

Required Report - public distribution

Date: 5/28/2003

GAIN Report Number: E23077

European Union

Dairy and Products

Semi-Annual

2003

Approved by:

Norval E. Francis, Jr.
US Mission to the European Union

Prepared by:

Justina Torry

Report Highlights: The EU dairy market in 2002 can be characterized as stable, as production and exports remained stable with slight increases in consumption. The outlook for 2003 could be less stable as a strengthened Euro, and the potential increase in dairy quotas could negatively affect prices of raw milk in the EU. Increased imports from Eastern European countries are also expected in 2003 as a result of a stronger Euro (Euro=\$1.165).

Includes PSD Changes: No
Includes Trade Matrix: No
Unscheduled Report
Brussels USEU [BE2]
[E2]

This EU consolidated dairy report was compiled with the active contribution the following FAS EU based staff: Bob Flach (FAS The Hague), Michael Hanley (FAS Dublin), Marie-Cecile Henard (FAS Paris), Steve Knight (FAS London), Hasse Kristensen (FAS Copenhagen), Asa Lexmon (FAS Stockholm), Sabine Lieberz (FAS Berlin), Diego Pazos (FAS Madrid), Franco Regini (FAS Rome).

EXECUTIVE SUMMARY

The EU dairy market in 2002 can be characterized as stable, as production and exports remained stable with slight increases in consumption. Marginal increases in the UK and the Netherlands shows recovery following the FMD crises in 2001. This recovery is forecast to continue into 2003. As previously forecast, the EU cheese market remained stable in 2002 and consumption is predicted to increase slightly in 2003. Butter production in the EU increased more than anticipated although household consumption of butter is still in long-term decline due to health concerns. In 2002 skim milk powder production increased as the EU increased the incorporation rate of nonfat dried milk in subsidized veal feed. This increasing trend is not expected to continue into 2003 as overall demand is declining. EU production of whole milk powder declined in 2002 as imports from Eastern Europe increased to certain EU countries, however this decline is expected to turn around in 2003. Additionally, the strength of the Euro and the potential increase of dairy quotas as debated in the Mid-term Review could negatively affect prices of raw milk in the EU. Increased imports from Eastern European countries are also expected in 2003 as a result of a stronger Euro (Euro=\$1.165).

FLUID MILK

PSD Table						
Country:	EU					
Commodity:	Dairy, Milk, Fluid					
		2001		2002		2003
	Old	New	Old	New	Old	New
Calendar Year Begin		01/2001		01/2002		01/2003
Cows In Milk	17815	18127	17760	17970	17500	17663
Cows Milk Deliveries to Dairies	115165	114856	115355	115130	115375	115150
Other Milk Production	2322	2299	2365	2360	2395	2400
TOTAL SUPPLY	117487	117155	117720	117490	117770	117550
Fluid Use Dom. Consum.	30970	30970	31050	31042	31080	31075
Factory Use Consum.	86517	86185	86670	86448	86690	86475
Feed Use Dom. Consum.	0	0	0	0	0	0
TOTAL DISTRIBUTION	117487	117155	117720	117490	117770	117550

Note: Revision of 2001 data due to revised Eurostat data

In 2002, cows milk delivered to dairies increased marginally (+ 0.3 percent) compared to 2001 levels. This figure is slightly lower than previously forecast. The main reason for this change was due to increased production in the UK as the industry returned to 2001 (pre FMD levels).

Whereas Dutch milk deliveries declined by 2 percent compared to 2001 levels because low cattle prices that year caused farmers to retain cattle on the farm. Increased production of milk from sheep and goats, continues as this milk does not fall under EU quotas and as marketing opportunities exist for cheese from sheep and goat milk. In 2000/2001 quotas had been increased for Italy, Spain, Greece, and Northern Ireland. Total increase of quota amounted to approximately 887,000 MT.

A slight increase in cows milk delivered to dairies is forecast for 2003 as countries continue to fill their slightly expanded quotas.

Fluid milk use for human consumption continued to increase slightly in 2002 and is expected to continue to increase slightly in 2003. The overall EU increase in 2002 however hides regional variations. Declines in fluid milk sales were recorded in France while Germany and Denmark showed gains. Despite these variations fluid milk sales are expected to increase in 2003 with a greater demand for flavored milk (particularly in Denmark).

CHEESE

PSD Table						
Country:	European Union					
Commodity:	Dairy, Cheese					
		2001		2002		2003
	Old	New	Old	New	Old	New
Calendar Year Begin		01/2001		01/2002		01/2003
Beginning Stocks	117	117	116	116	106	106
Production	5420	5420	5450	5470	5450	5500
Extra EC Imports	169	169	133	140	139	155
TOTAL SUPPLY	5706	5706	5699	5726	5695	5761
Extra EC Exports	447	447	463	465	465	465
Human Dom. Consumption	4858	4858	4855	4855	4855	4895
Other Use, Losses	285	285	275	300	275	300
TOTAL Use	5143	5143	5130	5155	5130	5195
Ending Stocks	116	116	106	106	100	101
TOTAL DISTRIBUTION	5706	5706	5699	5726	5695	5761

Please note: Per reporting instructions, fresh cheese figures were taken out of the PS&D table data as was done the previous report (E22116, November 2002). Fresh cheese figures however represent a large and dynamic segment of the cheese market in both Germany and France. Also, these member states include fresh cheese production in their total cheese production data reported to the EU Commission. This inconsistency explains the discrepancy between official USDA estimates and EU Commission estimates.

Note #2: Stocks listed above represent private storage aid (PSA) only, as there are no intervention stocks for cheese in the EU. Additionally commercial stocks are included in the Human Domestic Consumption" line.

Note #3: The "Other Use, Losses" line includes cheese used for processing in Germany and Italy.

The cheese market is consumption-oriented, and is the commodity driving the dairy market, as it is the highest value-added product made with milk. In 2002, as previously forecast, the EU cheese consumption remained stable. This stabilization followed a significant increase in 2001 consumption levels due to the partial offset of beef with cheese, resulting from the BSE crisis.

In 2002, EU cheese production increased by almost 1 percent, (i.e., slightly more than previously expected), mainly due to increased production in Spain and Denmark. In other member states production overall remained stable. In line with previous estimates (see report E22116), EU cheese exports increased by 4 percent. This increase can be attributed to increased shipments from Germany to Russia and the United States, as well as increased shipments from the UK to Malta, the Caribbean, North Africa, and Japan. Other member states exports were relatively stable.

According to Danish, German and French forecasts for 2003, EU domestic consumption of cheese is expected to increase by 1 percent. This increase is due to improved market prospects, and is in line with long-term upward trends. As a result, EU cheese production is expected to increase slightly. Consequently, higher imports are expected. EU cheese exports in 2003 are expected to remain at 2002 levels.

BUTTER

PSD Table						
Country:	EU					
Commodity:	Dairy, Butter					
		2001		2002		2003
	Old	New	Old	New	Old	New
Calendar Year Begin		01/2001		01/2002		01/2003
Beginning Stocks	121	121	141	141	220	242
Production	1710	1710	1740	1792	1740	1760
Extra EC Imports	115	115	108	116	100	100
TOTAL SUPPLY	1946	1946	1989	2049	2060	2102
Extra EC Exports	174	174	185	212	200	210
Domestic Consumption	1631	1631	1584	1595	1599	1612
Ending Stocks	141	141	220	242	261	280
TOTAL DISTRIBUTION	1946	1946	1989	2049	2060	2102

Note: Beginning and ending stocks are official intervention and private storage aid stocks only. Commercial stocks are included in the "Total Domestic Use" line.

Butter Production in the EU increased in 2002 more than previously forecast. The increase in butter production results from poor market conditions and low prices for dairy products. These factors caused dairies to increase their production of intervention supported products (butter and nonfat dry milk). This increase is reflected in higher ending stocks of butter at the end of 2002.

Household consumption of butter is in long-term decline, as consumers move away from butter toward substitute products, (such as olive oil or low fat spreads), due to health concerns. Surveys in the EU show that declining butter consumption can be attributed to an overall decrease in butter use (by those who use it) rather than fewer people using butter. In the past, part of this decrease was compensated for by increased industrial use of butter (for the production of ice cream or pastries). This was not the case in 2002. Total domestic use, (which includes human consumption, commercial stocks, other uses, and losses), declined in 2002. Some countries were able to increase their third country exports, in particular to Russia (the Netherlands and Germany), Iran (the Netherlands and Denmark), Syria (the Netherlands), the Czech Republic (Germany) and Romania (Germany).

For 2003, butter production is forecast to decline as prospects for other dairy products, namely cheese are expected to improve. As prices are low prices and stocks high, imports are expected to decline in line with previous forecasts. Exports are expected to remain stable. The expected increase in 'total domestic use' reflects higher commercial stocks, which mask the continued decline in human domestic consumption. Intervention stocks are expected to increase further due to continued low prices and bad market conditions, however the increase is not expected to be as prominent as in 2002.

NONFAT DRIED MILK (NFD) / SKIM MILK POWDER (SMP)

PSD Table						
Country:	EU					
Commodity:	Dairy, Milk, Nonfat Dry					
		2001		2002		2003
	Old	New	Old	New	Old	New
Calendar Year Begin		01/2001		01/2002		01/2003
Beginning Stocks	0	0	0	0	90	140
Production	953	953	1040	1070	990	1010
Extra EC Imports	59	59	50	65	50	50
TOTAL SUPPLY	1012	1012	1090	1135	1130	1200
Extra EC Exports	137	137	150	160	150	175
Human Dom. Consumption	330	340	300	260	290	260
Other Use, Losses	545	535	550	575	550	600
TOTAL Use	875	875	850	835	840	860
Ending Stocks	0	0	90	140	140	165
TOTAL DISTRIBUTION	1012	1012	1090	1135	1130	1200

In 2002, EU production of NFD increased mainly due to the possibility of intervention. Another important outlet was the use for feed due the fact that the EC increased the incorporation rate of NFD in subsidized veal feed from 25 to 50 percent as of January 2002 (for unsubsidized feed one can use as much or as little NFD as they want to). EU consumption of NFD for feed reportedly increased by 30 percent during the previous year. The increase in domestic consumption reflects a decline in commercial stocks, which were transferred into intervention stocks. Due to the global economic slowdown, NFD exports to third countries were initially limited in 2002. During the fall of 2002, however, NFD exports recovered partly

driven by increased export restitutions and the low NFDM production in Oceania. EU exports reportedly increased to Algeria, China and South Korea. By the end of 2002, the EC reduced export restitutions.

In 2003 NFDM is forecast to decline as export restitutions combined with lower export demand and a low USD/EURO exchange rate affect export sales of NFDM. It is also anticipated that NFDM production will decline if export demand for higher value dairy products improves. In 2003 intervention is expected to remain an attractive market outlet for fresh production. Sales from intervention stocks are forecast to be sustained by increased subsidy levels for use in animal feed.

WHOLE MILK POWDER (WMP)

PSD Table						
Country:	EU					
Commodity:	Whole Milk Powder (WMP)					
		2001		2002		2003
	Old	New	Old	New	Old	New
Calendar Year Begin		01/2001		01/2002		01/2003
Beginning Stocks	0	0	0	0	0	0
Production	840	840	840	800	850	810
Extra EC Imports	10	10	10	15	10	15
TOTAL SUPPLY	850	850	850	815	860	825
Extra EC Exports	469	469	500	475	490	485
Human Dom. Consumption	381	381	350	340	370	340
Other Use, Losses	0	0	0	0	0	0
TOTAL Use	381	381	350	340	370	340
Ending Stocks	0	0	0	0	0	0
TOTAL DISTRIBUTION	850	850	850	815	860	825

Note: Beginning / ending stocks under the new columns now only reflect intervention stocks, for which there is no official scheme. Furthermore, losses were incorporated into total use, which is now defined as disappearance.

WMP production in 2002 decreased compared to previous forecast in all countries except Germany and Ireland. Production decreased in 2002 compared to 2001 in all countries except the UK. This was due stock reductions resulting from unusually high stocks at the beginning of 2002. Consequently consumption figures dropped as these figures now include commercial stocks. The decrease in consumption figures only reflects stock reduction and not decreased consumption. WMP imports in 2002 from Eastern Europe increased to the Netherlands and Germany. In 2002 exports from the Netherlands to Kuwait, and from France to Turkey, Poland and Algeria increased.

WMP production is forecast to increase slightly in 2003 (particularly in the Netherlands). This corresponds to increases in export opportunities resulting from decreased production and drought in New Zealand and Australia.

WMP exports are forecast to increase in 2003 due to less competition from Australia and New Zealand in consequence to the drought in those countries.

MID-TERM REVIEW

For more than a year the debate on CAP reform and the various scenarios of how to best reform the dairy sector have been debated in various EU settings. The Commission however, is still faced with the challenge to find a solution that will allow the EU dairy sector the flexibility to expand, while at the same time remain in line with international commitments. To meet these challenges the Commission is proposing a 2 step approach: first to line up the Agenda 2000 dairy reform with the CAP reform proposals in general, then implement more progressive increases in quota accompanied by cuts in intervention prices and further compensatory payments. The Commission feels with this approach and gradual increases in quota, the lowering of prices and extra compensatory payments would not have a dramatic or sudden effect on the structure of the EU dairy industry. Additionally, the EU feels that with this arrangement EU exports would be less subsidy dependent, and would allow the EU dairy sector to prepare for the enlargement process.

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Previous EU dairy reports:

E22116	EU 2002 Annual Dairy and Report
E22073	EU 2002 Semi-Annual Dairy Report
E22058	EU 2002 Annual Dairy Report Trade Policy Report