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France

Dairy and Products

Impacts of Abnormally High Dairy Prices in France 2007

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Report Highlights:

World market prices have recently boomed for butter and milk powders. This results from the increased global demand for dairy products and the current shortage in world milk supply, due mainly to the structural reduction of Oceania's production and exports. France is facing difficulties adjusting these new market conditions. The higher producer prices that processors are paying have not been reflected in consumer prices, to date. While high world demand favors French exports of butteroil and dry milk, these are limited by short supply. As a result, the GOF is taking measures to increase domestic milk production for the 2007/08 campaign, but opposes significant changes in the dairy CAP such as a global quota increase.

Includes PSD Changes: No
Includes Trade Matrix: No
Unscheduled Report
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Short Supply and High Demand Strongly Increase Butter and Milk Powder Prices:

Prices for milk powders and butter boomed in the first half of 2007. In France, from January to July, nonfat dry milk prices for animal feed jumped from 2,250 to 3,600 euros per MT, while dry milk prices boomed from 2,500 to almost 4,000 euros per MT. At the same time, French butter prices ex works jumped from 2,500 to 3,600 euros per MT.

This sharp increase resulted from both limited world supply, mainly due to the reduction of Oceania's production and exports, and high world demand, mainly from China, India, Russia and the Middle-East. There is currently a high demand for European dairy products on the world market, as well as a recognition of the EU's potential to significantly increase production.

- **French Domestic Impact:**

- *Farmers: Higher Producer Prices*

In France, the milk price paid to farmers by dairy processors is indexed, based on a recommendation made quarterly by the industry at the national level. This recommendation is based on a number of parameters including world prices. As a result of the current jump in world market prices, producer prices for milk in France increased for the first time since the implementation of the Agenda 2000 Common Agricultural Policy. With the current increase in animal feed prices, mainly due to increased prices for feed grains, dairy farmers have welcomed the unexpected jump in milk prices.

- *No Change in Consumer Prices*

Unlike in Germany (see FAS Berlin report GM7038), increased milk producer prices and world market prices have not had an impact on consumer prices in France, to date. This results from the structure of food distribution in France, featuring powerful supermarket chains (accounting for the bulk of domestic food consumption). So far, the financial adjustment is being made at the level of the food processing industry.

- *Lower Margins for the Food Industry:*

The sharp increase in butter and milk powder prices has provoked a sharp reaction by food processors, particularly the biscuit and chocolate industries. These industries have communicated in the French press about the low margins small-to-medium enterprises are facing (butter is the main raw material used by the biscuit industry and milk powder is a major ingredient of the chocolate processing industry).

Butter prices have increased for the French food industry, not only as a result of higher market prices but also due to the reduction of the EU "pastry and ice-cream scheme," under which butter consumption by the industry was subsidized. This scheme was terminated in July 2007. In conjunction with the long-term trend of declining household consumption of butter, mainly for health reasons, total French butter consumption (by the industry and households) is declining.

- *Reduced Use of NonFat Dry Milk in Animal Feed*

The recent boom in nonfat dry milk prices, combined with the termination of the EU support to process nonfat dry milk for animal feed, resulted in reduced consumption of nonfat dry

milk for calf feed in France. Casein and dry whey are accounting for an increasing share of calf feed rations at the expense of nonfat dry milk.

This explains the recent increase in both dry whey (5 percent) and casein (almost 4 percent) production in France, and the decline in nonfat dry milk production (5 percent), during the first half of CY 2007.

- **French Trade: Increased Exports of Milk Powders and ButterOil, Limited by Supply Shortage**

With high world market prices and demand, and low Australian exports, French industrial dairy products have become more price-competitive and exports have increased. The French dairy industry does not expect Australian exports to recover in the near future, given that severe drought made ranchers reduce the dairy herd significantly.

During the first half of 2007, French exports of dry milk increased by 3.5 percent, while exports of nonfat dry milk increased 33 percent, primarily destined for Saudi Arabia, Algeria, Morocco and China, and also Germany. French exports of butteroil increased by 5 percent, mainly due to increased shipments to Egypt, and resulted in higher domestic production. The good outlook for butteroil exports boosted domestic production (28 percent increase).

However, the French dairy industry regrets that, despite these high prices and strong world demand, the increase in exports is limited by short supply. This results from the milk production quota system maintaining milk production stable in the EU, and from the continuous under-utilization of its quota by France. In fact, France under-utilized its milk production quota in the past 4 dairy marketing years.

- **Policy: Short-Term Change in France's Quota Management, Mid-to-Long Term Thinking About Changes in the Dairy CAP**

- *Changes in the French Management of the Milk Production Quota*

The French Ministry of Agriculture, whose position in 2006 was not to fulfill the additional 0.5 percent dairy quota provided to France under the reformed CAP, is now trying to fulfill it in 2007, as a result of the new market conditions.

In the past four milk production campaigns (2003/04 to 2006/07), France, which is the second largest EU dairy producer after Germany, under-utilized its milk production quota by 1.1 to 2.5 percent. Again in the first three months in MY 2007/08 (April-June 2007), milk deliveries were 0.4 percent lower than in MY 2006/07.

In 2006, the under-utilization was the largest (2.5 percent), as an impact of the reformed CAP and the implementation of full decoupling of public support to dairy farmers. With low dairy prices in 2006, many dairy producers changed to other types of farm production, for which compensation was assured through CAP's Single Farm Payments.

The recent drastic changes in 2007 in the dairy market made the French Dairy and Livestock Board (in French, "Office de l'Élevage") take policy measures to increase milk production, for the first time in more than 20 years of production quotas. The objective of the French Ministry of Agriculture now is to allow dairy farmers able to produce more to overshoot their quotas, compensating the low production those unable to produce more than their quotas.

The overshoot authorized announced in June by the French Dairy and Livestock Board is up to 15 percent. This is a maximum authorized to dairy processors, provided that they find farmers capable of producing significantly more milk, and provided that they find markets for their processed products. Although high, this 15 percent increase is a signal more than a target, as milk production depends on capacity, which cannot increase quickly.

The French dairy herd has declined gradually over the recent years, and more specifically in 2006, when beef meat prices were high and dairy cow slaughter was higher than average. As a result, as due to current dairy prices, heifer prices are currently very high.

- *French Position on the Dairy CAP*

The Common Agricultural Policy had put in place a number of measures to manage overproduction. However, as a result of its WTO commitments and of the current price situation, the EU Commission has stopped using a number of these tools, and only the Private Storage Aid (PSA) for butter persists (PSA butter stored continues to belong to the industrial operator, and the EU Commission funds the costs of storage for the private operator). Tools no longer being used are as follows:

- Intervention stocks are empty for butter and nonfat dry milk,
- Subsidized consumption: nonfat dry milk use in calf feed was subsidized until 2006, and the "pastry and ice-cream scheme" for butter (consisting of supporting butter use by the food industry) was terminated in July 2007,
- Subsidized exports: the EU Commission put at zero all export restitutions for dairy products in June.

The French Ministry of Agriculture is currently exploring a number of possibilities for changing the dairy CAP. Overall, France favors neither a global increase in the EU milk production quota nor a reduction in penalties in case of quota overshoot. Currently, France's short-term priority is to fulfill its quota.