup>28</sup> or powdered milk for infant formula. The 2017 number is up slightly from 73,623 MT in 2016.

### **Consumption**

#### **Consumption to rebound partially**

WMP consumption is forecast at 107,000 MT for 2018, rebounding partially from the dramatic decline in 2017. As previously reported, the 2017 consumption figure showed a sharp drop due to the unexpected and extraordinary exports to Venezuela. WMP is used by processors for the preparation of specialty dry milks, and reconstitution into fluid milk, sweetened milk, yogurts, and other added-value products. WMP is often packaged for reconstitution as a shelf stable product, including use by LICONSA.

### **Trade**

#### **Imports expected at 2014-2015 levels**

Imports of WMP for 2018 are forecast at 7,000 MT, or a return to 2014 and 2015 levels following the 2016 peak and 2017 drop. As of February 2018, import levels are already eight times as high as in 2017. Unlike with SMP, the WMP sector is principally supplied by domestic production, supplemented to a small degree by imports. Countries for which Mexico does not have a free trade agreement or who use the TRQ have an applied duty of 45 percent.<sup>29</sup>

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<sup>28</sup> Powdered milk for infant formula.

<sup>29</sup> <http://www.economia-snci.gob.mx/>

In 2017, imports from New Zealand, which dominates the market, fell to 1,933, from 7,044 MT in 2016. Also in 2017, imports from the United States grew marginally, bringing the U.S. market share back to 2015 levels. Argentina, however, has seen a steady decline of tonnage and market share since 2014.

### Favorite ports for traders in 2017

As highlighted in previous reports, the principal ports of entry for U.S. WMP are Ciudad Juarez, Nuevo Laredo, and Colombia. European, Central American, and South American countries (along with Canada) principally use Mexico's eastern seaport of Veracruz, while New Zealand and Australia send their shipments to Manzanillo and Lazaro Cardenas on the western shore of Mexico.<sup>30</sup>

### Mexico, a net exporter of WMP

Exports for 2018 are forecast at 40,000 MT, finding a middle ground between a spike in exports in 2017 and 2016. The unprecedented exports to Venezuela in 2017 (totaling 56,643 MT), appeared initially to be a one-off, however 2018 will determine if the trend will continue. The WMP appears to be a component in *dispensas*, or pre-packaged boxes of basic supplies, that are sold to Venezuela. In the first two months of 2018, Mexico had already exported 1,175 MT to Venezuela (as compared with 2,328 MT in 2017, and 0 MT in the three years preceding). Other traditional markets, such as Colombia, Cuba, and the United States, are expected to remain. In 2017, Mexico exported more WMP (4,723 MT) to the United States, than it imported from all sources.

Dairy, Dry Whole Milk Powder Market Begin Year	2016		2017		2018	
	Jan 2016		Jan 2017		Jan 2018	
	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Mexico						
Beginning Stocks	0	0	0	0	0	0
Production	144	144	150	139	155	140
Other Imports	12	12	4	4	4	7
Total Imports	12	12	4	4	4	7
Total Supply	156	156	154	143	159	147
Other Exports	20	20	32	77	35	40
Total Exports	20	20	32	77	35	40
Human Dom. Consumption	136	136	122	66	124	107
Other Use, Losses	0	0	0	0	0	0
Total Dom. Consumption	136	136	122	66	124	107
Total Use	156	156	154	143	159	147
Ending Stocks	0	0	0	0	0	0
Total Distribution	156	156	154	143	159	147

(1000 MT)

Not Official USDA Data

<sup>30</sup> Source: INEGI

### Other Relevant Reports Submitted by FAS/Mexico

Report Number	Title
<a href="#">MX7047</a>	Dairy Annual: Mexico's Processing Sector Fuels Demand for Dairy Inputs
<a href="#">MX7067</a>	Mexico Analyzes Draft Regulations for Selected Dairy Products
<a href="#">MX8012</a>	Mexico Publishes Draft Regulations for Selected Dairy Products

*FAS/Mexico Web site:* We are available at <https://www.fas.usda.gov/regions/mexico> or readers may visit the FAS headquarters' homepage at [www.fas.usda.gov](http://www.fas.usda.gov) for a complete selection of FAS worldwide agricultural reporting.

*Useful Mexican Web Sites:* Mexico's equivalent to the U.S. Department of Agriculture (SAGARPA) can be found at [www.sagarpa.gob.mx](http://www.sagarpa.gob.mx), equivalent to the U.S. Department of Commerce (SE) can be found at [www.economia.gob.mx](http://www.economia.gob.mx) and equivalent to the U.S. Food and Drug Administration (SALUD) can be found at [www.salud.gob.mx](http://www.salud.gob.mx). These websites are mentioned for the readers' convenience but USDA does NOT in any way endorse, guarantee the accuracy of, or necessarily concur with, the information contained on the mentioned sites.