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Report Highlights:

Based on six months of available production data for 2005, total milk production for calendar year 2005 is forecast to decline to approximately 7.8 million metric tons (MMT). Production of cheese and butter are forecast to increase in 2005. Non-fat dry milk (skim milk powder) production is expected to decline as the industry continues to make adjustments to reduce the structural surplus of skim milk powder. Imports of the four products under the Import for Re-Export Program (IREP) accounted for 62.5% of the total imports of the four products in 2004. Based on available trade data for 2005, imports of the four products under IREP will continue to remain high and may account for a larger portion of total imports of milk, butter, cheese and skim milk powder. The U.S. was a primary source and market for Canadian dairy products exports and imports in 2004 and is expected to remain that way in 2005 and into 2006.

Includes PSD Changes: No
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PRODUCTION

Milk production in Canada supplies two markets. The first market is the fluid milk market, which accounts for approximately 38% of total milk production and includes creams and flavored milks. The second market is the industrial milk market, which accounts for approximately 62% of total milk production and is used to make products such as butter, cheese, yogurt, ice cream and milk powders. Each province is responsible for the production of its own fluid milk and sets its own pricing formulas, quota policies and other regulations. The Market Sharing Quota (MSQ) is a national management tool through which industrial milk production levels are allocated. The quota is set each year by the Canadian Milk Supply Management Committee (CMSMC) and is constantly monitored and adjusted when necessary to reflect changes in demand for industrial milk products. The CMSMC applies the terms of the National Milk Marketing Plan, a federal-provincial agreement, to establish each province's share of the MSQ. The provinces are then responsible for distributing shares of the quota to producers according to provincial policies and in accordance with pooling agreements. On October 1, the CMSMC reduced the MSQ to 48.88 million hectoliters based on 3.6 kilograms of butterfat per hectoliter (175.97 million kilograms of butterfat), as the CMSMC determined that changes in production (supply) and Canadian Requirements (total consumer demand plus planned exports for industrial dairy products) indicated a need to decrease industrial milk production.

Based on six months of available production data from Statistics Canada for 2005, total milk production for calendar year 2005 is forecast to decline to 7.8 million metric tons (MMT) from 7.9 MMT in 2004. Ontario and Quebec experienced high summer temperatures in 2005. High, prolonged heat negatively impacts milk production, thereby resulting in the forecast decline for milk production in 2005. For 2006, milk production is forecast to decline slightly to 7.75 MMT as a result of the adjustment to the national MSQ and the forecast decline of cows in milk. Since the occurrence of BSE in Canada, dairy producers have been holding onto a larger number of cull animals due to the ban on exports of cattle over 30 months of age and limited slaughter facilities for older cows. As a result, the number of cows in milk increased during the first couple of years of the ban as the industry was forced to adjust to the new market situation. The Government of Canada introduced programs to aid producers and processors in making the necessary changes. As a result, the amount of available slaughter space for older animals has increased and the industry is adjusting to the new market situation. Therefore, after a small increase in the number of cows in milk in 2005, the number of the cows in milk for 2006 is expected to drop slightly, returning to the pre-BSE trend in dairy cow numbers.

Total cheese production for 2005 is expected to increase slightly to 307,000 metric tons (MT). Cheese production for 2004 and 2005 has been adjusted to exclude fresh cheese such as ricotta and cream cheese, which accounts for the difference between 2004's production estimate of 305,000 MT in this reported compared to the CA5033's 2004 cheese production estimate of 345,000 MT. Production of specialty (variety) cheese (excluding ricotta and cream cheese) is forecast to increase slightly to 180,000 MT in 2005. Cheddar cheese production is forecast to decline slightly to approximately 125,000 MT in 2005. Total cheese production is forecast to slightly increase in 2006, as cheese consumption continues to be strong and demand for specialty cheeses continues to increase. Mozzarella is the primary specialty cheese produced in Canada.

Butter production for 2005 is expected to increase by 2.3% to 88,000 MT. The increase in production will offset the small decline in butter imports in 2005 but maintain butter supplies at the same level as 2004. Butter production is forecast to increase again in 2006, despite the expected decline in domestic milk production. This is most likely as a result of the required changes in milk composition, producing milk with higher butterfat content and lower other solids content. This is expected to result in an increase in butter production in order to utilize in the increased butterfat production. Butter production declined from a high of 99,426 MT in 1990 to a low of 75,832 MT in 2002. Since 2002, butter production has rebounded and is expected to continue to do so, due to the increasing demand for butter for pastries and other baked products, the increase in dairy spread production and the increasing use in the domestic market.

Non-fat dry milk production (skim milk powder (SMP)) production for 2005 is expected to decrease by 16% to 74,000 MT from 88,000 MT in 2004. The decline in milk production is one contributing factor to the predicted decline in skim milk powder. In addition, in order to help reduce the structural surplus of skim milk powder, provinces have put in place incentives to correct the milk composition at the farm

level so that the milk consists of more butterfat and fewer other solids. In Ontario, the Solids-Not-Fat (SNF) to Butterfat Ratio Cap became effective August 1, 2005. As a result, producers who exceed the Ratio Cap of 2.36 kilograms of SNF to one kilogram of butterfat will receive zero payment for the amount of SNF above the cap. As a result, production of skim milk powder is expected to continue to decline as milk composition changes in favor of butterfat. Therefore, in 2006, skim milk powder production is forecast to decline to 70,000 MT. The declining production should help reduce the stocks of skim milk powder, as long as additional markets are found as an outlet for the surplus.

CONSUMPTION

Per-capita milk consumption (excluding chocolate milk and buttermilk) declined slightly in 2004 to 79.77 liters from 79.83 liters in 2003. Consumption of higher-fat milk like 3.25% and 2%, continued to decline in 2004 as consumers continue to shift consumption away from higher-fat milk in favor of 1% and skim milk. Skim milk consumption increased again in 2004 after declining in 2003. Consumption of 1% milk has been continuously increasing and increased 2.4% in 2004 over 2003. Chocolate milk consumption also continued to increase in 2004, jumping 6.3% over 2003's per-capita consumption rate. The increase in chocolate milk consumption was the primary reason total fluid milk per-capita consumption (includes chocolate milk and buttermilk) increased slightly in 2004 to 85.61 liters from 85.34 liters in 2003. In the move away from higher-fat milk, consumers are shifting primarily towards 1% milk. In 2004, 3.25% milk accounted for 15% of consumption (16% in 2003), 2% milk accounted for 47% of consumption (unchanged from 2003), 1% milk accounted for 21% of consumption (20% in 2003), skim milk accounted for 10% of consumption (unchanged from 2003), and chocolate milk accounted for 6% of total fluid milk consumption. Fluid milk sales also support the changing trend in fluid milk consumption. Over the last ten years, sales of 3.25% milk fell 16%, while sales of 2% milk declined by 12 percent. Sales of 1% milk have increased steadily since being introduced in the early 1990s to 5.71 million hectoliters (588,000 metric tons) in 2004. Since 1980, the per-capita consumption of milk (excluding chocolate milk and buttermilk) has declined by 19% and declined by 3.2% since 2000. The availability of other beverages, like sodas and fruit juices have reduced consumer demand for milk. However, the development of new milk products including flavored milk beverages beyond traditional chocolate milk, functional milks with added vitamins or enriched calcium and omega-3 should have an impact on consumer demand for fluid milk in the coming years.

Despite the consumer shift away from higher-fat milk, consumption of cream (excluding sour cream) increased 4.5% in 2004 from 2003. Per-capita cream consumption (excluding sour cream) has increased 93% since 1980. Cream consumption (excluding sour cream) has increased 77% in the last 10 years. Increased consumption of coffee, specialty coffee products and desserts have contributed to the increase in the use of cream.

Per-capita total cheese consumption (including fresh cheese) in 2004 was 11.14 kilograms, a 2.5% increase from 2003. Per-capita cheddar consumption declined slightly to 3.78 kilograms in 2004 from 3.88 kilograms in 2003. Specialty cheese per-capita consumption continued to increase in 2004 to 7.36 kilograms from 6.99 kilograms in 2003. Since 1990, the per-capita consumption of cheese has increased from 9.45 kilograms to 11.14 kilograms in 2004, an 18% increase. The increase in cheese consumption and production has been primarily as a result of the rise in popularity and demand of specialty cheeses. Per-capita consumption of specialty cheeses has jumped from 5.64 kilograms in 1990 to 7.36 kilograms in 2004, a 30% increase. The increased demand and consumption of specialty cheeses has come as a result of an increased demand for ready-to-eat foods. Cheeses like mozzarella are utilized in frozen and fast food pizzas and other packaged foods. Despite the small decline in cheddar consumption in 2004, per-capita consumption of cheddar has been relatively steady over the last 25 years; therefore it is expected that the per-capita consumption of cheddar will continue to remain stable. The demand for specialty cheeses is forecast to continue increasing with per-capita consumption expected to increase in 2005 and again in 2006.

Per-capita butter consumption has been increasing in the last 10 years. Much of the increase can be attributed to the recent climb in the number of imports arriving under the Import for Re-Export Program (IREP). These imports are a part of the per-capita consumption calculation. IREP imports of butter increased significantly in 2004, as processors are finding additional uses for butter, including the production of margarine and dairy blends or spreads, which are a combination of margarine and butter. In addition, importation of butter under IREP allows commercial industries that utilize butter for the production of processed items, like bakery and confectionary products, to be competitive on the world

market. It is expected that the demand for these products will continue to increase in the following years; therefore, the per-capita consumption of butter is expected to continue to increase in 2006 in order to meet the requirements of processors. The calculation of per-capita consumption of skim milk powder, cheese and milk also include imports through IREP. According to Statistics Canada, the utilization of butter increased in 2004 to 3.08 kilograms per person from 2.92 kilograms in 2003. Butter utilization has been slowly increasing since 2000. As the consumers continue to demand healthier and lower-fat alternatives to traditional products, the development of fat-reduced butter may also help contribute to increased consumer consumption of butter in years to come.

Domestic consumption of skim milk powder is forecast to increase in 2005, as a result of the development of new uses and markets for the surplus powder. The Dairy Marketing Program was expanded in 2004/2005 into the area of innovation; the Program's main objectives are to promote awareness and increase utilization of dairy products and components for dairy product manufacturers. This includes finding new and innovative uses for skim milk powder in dairy and food products. In addition, the creation of a new milk class that encourages the use of products like skim milk powder in non-standardized processed cheese products should also aid in the utilization and reduction of the surplus skim milk powder. The utilization of skim milk powder in animal feed is an additional outlet that is aggressively being pursued. In the 2004/2005 dairy year (August-July), 22.3 million kilograms were sold to the animal feed industry, which was a 430% increase. The consumption of skim milk powder is expected to stay high, though it does face competition from increasing imports of milk protein and powders. Domestic consumption of skim milk powder is forecast to decline in 2006 as result of increased competition from other milk proteins and powders, which can be used in place of skim milk powder, and a forecast decline in consumption of skim milk powder by the animal feed industry.

TRADE

Regulations For Imports and Exports of Dairy Products

Tariff Rate Utilization Tables and Quota holders for various dairy products in Canada:

<http://www.international.gc.ca/trade/eicb/agric/milk-en.asp>

Export and Import Permits Act:

<http://laws.justice.gc.ca/en/E-19/index.html>

Export and Import Controls for dairy products:

Quantitative restrictions in ten categories of dairy products were converted to TRQs to support supply management of industrial milk under the *Canadian Dairy Commission Act* and as a result of the agreement at the World Trade Organization (WTO) in 1994. These products are:

- Butter (implemented on August 1, 1995);
- Cheese of all types other than imitation cheese (implemented on January 1, 1995);
- Buttermilk in dry, liquid or other form (implemented on January 1, 1995);
- Fluid milk (implemented on January 1, 1995);
- Skimmed milk in dry, liquid or other form (implemented on January 1, 1995);
- Dry whole milk (implemented on January 1, 1995);
- Animal feeds containing more than 50% non-fat milk solids (implemented on January 1, 1995);
- Dry whey (implemented on August 1, 1995);
- Evaporated and condensed milks (implemented on January 1, 1995);
- Heavy cream (implemented on August 1, 1995);
- Products consisting of natural milk constituents (implemented on January 1, 1995);
- Ice cream and ice cream novelties in retail packaging (implemented on January 1, 1995); and
- Yogurt (implemented on January 1, 1995).

Imports

One of the pillars of supply management in Canada is import control, resulting in the regulation of imports of dairy products into Canada. There are import quotas on various dairy products and high over-quota tariffs.

Figure 1: Tariff-Rate Quota for Dairy Imports into Canada

Dairy Products	Tariff item number	Year	TRQ
Fluid Milk	0401.10.10 0401.20.10	2004	64,500 metric tons Note: this quantity represents estimated annual cross-border purchases by Canadian consumers. The goods are imported under <u>General Import Permit No. 1 - Dairy Products for Personal Use</u> , not for commercial use.
Cream*	0401.30.10	2003/04	394 metric tons
Butter*	0405.10.10 0405.90.10	2003/04	3,274 metric tons
Cheese	04.06	2004	20,411.866 metric tons
Skim Milk	0402.10.10	2004	0 metric tons

* Quota determined on a dairy year basis (August 1, 2004 – July 31, 2005)

The fluid milk access level for 2004 was 64,500 MT, a figure which represents estimated annual cross-border purchases by Canadian consumers. The goods are imported under [General Import Permit No. 1 - Dairy Products for Personal Use](#). Fluid milk may be imported by companies in Canada under IREP and through supplemental permits issued by International Trade (IT) Canada. IREP imports account for a majority of the fluid milk imports into Canada, with a small amount of over-access milk being imported. In 2004, import permits for re-export for fluid milk totaled 8,751 MT. There were no additional permits issued by IT Canada. According to IT Canada, during the first six months of 2005, import permits for re-exports for fluid milk have significantly increased to 8,903 MT and supplementary imports were 34 MT. During the same time frame in 2004, the import permits for re-exports totaled only 5,214 MT, with no additional permits issued. Fluid milk imports in 2005 have already surpassed 2004 imports, as a result of the growth in IREP imports. IREP is utilized to import milk and other dairy products from international markets to enable processors to utilize those products in the production of other products so that the processors are then able to either develop or maintain export markets. Unlike other dairy products, fluid milk does not have a commercial quota that can be allocated to Canadian processors, which prevents them from importing milk into Canada at a favorable tariff level. Rather, processors would be forced to import milk at the over-access tariff rate, which is not economically efficient and results in products that would not be competitive on the world market. Therefore, processors import fluid milk and other dairy products to produce their products and then export the finished products, like pastries and confectionary items, cheeses, butter, onto the world market. As a result, imports of fluid milk in 2006 are expected increase as processors continue to take advantage of IREP to import milk for production.

Like fluid milk, a majority of the cream is imported through IREP. Unlike fluid milk, cream does have a small quota, which is determined on a dairy year (August-July) basis rather than an annual calendar year (CY) basis like other dairy products. For dairy year 2004/2005, the cream access level was 394 MT. For CY 2004, import permits for re-export totaled 1,823 MT with no supplementary import permits indicated. According to IT Canada, during the first six months of 2005, import permits for re-export already total 1,736 MT, which is a significant increase compared to the same 2004 time frame. Total milk imports (fluid milk plus cream) for 2005 are forecast to increase to 13,000 MT. Imports of fluid milk and cream under IREP accounted for approximately 98% of the total milk imports in 2004. The U.S. is the primary source for imports of milk and cream into Canada. As processors continue to utilize IREP for fluid milk and cream imports, total milk imports are forecast to increase in 2006.

Cheese imports for 2004 dropped slightly from 2003, as imports of specialty and cheddar cheeses declined in 2004 and domestic production increased. In addition, there was a decline in imports under IREP. Total cheese imports (including fresh and cottage cheese) through IREP accounted for 12.1% of total cheese imports in 2004, with permits for re-export issued for 2,983 MT. Within-access commitment import permits were issued for 20,412 MT and other supplementary permits totaled 1,024 MT. For 2005, permits for cheese imports under IREP in the first six months have increased from 1,393 MT to 2,389 MT. Total cheese imports for the first six months of 2005 are 11% higher than during the same time frame in 2004. As a result, total cheese imports for 2005 are forecast to increase approximately 8% over 2004 imports. Post is forecasting that cheese imports under IREP will continue to increase in 2006, resulting in another increase in total cheese imports for calendar year 2006, as the demand for cheese in fast food products and convenience foods is expected to continue.

The small decline in production for cheddar cheese has translated into a small increase in imports of cheddar during the first six months of 2005. Cheddar imports in 2005 increased to 1,012 MT from 994 MT in 2004. The demand for specialty cheese has also helped increase imports during the first six months of 2005 to 7,000 MT from 6,648 MT in 2004. In 2004, 5.9% of Canadian cheese imports were from the European Union (EU-25). Cheese imports from the EU-25 were approximately 14,000 MT, a 1.3% decline from 2003. Based on year-to-date trade statistics for 2005, the EU-25 market share of Canadian cheese imports will remain relatively constant, with only a 1% decline in total cheese imports from the EU-25. The U.S. was the second largest supplier of cheese to the Canadian market in 2004, despite a 12.8% decline in cheese exports to Canada from 2003. Based on year-to-date trade data, imports of cheese from the U.S. have increased and are on pace to match 2003's level of roughly 5,800 MT. The domestic demand for specialty cheeses is expected to remain strong, thereby increasing the imports of specialty cheeses in 2005 and in 2006. Imports of cheddar are forecast to continue to fluctuate, increasing in years of smaller production and decreasing in years of slightly larger production as the per-capita consumption of cheddar continues to be relatively steady, fluctuating slightly each year.

Total butter imports are comprised of three HS codes: 0405.10.00 for butter, 0405.90.00 for fats and oils from milk, and 0405.20.00 for dairy spreads, which contain butter. Similar to cream imports, the butter import access level is determined based on the dairy year, rather than the calendar year. For dairy year 2004/2005, the butter access quota was 3,274 MT. For calendar year 2004, total butter imports were approximately 28,000 MT. According to IT Canada, import permits for re-export totaled 24,744 MT in calendar year 2004, which was a 60.4% increase from 2003, as processors continue to utilize IREP to import butter for production of bakery and confectionary products. During the first six months of 2005, import permits for re-export declined by 7.5% in comparison to the first six months of 2004. As a result, Post is forecasting that total butter imports for calendar year 2005 will decline slightly to approximately 25,000 MT, due to the increase in domestic production. In 2004, New Zealand was the largest source of butter imports for Canada, accounting for 53% (14,725 MT) of the total imports. The U.S. accounted for 10.9% of total butter imports for Canada. In the first eight months of 2005, Australia (9.9%), Argentina (21.8%), Uruguay (20.4%) and Belgium (7.2%), significantly increased their share of total butter imports to Canada. As a result, U.S. and New Zealand imports declined to 4.5% and 23.6% respectively. Despite the forecast increase in production and consumption in 2006, butter imports are forecast to remain unchanged from 2005 due to continued strong imports under IREP.

According to IT Canada, in 2004, import permits for re-exports were issued for 2,330 MT of skim milk powder (SMP) (non-fat dry milk). Supplementary permits for other purposes were issued for 88 MT of skim milk powder. As of June 2005, imports permits for re-export for 1,730 MT of SMP have been issued. This is 53% higher than in the same 2004 time frame. Supplementary permits for 27 MT have been issued for other purposes. The increase is as a result of the forecast increase in utilization of SMP by the processing industry in 2005. As a result, it is expected that imports of SMP in 2005 will reach 4,000 MT. Domestic price of SMP is another driving factor in the increase in imports of SMP under IREP. In a recent study on the structural surplus of SMP in Canada by the George Morris Centre, one of the issues facing the Canadian industry in its attempts to reduce the surplus is that the domestic support price of SMP in Canada is significantly higher and continues to increase in comparison to the Oceanic SMP export prices. The resulting effect of continually increasing and maintaining high support prices, thus provides greater incentive to processors to import the cheaper oceanic SMP rather than pay the higher domestic prices for SMP. Therefore, the increase in SMP is forecast to continue in 2006, as a

result of the expected increase of imports under IREP. In 2004, imports from the U.S. accounted for approximately 98% of total SMP imports, with New Zealand accounting for roughly 2 percent. To date in 2005, the U.S. accounts for approximately 96% and imports from New Zealand account for just over 4 percent.

For 2004, total imports of fluid milk and cream, butter, cheese, and skim milk powder were approximately 65,000 MT, of which imports under IREP accounted for approximately 62.5% of total imports (40,600 MT). The total amount of products imported under IREP continues to become a larger portion of total imports as processors rely on them to be able to export dairy products onto the world market. The 2002 WTO decision capped Canadian dairy exports and by using IREP, processors are able to produce and export without being hindered by the cap. Based on data from IT Canada, Post is forecasting that total imports of the four products under IREP will account for a similar or greater amount of total imports in 2005, as IREP continues to provide Canadian exporters the ability to use milk products and ingredients from international markets to remain competitive in international markets and to develop or maintain export markets. Imports of products under IREP will continue to be strong in 2006 and are expected to be equal or greater than 2005's forecast as the processing industry continues to rely on them to produce products for export.

The imports of other products like casein and caseinates have increased by 86.3% between 1999 and 2004. In addition, imports of butteroil/sugar blends have also increased dramatically in the last 10 years. Both products are not subject to the prohibitive import quotas and tariffs applied to most dairy products coming into Canada and can be used in place of more expensive dairy products like milk, skim milk powder, cream and butter in the production of a variety of dairy products. As a result, Post is expecting that imports of these products will continue to increase in 2005 and 2006, used in place of traditional dairy products like butter.

Exports

The 2002 ruling by the World Trade Organization (WTO) capped subsidized exports of dairy products from Canada. The ruling also resulted in the elimination of commercial export milk (CEM) practices, as the CEM was ruled to be an export subsidy. Therefore, Canadian dairy producers are limited in the quantity of dairy products that can be exported from Canada. The ruling also resulted in a restructuring of the dairy industry in Canada to limit the production of over-quota milk, as the cap limits producers' exports, resulting in an inability to export it or the products it produced. This, as well as the appreciation of the Canadian dollar, has negatively impacted total dairy exports from Canada.

Total milk exports in 2004 declined by approximately 15% from 2003, as the industry continued to adjust and comply with international obligations. Accounting for approximately 52% of total Canadian milk exports (including cream), the U.S. continued to be the largest market for Canadian milk exports in 2004. Despite remaining the primary destination of Canadian milk exports, total milk exports to the U.S. declined 29% in 2004 compared to 2003 as a result of attempting to comply with the WTO ruling and the negative impact of the high Canadian dollar. Based on data for the first eight months of 2005, total milk exports to the U.S. have rebounded and are accounting for 61.2% of total milk exports. As a result, Post is forecasting that milk exports to the U.S. in 2005, will return to 2003 levels, which was approximately 5,390 MT. The dairy industry required time to adjust to its new commitment levels as set out in the 2002 WTO ruling and as a result had dramatically reduced exports. As a result, it is assumed that calendar year 2003 and 2004 were the adjustment periods, which is why exports in both years dropped compared to prior to the ruling. In 2005, Post is assuming that the industry has finished adjusting and determined a level at which it can export dairy commodities within its obligations, which is why there has been a rebound in exports for 2005. In addition, the industry has also enough time to adjust to realities of the higher Canadian dollar. As a result, exports in 2006 are expected to remain at a similar level as in 2005. Exports of fluid milk and other dairy products from Canada are hampered to a certain extent by the domestic support prices, which are higher than world prices and limit what can be exported under the WTO cap.

Taiwan was the second largest market for Canadian milk exports, at 2,400 MT, a 17% increase from 2003 and accounting for approximately 33% of Canadian fluid exports. In the first eight months of 2005, Taiwan continues to remain Canada's second largest market for fluid milk exports, but is only accounting for approximately 28.8% of total Canadian milk exports. Exports to China increased during

the first months of 2005, and with a rapidly growing population and changing consumer habits, China is a promising market for a continued increase in Canadian dairy exports.

Total cheese exports (excluding cream and fresh cheeses) for 2005 are forecast to decline to approximately 9,000 MT, from 10,187 MMT in 2004, as a result of the forecast decline in cheddar exports. Based on available data, cheddar exports for the first eight months of 2005 have declined significantly to 1,859 MT from 3,409 MT for the first eight months of 2004, due to the decline in cheddar production. Canadian cheddar faces strong competition on the world market from other countries, which specialize in cheddar production. In addition, the strong Canadian dollar makes it difficult for Canadian cheddar exports to compete favorably with cheddar exports from other countries. Some Canadian specialty cheeses have found favor in some world markets, which is most likely one of the reasons there has been an increase in exports of specialty cheeses since 2002. In addition, as mentioned previously in regards to milk exports, the industry has settled into the new realities of its export commitments, resulting in an increase in exports of cheese products from the dramatic cut following the ruling. In 2005, the increase in specialty cheese exports will be unable to offset the decline in cheddar exports. Also, along with an overall decline in exports, cheddar cheese exports increasingly make up a smaller percentage of total Canadian cheese exports. For example, in 2004, cheddar cheese exports accounted for approximately 58.8% of cheese exports, while specialty cheese exports only accounted for 40.6 percent. This is in contrast to the export numbers for the first eight months of 2005, during which cheddar cheese exports accounted for only 34.8%, while specialty cheese exports accounted for 64.2 percent. Based on current trends in production and consumption, specialty cheeses will continue to increase in exports and make up a larger percentage of total cheese exports, while cheddar exports will most likely continue to decline. Exports for 2006 are forecast to slightly decline again from 2005 export levels, due to the expected decline in cheddar production and exports. Specialty cheese exports are forecasted to increase slightly in 2006, but again by not enough to offset the decline in cheddar cheese exports. In 2004, the U.S. and the U.K. were the two primary markets for Canadian cheese, accounting for 3.9% and 38.9% of exports respectively. During the first eight months of 2005, cheese exports to both countries have declined, with exports to Mexico and Saudi Arabia increasing. The U.K. has also displaced the U.S. as Canada's number one cheese export market during the first eight months of 2005. Canada has specific market access for 4,000 MT in the U.K. markets and has three specific quotas for U.S. cheese markets, for cheddar, Swiss- and Emmental-type cheeses, and non-specific cheeses.

Total butter exports are comprised of three HS codes: 0405.10.00 for butter, 0405.90.00 for fats and oils from milk, and 0405.20.00 for dairy spreads, which contain butter. Total butter exports for 2005 are forecast to increase slightly from 2004, as exports of all three products are forecast to increase. As with all other dairy products, exports of butter and products dramatically declined after 2002, so that the industry would comply with its WTO obligations and make the necessary adjustments to export quantities in order to do so. As was mentioned in regards to milk exports, 2003 and 2004 were adjustment years for the industry and 2005 is the first post adjustment year in which industry is functioning within its new commitments. In 2004, actual butter exports account for less than 1% of the total butter exports, but data for the first eight months of 2005 indicate that actual butter exports are increasing after declining for the last couple of years, as the industry has adjusted its butter exports to comply with its WTO obligations. The U.S. is the primary market for total butter exports, receiving 99% in 2004, and is expected to remain Canada's number one market, but exports to other countries have increased in 2005. Total butter exports are forecast to increase again in 2006, driven by the forecast increase in production and exports of dairy spreads. An increase in butter production and exports are also expected to contribute slightly to the forecast increase in total butter exports in 2006. In addition, the development and increasing production of dairy blends or spreads has resulted in a steady increase in exports of those products since 2001, despite a small decline in 2003. Exports of dairy spreads rebounded in 2004 and are forecast to continue increasing. The United States is the primary market for dairy spreads exported from Canada. In 2005, Canada also began exporting dairy spreads to Bermuda. In 2004, dairy spreads accounted for 98% of the total butter exports. Exports of fats and oils derived from milk are also forecast to continue increasing in 2005.

Total non-fat dry milk (skim milk powder (SMP)) exports are forecast to continue declining in 2005. SMP exports in 2005 are forecast to be approximately 4,000 MT, which is a 75% decline from 2004's 16,000 MT. Based on data for the first eight months of 2005, SMP exports have already fallen 69% compared to the same 2004 time period. The continual decline of the SMP exports is a result of a couple of factors. The 2002 WTO ruling capped Canada's exports of SMP at 44,953 MT or \$31.13

million. As a result, general exports and exports of SMP as foreign aid have been declining since the ruling, despite a structural surplus of SMP that is plaguing the industry. In addition, high support prices also limit the quantity of SMP that Canada can export based on the WTO cap. In February 2005, the domestic support price for skim milk powder increased from \$5.3928 to \$5.7282 per kilogram. As the gap between world prices and domestic support prices continues to grow, the quantity of SMP that can be exported is reduced. Exports of SMP to the U.S. in 2004 were very small, accounting for less than 1% of total SMP exports. Based on data for the first eight months of 2005, SMP exports to the U.S. are continuing to decline, but because overall SMP exports are also falling, exports to the U.S. actually account for an increasing portion of total SMP exports. SMP exports to Cuba account for approximately 51% of total SMP in the first eight months of 2005, although total exports to Cuba are forecast to decline. In 2006, SMP exports are forecast decline slightly from 2005, as the high support price continues to hinder the quantity that can be exported. In addition, competition from other countries and other milk powders continues to be strong.

STOCKS

In order to ensure that supply management operates as it is designed and the Canadian market has a constant supply of product, the Canadian Dairy Commission (CDC) holds stocks of butter in storage throughout the year. During the 2004/2005 dairy year (August-July), the CDC held 12,000 MT of butter as target stocks. This is referred to as the normal butter inventories. In addition, the CDC also purchases butter that is surplus in order to balance the system. The CDC also purchases and sells stocks of milk powders. The CDC beginning stocks for the 2004/2005 dairy year for butter and skim milk powder were 14,400 MT and 32,700 MT respectively. The CDC then purchased 30,200 MT of butter and 29,300 MT of skim milk powder during the dairy year. In addition to the purchases of those products, the CDC sold 26,200 MT of butter and 38,100 MT of skim milk powder, resulting in ending stocks of 18,300 MT of butter and 23,900 MT of skim milk powder on July 31, 2005. With the forecast increase in production of butter in calendar year 2005 and 2006, Post expects butter stocks held by the CDC in dairy year 2005/2006 will increase. With a decrease in production of skim milk powder forecast in calendar year 2005 and 2006, an increase in consumption in 2005 and the continual efforts by the CDC to find additional markets for the surplus skim milk powder, Post is expecting that stocks held by the CDC will decline in dairy year 2005/2006.

ADDITIONAL DAIRY PRODUCTS

Total per-capita yogurt consumption has more than doubled since 1994 reaching 6.75 liters in 2004. This has resulted in a dramatic 137% increase in the total volume of yogurt produced - from 90,940 MT in 1990 to 215,270 MT in 2004. Yogurt production during the first six months of 2005 is on pace to exceed yogurt production in 2004. Increasing consumer demand, the development of new products, increased consumer awareness of the health benefits associated with yogurt cultures and probiotics, have all been driving forces behind the increase in production and the increase in per-capita yogurt consumption. Like all dairy products, imported yogurt is regulated by a tariff-rate quota, which is 332 MT per year. The increased demand for a variety of yogurt products has resulted in the issuing of supplementary permits totaling 246,214 kilograms (246 MT) in the first six months of 2005. Exports of yogurt have also increased 31.4% in the last few years. Growth in yogurt exports has occurred uninterrupted over the past four years, as exports of liquid yogurt to the U.S. are not subject to tariff rate quotas and have a 0 percent tariff under NAFTA.

In 2004, total per-capita consumption of ice cream in Canada declined to 9.28 liters from 9.37 liters in 2003. Lower levels of consumption may be partially explained by the increase in demand for other frozen desserts such as frozen yogurt. Since 1980, total per-capita consumption of ice cream has declined by 27 percent. Despite the decline in consumption of ice cream in 2004, the volume of ice cream produced increased slightly, but overall production of ice cream since 1990 has declined 4.7 percent. The increased production of frozen yogurt products and other desserts are most likely the reason for the decline in production.

STATISTICAL TABLES

Table 1: Fluid Milk PSD

PSD Table

Country Commodity	Canada		Dairy, Milk, Fluid		(1000 HEAD)(1000 MT)		UOM
	2004	Revised	2005	Estimate	2006	Forecast	
Market Year Begin	USDA Official [	Estimate[NA	Official [	Estimate[NA	Official [	Estimate[New]	
	01/2004	01/2004	01/2005	01/2005	01/2006	MM/YYYY	
Cows In Milk	1057	1057	1065	1065	0	1059	(1000 HEAD)
Cows Milk Production	7885	7885	7775	7800	0	7750	(1000 MT)
Other Milk Production	0	0	0	0	0	0	(1000 MT)
TOTAL Production	7885	7885	7775	7800	0	7750	(1000 MT)
Intra EC Imports	0	0	0	0	0	0	(1000 MT)
Total Imports	10	11	11	13	0	14	(1000 MT)
TOTAL Imports	10	11	11	13	0	14	(1000 MT)
TOTAL SUPPLY	7895	7896	7786	7813	0	7764	(1000 MT)
Intra EC Exports	0	0	0	0	0	0	(1000 MT)
Total Exports	7	7	7	8	0	8	(1000 MT)
TOTAL Exports	7	7	7	8	0	8	(1000 MT)
Fluid Use Dom. Consum.	2825	2826	2835	2835	0	2796	(1000 MT)
Factory Use Consum.	4580	4580	4477	4503	0	4500	(1000 MT)
Feed Use Dom. Consum.	483	483	467	467	0	460	(1000 MT)
TOTAL Dom. Consumpti	7888	7889	7779	7805	0	7756	(1000 MT)
TOTAL DISTRIBUTION	7895	7896	7786	7813	0	7764	(1000 MT)
Calendar Yr. Imp. from U	9	10	10	12	0	13	(1000 MT)
Calendar Yr. Exp. to U.S.	3	4	3	4	0	4	(1000 MT)

Table 2: Cheese PSD

Country Commodity	Canada Dairy, Cheese						UOM
	(1000 MT)						
Market Year Begin	2004	Revised	2005	Estimate	2006	Forecast	MM/YYYY
	USDA Official [	Estimate[NA	Official [	Estimate[NA	Official [	Estimate[New]	
	01/2004		01/2005		01/2006		
Beginning Stocks	59	59	59	59	57	57	(1000 MT)
Production	345	305	347	307	0	308	(1000 MT)
Intra EC Imports	0	0	0	0	0	0	(1000 MT)
Total Imports	24	24	24	26	0	27	(1000 MT)
TOTAL Imports	24	24	24	26	0	27	(1000 MT)
TOTAL SUPPLY	428	388	430	392	57	392	(1000 MT)
Intra EC Exports	0	0	0	0	0	0	(1000 MT)
Total Exports	10	10	9	9	0	8	(1000 MT)
TOTAL Exports	10	10	9	9	0	8	(1000 MT)
Human Dom. Consumpti	359	319	364	326	0	327	(1000 MT)
Other Use, Losses	0	0	0	0	0	0	(1000 MT)
Total Dom. Consumption	359	319	364	326	0	327	(1000 MT)
TOTAL Use	369	329	373	335	0	335	(1000 MT)
Ending Stocks	59	59	57	57	0	57	(1000 MT)
TOTAL DISTRIBUTION	428	388	430	392	0	392	(1000 MT)
Calendar Yr. Imp. from U	4	4	5	4	0	3	(1000 MT)
Calendar Yr. Exp. to U.S.	4	4	3	3	0	2	(1000 MT)

Table 3: Butter PSD

PSD Table

Country Commodity	Canada Dairy, Butter						UOM
	(1000 MT)						
Market Year Begin	2004	Revised	2005	Estimate	2006	Forecast	MM/YYYY
	USDA Official [	Estimate[NA	Official [	Estimate[NA	Official [	Estimate[New]	
	01/2004		01/2005		01/2006		
Beginning Stocks	13	13	14	14	10	11	(1000 MT)
Production	86	86	85	88	0	90	(1000 MT)
Intra EC Imports	0	0	0	0	0	0	(1000 MT)
Total Imports	28	28	28	25	0	25	(1000 MT)
TOTAL Imports	28	28	28	25	0	25	(1000 MT)
TOTAL SUPPLY	127	127	127	127	10	126	(1000 MT)
Intra EC Exports	0	0	0	0	0	0	(1000 MT)
Total Exports	17	17	19	18	0	19	(1000 MT)
TOTAL Exports	17	17	19	18	0	19	(1000 MT)
Domestic Consumption	96	96	98	98	0	99	(1000 MT)
TOTAL Use	113	113	117	116	0	118	(1000 MT)
Ending Stocks	14	14	10	11	0	8	(1000 MT)
TOTAL DISTRIBUTION	127	127	127	127	0	126	(1000 MT)
Calendar Yr. Imp. from U	3	3	2	2	0	0	(1000 MT)
Calendar Yr. Exp. to U.S.	17	17	19	19	0	19	(1000 MT)

Table 4: Nonfat Dry Milk (Skim Milk Powder) PSD

PSD Table

Country Commodity	Canada Dairy, Milk, Nonfat Dry (1000 MT)						Forecast Estimate[New]	UOM
	2004 USDA Official	Revised Estimate[NA]	2005 Official	Estimate Estimate[NA]	2006 Official	Forecast Estimate[New]		
Market Year Begin	01/2004	01/2004	01/2005	01/2005	01/2006	01/2006	MM/YYYY	
Beginning Stocks	23	23	41	41	32	36	(1000 MT)	
Production	88	88	85	74	0	70	(1000 MT)	
Intra EC Imports	0	0	0	0	0	0	(1000 MT)	
Total Imports	2	2	3	4	0	5	(1000 MT)	
TOTAL Imports	2	2	3	4	0	5	(1000 MT)	
TOTAL SUPPLY	113	113	129	119	32	111	(1000 MT)	
Intra EC Exports	0	0	0	0	0	0	(1000 MT)	
Total Exports	17	16	15	4	0	3	(1000 MT)	
TOTAL Exports	17	16	15	4	0	3	(1000 MT)	
Human Dom. Consumption	50	51	48	48	0	40	(1000 MT)	
Other Use, Losses	5	5	34	31	0	33	(1000 MT)	
Total Dom. Consumption	55	56	82	79	0	73	(1000 MT)	
TOTAL Use	72	72	97	83	0	76	(1000 MT)	
Ending Stocks	41	41	32	36	0	35	(1000 MT)	
TOTAL DISTRIBUTION	113	113	129	119	0	111	(1000 MT)	
Calendar Yr. Imp. from U	3	2	1	4	0	5	(1000 MT)	
Calendar Yr. Exp. to U.S.	0	0	0	0	0	0	(1000 MT)	

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