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Dairy and Products

Update on the EU dairy market

2007

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Report Highlights:
Implementation of the CAP Reform of 2003, combined with a summer drought, led to a decrease in EU milk deliveries in 2006. As processors decided to honor increased domestic and export demand for cheese, EU production of butter, NFDM and WMP decreased significantly compared to 2005. While domestic consumption of butter and WMP further increased, consumption of NFDM decreased as a result of lower use in feed. Exports of WMP and NFDM decreased, but butter intervention stocks supplemented EU butter supplies.
EU milk deliveries in 2007 are forecast to rebound, although still below the 2005 level. Further increases in cheese production are forecast to use this additional milk supply, leaving no room for a recovery in production of butter, NFDM and WMP. This is forecast to result in continued slow exports of NFDM and WMP, a further decrease in domestic consumption of NFDM and the complete depletion of EU butter intervention stocks.

Includes PSD Changes: No
Includes Trade Matrix: No
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DISCLAIMER and ACKNOWLEDGEMENT

The numbers in PS&D's in this voluntary report are not official USDA numbers. Contrarily to EU required consolidated reports, which result from a group effort by FAS offices EU-wide, these PSD's were compiled from preliminary EUROSTAT production data and trade numbers as available from Global Trade Atlas. Because the main focus of this voluntary report is on updating European dairy market evolutions in 2006, this report still focuses on the EU-25. Nevertheless, I want to thank those colleagues in FAS/EU offices, who provided input for this report from their EU Member State perspectives.

Executive Summary

Implementation of the 2003 CAP reform, especially the decoupling of support for dairy farmers, led to a decrease in milk production in 2006. A drought in the summer of 2006 strengthened this decrease in milk production. EU milk production is expected to recover in 2007 as efficient milk producers pick up abandoned production quota from their inefficient colleagues, but milk production is not forecast to match 2005 production levels yet, despite the second of three annual 0.5 percent quota increases. European dairy producers complain that big increases in prices for dairy products haven't sufficiently filtered through to milk producer prices yet, while feeding costs have increased significantly because of increased grain prices and constrained fodder production as a consequence of the widespread draught in April 2007.

Exports and domestic consumption of cheese showed robust growth in 2006 and this trend is forecast to continue in 2007. Because cheese production is the preferred use for milk deliveries, the decrease in milk deliveries in 2006 led to a significant decrease in butter, Non-Fat Dry Milk (NFDM) and Whole Milk Powder (WMP) production. While domestic consumption of butter and WMP slightly further increased, the halt of subsidies for the use of NFDM in feed resulted in a decrease in EU NFDM consumption. The decrease in butter production was supplemented from EU intervention stocks.

Forecasts for 2007 are that increased milk deliveries will end up in increased cheese production and fresh dairy products, leaving no room for production increases for butter, WMP and NFDM. EU cheese production increased by 4 percent in the first quarter of 2007, as this coincided with the last quarter of the 2006-2007 milk quota year. However, this increase in cheese production is forecast to slow as a result decreasing milk deliveries again over the 2007 summer period. EU domestic cheese consumption and exports are forecast to continue their trend increase in 2007. Changes may occur on the disappearance side for other dairy products. The halt to subsidies for incorporation of NFDM in feed is forecast to further decrease domestic consumption and free up more NFDM for exports. Exports of WMP could be reoriented to other destinations as a result of decreased demand from African countries because of high prices and the end of export subsidies for WMP. EU butter intervention stocks were depleted at the end of March 2007 and high butter prices will probably not allow any rebuilding of EU butter intervention stocks in the course of 2007.

Milk Production

Country:	EU-25					
Commodity:	Dairy, Milk (1000 Head / 1000 MT)					
	2005		2006		2007	
	Old	New	Old	New	Old	New
Calendar Year Begin	**01/2005**		**01/2006**		**01/2007**	
Cows In Milk	23,400	23,400	22,974	22,970	22,700	22,340
Cows Milk Deliveries to Dairies	131,652	131,652	130,500	130,400	130,600	131,500
Other Milk Production	4,526	4,526	4,525	4,525	4,553	4,550
Total Milk Production	136,178	136,178	135,025	134,925	135,153	136,050
Extra EU25 Imports	9	9	13	7	10	7
TOTAL SUPPLY	**136,187**	**136,187**	**135,038**	**134,932**	**135,163**	**136,057**
Extra EU25 Exports	132	132	135	142	135	135
Fluid Use Dom. Consum.	34,064	34,064	34,079	34,030	34,140	34,050
Factory Use Consum.	101,991	101,991	100,824	100,760	100,888	101,872
Feed Use Dom. Consum.	0	0	0	0	0	0
Total Dom. Consumption	136,055	136,055	134,903	134,790	135,028	135,922
TOTAL DISTRIBUTION	**136,187**	**136,187**	**135,038**	**134,932**	**135,163**	**136,057**

Sources: based on EUROSTAT; Global Trade Atlas

Implementation of the 2003 CAP reform, especially the decoupling of support for dairy farmers, led to a decrease in milk production in 2006. As a result, milk production decreased in most EU-15 Member States (MS), while milk production in the 10 New Member States (NMS) increased, with Hungary a notable exception. This decrease in milk production was reinforced by the 2006 summer drought and a consequent reduction in dairy herds. Preliminary and incomplete milk production data for 2006 suggest that EU-25 milk production was even slightly below previous FAS/EU forecasts. This occurred despite the first of three annual 0.5 percent increases in milk production quota. As a result, only six EU MS have reported overshooting their 2006-2007 production quota (April-March), compared to ten MS in 2005-2006. These six MS are Austria, Denmark, Greece, Ireland, Italy and The Netherlands. EU milk production is expected to recover in 2007 as fewer farmers had to reduce their production at the end of the quota year to avoid having to pay the super levy compared to 2006. However, milk production is not forecast to match 2005 production levels, despite the second 0.5 percent quota increase. Efficient milk producers are picking up abandoned production quota from their inefficient colleagues. The ongoing increase in milk productivity per cow results in a continued decrease in cow numbers. European dairy producers complain that big increases in prices for dairy products haven't sufficiently filtered through to milk producer prices yet, while feeding costs have increased significantly because of increased grain prices and constrained fodder production as a consequence of the widespread drought in April 2007. High energy prices have also added to the increase in feeding costs, both for compound feed as well as for on farm feed production.

Cheese

Country:	**EU-25**					
Commodity:	**Dairy, Cheese** (1000 MT)					
	2005		**2006**		**2007**	
	Old	New	Old	New	Old	New
Calendar Year Begin	**01/2005**		**01/2006**		**01/2007**	
Beginning Stocks	0	0	0	0	0	0
Production	6,480	6,480	6,580	6,580	6,640	6,700
Extra EU25 Imports	95	95	85	101	80	100
TOTAL SUPPLY	**6,575**	**6,575**	**6,665**	**6,681**	**6,720**	**6,800**
Extra EU25 Exports	492	492	495	529	495	550
Domestic Consumption	6,083	6,083	6,170	6,152	6,225	6,250
Other Use, Losses	0	0	0	0	0	0
TOTAL Dom. Consumption	6,083	6,083	6,170	6,152	6,225	6,250
Ending Stocks	0	0	0	0	0	0
TOTAL DISTRIBUTION	**6,575**	**6,575**	**6,665**	**6,681**	**6,720**	**6,800**

Sources: based on EUROSTAT; Global Trade Atlas

Cheese production is the most profitable and preferred use for EU milk deliveries, especially as additional cheese production capacity was installed in recent years. EU domestic consumption, as well as EU cheese exports, continues to show steady increases. Cheese consumption in 2006 increased most vigorously in Germany and Italy. EU cheese exports in 2006 ended higher than previously estimated, especially to Russia, despite decreasing export refund levels. Cheese imports also ended higher in 2006, especially because of increased cheese imports from New Zealand and partly at the expense of imports from Australia. Forecasts for 2007 predict a continuation of the increase in cheese production. The first three months of 2007 saw a 4 percent increase in cheese production compared to 2006, but this increase is forecast to level off to about a 2 percent average for total 2007. Both exports and domestic consumption of cheese are expected to further increase in 2007.

Butter

Country:	**EU-25**					
Commodity:	**Dairy, Butter** (1000 MT)					
	2005		**2006**		**2007**	
	Old	New	Old	New	Old	New
Calendar Year Begin	**01/2005**		**01/2006**		**01/2007**	
Beginning Stocks	232	232	185	185	160	122
Production	2,155	2,140	2,065	2,055	2,050	2,055
Extra EU25 Imports	80	82	80	84	80	85
TOTAL SUPPLY	**2,467**	**2,454**	**2,330**	**2,322**	**2,290**	**2,262**
Extra EU25 Exports	342	345	230	254	220	260
Domestic Consumption	1,940	1,924	1,940	1,948	1,940	1,952
Other Use, Losses	0	0	0	0	0	0
TOTAL Dom. Consumption	1,940	1,924	1,940	1,948	1,940	1,952
Ending Stocks	185	185	160	122	130	50
TOTAL DISTRIBUTION	**2,467**	**2,454**	**2,330**	**2,322**	**2,290**	**2,262**

Sources: based on EUROSTAT; Global Trade Atlas

The decrease in milk deliveries in 2006, in combination with increasing cheese production, led to a significant decrease in EU butter production. Preliminary data indicate that EU butter production ended even below previous estimates. EU butter exports, despite a serious decrease compared to 2005, ended higher than anticipated. Much lower exports from the EU-15 were partly compensated by increased exports from the NMS-10, mainly from Poland. As a result, official EU butter ending stocks in 2006 decreased significantly more than anticipated.

Butter production in the EU is not forecast to increase again in 2007. High demands from domestic and export markets allowed the European Commission (EC) to announce the liquidation of all remaining butter intervention stocks to the EU market at the end of March 2007. This is the first time EU butter intervention stocks run empty since the EU started butter intervention in 1964. Because EU butter production in early 2007 continues at low levels, EU butter prices have increased, preventing all butter intervention buying. As a result, it is forecast that there will be no butter in intervention storage at the end of 2007, with companies building only some stocks on Private Storage Aid. As a result, butter exports and domestic consumption are forecast to remain stable in 2007 compared to 2006. There is speculation that the EU might even increase its butter imports in 2007.

Whole Milk Powder (WMP)

Country:	**EU-25**					
Commodity:	**Dairy, Whole Milk Powder** (1000 MT)					
	2005		**2006**		**2007**	
	Old	New	Old	New	Old	New
Calendar Year Begin	**01/2005**		**01/2006**		**01/2007**	
Beginning Stocks	0	0	0	0	0	0
Production	840	858	790	810	770	805
Extra EU25 Imports	2	2	1	2	1	2
TOTAL SUPPLY	**842**	**860**	**791**	**812**	**771**	**807**
Extra EU25 Exports	494	493	440	430	420	430
Domestic Consumption	348	367	351	382	351	377
Other Use, Losses	0	0	0	0	0	0
TOTAL Dom. Consumption	348	367	351	382	351	377
Ending Stocks	0	0	0	0	0	0
TOTAL DISTRIBUTION	**842**	**860**	**791**	**812**	**771**	**807**

Sources: based on EUROSTAT; Global Trade Atlas

Revised data for 2005 and preliminary data for 2006 suggest that previous WMP production numbers were slightly underestimated. The decrease in WMP production in 2006 compared to 2005 was mainly reported in France and The Netherlands. Tight supplies from Oceania have provoked continued demand for EU WMP exports in 2006 and this is expected to continue in 2007. Increased WMP demand was recorded from China and the North African countries, but the EU lost market shares in these markets due to its limited WMP supply. However, the continuing focus on increasing cheese production in the EU is not forecast to allow any increase in WMP production in 2007, although some of the NMS, like Slovenia, expect significant increases in milk powder production as a result of increasing milk production. EU WMP exports could eventually come under further downward pressure if price increases for WMP and the halt of export subsidies for WMP reduce the demand from African countries.

Non-Fat Dry Milk

Country:	**EU-25**					
Commodity:	**Non Fat Dried Milk** (1000 MT)					
	2005		**2006**		**2007**	
	Old	New	Old	New	Old	New
Calendar Year Begin	**01/2005**		**01/2006**		**01/2007**	
Beginning Stocks	77	77	8	8	0	0
Production	1,075	1,065	975	975	940	975
Extra EU25 Imports	7	7	12	19	10	20
TOTAL SUPPLY	**1,159**	**1,149**	**995**	**1,002**	**950**	**995**
Extra EU25 Exports	195	194	130	88	120	100
Domestic Consumption	956	947	865	914	830	895
Other Use, Losses	0	0	0	0	0	0
TOTAL Dom. Consumption	956	947	865	914	830	895
Ending Stocks	8	8	0	0	0	0
TOTAL DISTRIBUTION	**1,159**	**1,149**	**995**	**1,002**	**950**	**995**

Sources: based on EUROSTAT; Global Trade Atlas

EU NFDM production decreased significantly in 2006 because of lagging milk supplies. This started the spiral of NFDM price increases, as supplies couldn't meet export demands. At the same time, the decrease, followed by a complete halt to EU subsidies for incorporation of NFDM in feed decreased NFDM use in feed, as whey powder became a more price-efficient substitute. The continued constraint in available milk in 2007 because of the continued focus on cheese production is forecast to leave little room for increased NFDM production, despite important price increases. The increased cost of NFDM is expected to further decrease its use in feed and thus make some additional NFDM supplies available for exports in 2007, especially after competition from Oceania and South America decreased as a result of the drought in Australia and the export tax in Argentina.

Dairy Mini-package

On February 15, 2007, the European Commission (EC) adopted a so-called "mini-package" amendment[1] to several dairy regulations (See GAIN E46016). The main goals of this amendments to the dairy regime is increased harmonization of EU dairy product compositions internally as well as with Codex definitions, especially for NFDM and butter, as well as consolidating some of the recent positive dairy market developments. The main feature is believed to mainly improve the EU butter market organization. This dairy "mini-package" will also change the subsidy scheme for school milk. The subsidy level will be untied from the fat content, as this had become unacceptable from a dietary point of view.

Some delays in the approval procedure at the European Parliament and the EU Council will not allow the amendment to be implemented on July 1, 2007 as anticipated, but implementation is now expected on January 1, 2008.

[1] http://eur-lex.europa.eu/LexUriServ/site/en/com/2007/com2007_0058en01.pdf

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