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## EU-27

## Dairy and Products

## Annual

## 2007

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### Report Highlights:

The EU integrated dairy market is experiencing changes from CAP reform and member state expansion. High global dairy product prices will not result in a large increase in dairy production in the EU, as quota limitations remain a strong moderating force on surpluses, but prices will have a positive production impact. Notably, demand for cheese inside the EU and abroad will increase its processing and use. There are potential production and processing changes in the EU from disease, an upcoming dairy policy "Health Check", and the desirability of low-fat dairy products among consumers. This report updates USDA's dairy estimates for the consolidated EU report to include Bulgaria and Romania, reflecting their new membership status from January 1, 2007.

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**DISCLAIMER**

The numbers in PS&D's in this report are not official USDA numbers, but they result from a group effort by FAS EU offices to consolidate PS&D's from all 27 EU member states into the first set of EU-27 dairy PS&Ds.

The collaboration of the following EU FAS colleagues in the member states has been critical for the completion of this report. The authors of this report wish to thank especially those colleagues that participated in its report meeting to discuss the numbers and the report content, as well as in further editing the narrative.

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## Executive Summary

2007 brought enormous changes to the EU dairy market. Three major movements, reinforced by each other, were strong world demand for dairy products, reduced supplies from Oceania as a result of Australia's drought and the impact of CAP reform.

The decrease in intervention prices for butter and Non Fat Dry Milk (NFDM) agreed in the 2003 CAP Reform agreement, led to a squeeze on processor profitability. In 2006 milk production decreased for the first time, despite a 0.5 percent increase in milk production quota. The production decrease resulted from strict milk quota mobility rules that prohibit the uptake of milk quota by efficient milk producers from inefficient producers leaving the sector. This was enhanced by a widespread summer drought throughout Europe. Drought led to increased slaughter of cattle, including dairy cows. The end of intervention subsidies for NFDM in September 2006 and the depletion of NFDM intervention stocks by the end of 2006 were also remarkable milestones.

In the first quarter of 2007, EU milk production increased temporarily, because unlike 2006, milk producers did not have to restrict production to avoid superlevies for overshooting their individual quota. However, a widespread drought in April 2007 led to early worries about fodder production and milk production rapidly decreased to a lower level compared to 2006. As milk deliveries continued to be preferentially channeled to cheese-making, production of milk powders and butter significantly decreased. Milk powder prices started to rally. The EU butter production shortfall was supplemented by increased sales from EU intervention butter stocks. When these butter stocks ran low, in order to ease demand, the European Commission (EC) decided to halt all subsidies for dairy products. This pushed milk powder prices up further than normal. Profitability in cheese-making was outpaced by the profitability of producing Non Fat Dry Milk (NFDM) + butter. As well, input and feed costs for milk production also increased and milk producer prices did not follow the price rally for dairy products. As a result of long-term supply contracts with processors and retailers, milk producers faced a disincentive and further decreased milk production in summer 2007. The decrease occurred despite another agreed 0.5 percent increase in milk production quota in the EU-15. FAS/Europe expects that the increase of producer prices at summer's end, combined with EC measures to ease feeding costs, will trigger renewed milk production increases at the end of 2007 and the first quarter of 2008. Processors will again focus on shifting milk to cheese again.

2008 forecasts assume that world demand for dairy products remains solid and that the market's supply response is limited and needs considerable time to develop. Feeding costs are forecast to remain high as the zero set aside will not yield higher feed production until harvest 2008. Much depends also on whether the EC will agree in December 2007 on a further quota increase for 2008/09. If the EC refuses, quota mobility restrictions may further hamper efficient milk quota redistribution. Another unknown is the impact of Bluetongue disease in Europe in 2008 and whether a vaccination campaign will start. For 2008, dairy prices will depend on whether larger U.S. supplies become available for export.

January 1, 2007, Bulgaria and Romania acceded to the European Union creating the EU-27. Bulgaria and Romania combined add two million MT of milk deliveries. Bulgaria and Romania are experiencing major restructuring challenges to meet EU sanitary and quality standards. However, Bulgaria and Romania add some 30 million consumers to the European market.

## Milk production

Country:	EU-27								
Commodity:	Dairy, Milk (1000 Head / 1000 MT)								
	2006			2007			2008		
	USDA Official	Post Old (EU-25)	Post New (EU-27)	USDA Official	Post Old (EU-25)	Post New (EU-27)	USDA Official	Post Old	Post New (EU-27)
Calendar Year Begin	01/2006			01/2007			01/2008		
Cows In Milk	22,970	22,970	24,944	22,340	22,340	24,344	0	0	24,000
Cows Milk Deliv. to Dairies	130,400	130,400	132,206	131,500	131,500	132,600	0	0	133,400
Other Milk Production	4,525	4,525	4,075	4,550	4,550	4,125	0	0	4,150
Total Milk Production	134,925	134,925	136,281	136,050	136,050	136,725	0	0	137,550
Extra EU25 Imports	7	7	6	7	7	7	0	0	10
<b>TOTAL SUPPLY</b>	<b>134,932</b>	<b>134,932</b>	<b>136,287</b>	<b>136,057</b>	<b>136,057</b>	<b>136,732</b>	<b>0</b>	<b>0</b>	<b>137,560</b>
Extra EU25 Exports	142	142	140	135	135	155	0	0	160
Fluid Use Dom. Consum.	34,030	34,030	34,084	34,050	34,050	34,000	0	0	34,000
Factory Use Consum.	100,760	100,760	102,063	101,872	101,872	102,577	0	0	103,400
Feed Use Dom. Consum.	0	0	0	0	0	0	0	0	0
Total Dom. Consumption	134,790	134,790	136,147	135,922	135,922	136,577	0	0	137,400
<b>TOTAL DISTRIBUTION</b>	<b>134,932</b>	<b>134,932</b>	<b>136,287</b>	<b>136,057</b>	<b>136,057</b>	<b>136,732</b>	<b>0</b>	<b>0</b>	<b>137,560</b>

Source: FAS EU offices

**Please note:** Milk production quota for direct sales are a relic of historical milk marketing channels in Europe. EU milk production quota consists of two parts: a quota for deliveries to the processing industry and a quota for direct sales. This report only focuses on milk deliveries to the processing industry and its products, thus numbers on the production and consumption of direct sales of milk are not included. However, cows which produce milk for direct sales quota are included in the inventories as census numbers do not discriminate for this. As a result, the calculated milk production per cow based on the numbers of this report underestimate the true levels. Direct sales of milk have marginal importance in most EU-15 countries but remain a significant source of fluid milk and homemade dairy products in the New Member States (NMS), especially Bulgaria, Romania, Poland, and Slovenia. From EU-15 countries, homemade dairy products and direct milk sales mainly still occur in Spain, Portugal, Italy and Greece. FAS/Europe expects that as the restructuring of dairy farming in the NMS continues, most of this milk will move off the farm and result in higher fluid milk production by dairy plants and consumption ([GAIN BU7026](#)<sup>1</sup>). Poland's and, in September 2007, Bulgaria's quota were already increased by the Commission's transfer of former direct sales' quantities to their wholesale quota.

## 2006

Milk production in 2006 was adversely affected by implementation of 2003 CAP reform, due to the decoupling of support for dairy farmers and also severe summer drought which reduced cow herds and lowered milk output. A reduction in Other Milk Production numbers resulted from a review of non-cow milk production numbers in Spain and Portugal.

<sup>1</sup> <http://www.fas.usda.gov/gainfiles/200708/146292229.pdf>

## 2007

In 2007, EU-27 dairy production is stimulated by high world market prices for most dairy products but limited by the existing milk quota system, despite the second of three consecutive 0.5 percent increases in milk production quota in the EU-15. The prospect of potential loss of market value of the milk production quota discourages efficient producers from acquiring the quota that is released by small and inefficient producers (see policy section below). This limits the increase in production of raw milk and dairy products in response to growing export demand. Due to Romania and Bulgaria's EU accession January 1, 2007, dairy herd numbers were increased by 9 percent on average and EU milk production quota for deliveries was enlarged by two million MT of cow milk or just one percent of total EU production. The milk productivity per cow is very low in Romania and Bulgaria.

EU-27 milk production is expected to increase in 2007, but to remain below the 2005 level, due to growth of export demand and higher domestic consumption. Cow inventories are expected to decrease in 2007 due to restructuring of the dairy industry in the NMS and further decreases in cow-herds in the EU-15 countries due to the decoupling process of CAP reform. However, growing animal productivity is expected to offset lower inventories. Raw milk production is expected to grow slowly in the NMS and slightly decrease in the EU-15 countries. Among EU-15 nations, milk production is expected to increase in Germany, Ireland and Italy. France and the United Kingdom are expected to decrease milk production in 2007. Among the NMS, milk production is expected to increase mainly in Poland due to its favorable feed supplies and the increase of its wholesale milk quota. Production numbers for the first semester of 2007 suggest a 0.7 percent increase in cow milk deliveries. However, the increase was exclusively in the first quarter. It was largely a result of fewer farmers having to slow down milk output at the end of the quota year in order to avoid superlevies. In the second quarter (first quarter of the 2007/08 quota year) milk deliveries show a year to year decrease of 0.6 percent. This is only partly explained by the lower fat content of milk deliveries in several larger Member States. Decreases in milk deliveries compared to the first quarter of the 2005/06 quota year are observed in France, the United Kingdom, the Iberian Peninsula, wildfire stricken Greece and the Scandinavian countries Finland and Sweden, but also in NMS-10 countries Hungary, Poland and the Slovak Republic. Early reports announce further drops in year to year deliveries for July and August in many Member States. France is facing difficulties adjusting to favorable world market conditions. In the United Kingdom, the decoupling of dairy aid from milk production has lowered supply from some less efficient producers. The hot summer and subsequent drought have impacted forage supplies and hence milk production in Southeastern Europe (Bulgaria, Romania, Hungary, Italy and Greece). High world market and increased consumer prices for milk are only slowly being passed on to the farmer through higher producer prices, because dairy wholesale prices only increased after long-term contracts with retailers expired. In the mean time high grain and feed prices are adversely affecting the profitability of milk production in 2007 ([GAIN FR7626](#)<sup>2</sup>). So far this season, growing raw milk prices have lagged the increasing costs of milk production and dairy farmers struggle to maintain their profit margin. This is less true for Member States where milk production is mainly based on grazing like the Benelux countries, Denmark, parts of Germany, Ireland and Poland. Other milk production is also expected to continue to expand as increases in ewe and goat milk production across the EU are offsetting the decreased production in Greece as a consequence of this summer's wildfires ([GAIN GR7016](#)<sup>3</sup>).

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<sup>2</sup> <http://www.fas.usda.gov/gainfiles/200708/146292220.pdf>

<sup>3</sup> <http://www.fas.usda.gov/gainfiles/200710/146292608.pdf>

Higher raw milk output will enable higher factory use, while fluid milk consumption remains stable. In 2007, high world dairy product prices led to changes in intra EU raw milk trade flows. For example, in the first six months of 2007, Polish exports of raw milk for further processing to Germany decreased by 40 percent. This trend is also occurring in other EU Member States. On December 31, 2006, the transition period ended for Polish dairy processors who at accession did not meet EU sanitary standards. Currently, all Polish dairy plants fulfill EU sanitary requirements regarding raw milk and milk processing. Bulgaria and Romania requested a transitional period until December 31, 2009, to modernize milk processing plants and to organize milk collection centers to comply with the EU requirements. Products from establishments subject to transitional arrangements can not be sold to other Member States and must be clearly identified (labeled) ([GAIN BU7023](#)<sup>4</sup>).

## 2008

EU milk production is forecast to continue to grow in 2008. A third and final 0.5 percent increase in production quota in the EU-15, as agreed in the 2003 CAP reform, will enable further increase of milk production in 2008. Continuously growing EU domestic consumption and continued strong export demand for certain dairy products through the first half of 2008 are forecast to generate about half a percent increase in EU milk production. Increased or stable milk production is forecast in almost all EU-27 Member States except the United Kingdom. However, considerable uncertainty exists about the evolution of the profitability of dairying as feed cost is expected to remain high in 2008 and the first reports about dairy processors decreasing producer milk prices again have already been published. Concern is also growing that the impact of the epidemic of Bluetongue disease in the midst of Europe may have some impact on milk cow productivity in 2008 (see policy section below). Consumption of fluid milk is forecast to increase mainly due to increased NMS' consumption, but the majority of the additional milk supply is forecast to flow to increased factory use. Speculation also exists on whether the EC will agree on a further quota increase for 2008/09 in December 2007 in response to a dairy market report ahead of the 2008 Health Check. If not, quota mobility restrictions may further hamper efficient milk quota redistribution.

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<sup>4</sup> <http://www.fas.usda.gov/gainfiles/200707/146291846.pdf>

## Cheese

Country:	EU-27								
Commodity:	Dairy, Cheese (1000 MT)								
	2006			2007			2008		
	USDA Official	Post Old (EU-25)	Post New (EU-27)	USDA Official	Post Old (EU-25)	Post New (EU-27)	USDA Official	Post Old	Post New (EU-27)
Calendar Year Begin	01/2006			01/2007			01/2008		
Beginning Stocks	0	0	0	0	0	0	0	0	0
Production	6,580	6,580	6,801	6,700	6,700	6,870	0	0	6,940
Extra EU25 Imports	101	101	99	100	100	105	0	0	110
<b>TOTAL SUPPLY</b>	<b>6,681</b>	<b>6,681</b>	<b>6,900</b>	<b>6,800</b>	<b>6,800</b>	<b>6,975</b>	<b>0</b>	<b>0</b>	<b>7,050</b>
Extra EU25 Exports	529	529	561	550	550	600	0	0	620
Domestic Consumption	6,152	6,152	6,339	6,250	6,250	6,375	0	0	6,430
Other Use, Losses	0	0	0	0	0	0	0	0	0
TOTAL Dom. Consumption	6,152	6,152	6,339	6,250	6,250	6,375	0	0	6,430
Ending Stocks	0	0	0	0	0	0	0	0	0
<b>TOTAL DISTRIBUTION</b>	<b>6,681</b>	<b>6,681</b>	<b>6,900</b>	<b>6,800</b>	<b>6,800</b>	<b>6,975</b>	<b>0</b>	<b>0</b>	<b>7,050</b>

Source: FAS EU offices

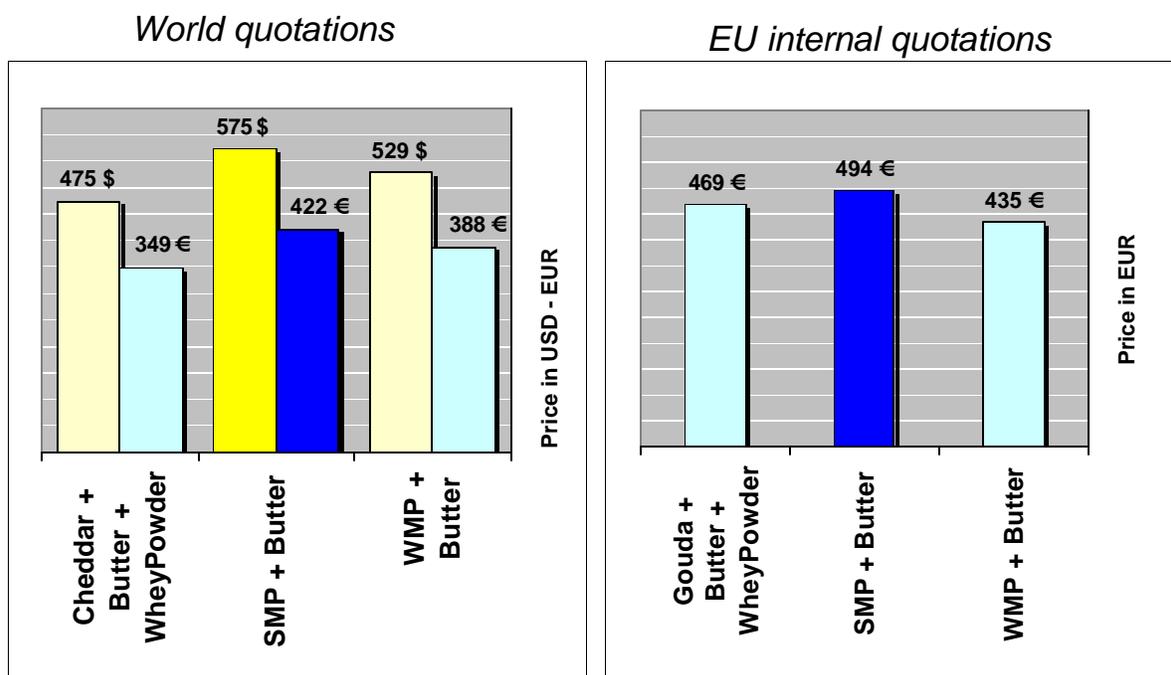
## 2006

Output of cheese in 2006 increased in comparison to 2005 despite lower milk supplies. Higher output was due to growing domestic consumption, increasing exports and withdrawal of subsidies for export of butter and non fat dry milk (NFDM). The accession of Romania and Bulgaria is responsible for the increase in this report's cheese production numbers.

## 2007

EU cheese production continues its upward trend in response to EU-wide growth in cheese consumption. Higher cheese output is further enabled by an expected increased output of raw milk and high export demand for dairy products. Germany, France, Italy and The Netherlands are the major producers of cheese in the EU market. As the CAP dairy program continues to phase out support for butter and milk powder, there is also a greater incentive to increase cheese production. Europe's dairy industry continues to invest in cheese production capacity and believes that EU cheese will remain competitive on the world market. Cheese production is increasing EU-wide in both EU-15 and NMS. The increase in cheese production amounted to 2.6 percent in the first half of 2007. During the spring, cheese production slowed down because of a processing profitability gap compared to the NFDM+buttermilk complex. Due to the limited cheese production, cheese prices rose significantly during the end of July and August.

## Income of Cheese-Wheypowder manufacturing compared to SMP-Butter and WMP-Butter Prices



Market Situation, 27 September 2007

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Source: EC DGAgri Management Committee meeting from September 27, 2007

Higher cheese consumption is expected as well, satisfied by higher output. However, consumption increases in the NMS are slower than in the EU-15 as higher cheese output in NMS is directed mostly for exports to former EU-15 countries. High domestic prices make Germany an attractive destination for cheese exports, particularly from other EU Member States. Production of cheeses from sheep and goat milk also show growth.

EU cheese imports are expected to increase slightly, mainly from Australia and New Zealand. EU cheese exports are expected to grow seven percent in 2007 despite the phase out of all export subsidies as of June 15, 2007. Major exporting countries are Germany, France, Italy and the Netherlands. Major export destinations are Russia, United States and Japan. Exports of cheese in the fourth quarter of 2007 will depend on the relationship of profitability margins for butter and NFDM processing in comparison to the margins of processing cheese for exports. It seems that world market prices for butter and NFDM already have reached their ceiling and may decline again towards the end of the year. If so, EU exports of cheese may increase further, if world market prices hold firm.

### 2008

Cheese consumption in the EU is forecast to continue growing in 2008, stimulating cheese output, especially as it is expected that the profitability of NFDM+butter will fall below profitability of cheese processing again. However, increases in cheese production and consumption are forecast to slow down in 2008 from recent trends due to high domestic and world market prices. Cheese imports are forecast to increase slightly but remain at a low

level due to growing domestic supplies. Exports will depend on prices, however, it seems that a strong market for cheese exports will continue in the first half of 2008 due to growing demand in Russia and despite some concern that the high €/ \$ exchange rate and a slowing economy might put a brake on U.S. branded cheese imports from Europe.

## Butter

Country:	EU-27								
Commodity:	Dairy, Butter (1000 MT)								
	2006			2007			2008		
	USDA Official	Post Old (EU-25)	Post New (EU-27)	USDA Official	Post Old (EU-25)	Post New (EU-27)	USDA Official	Post Old	Post New (EU-27)
Calendar Year Begin	01/2006			01/2007			01/2008		
Beginning Stocks	185	185	185	122	122	122	0	0	50
Production	2,055	2,055	2,035	2,055	2,055	2,040	0	0	2,045
Extra EU25 Imports	84	84	84	85	85	88	0	0	88
<b>TOTAL SUPPLY</b>	<b>2,324</b>	<b>2,324</b>	<b>2,304</b>	<b>2,262</b>	<b>2,262</b>	<b>2,250</b>	<b>0</b>	<b>0</b>	<b>2,183</b>
Extra EU25 Exports	254	254	248	260	260	260	0	0	240
Domestic Consumption	1,948	1,948	1,934	1,952	1,952	1,940	0	0	1,903
Other Use, Losses	0	0	0	0	0	0	0	0	0
TOTAL Dom. Consumption	1,948	1,948	1,934	1,952	1,952	1,940	0	0	1,903
Ending Stocks	122	122	122	50	50	50	0	0	40
<b>TOTAL DISTRIBUTION</b>	<b>2,324</b>	<b>2,324</b>	<b>2,304</b>	<b>2,262</b>	<b>2,262</b>	<b>2,250</b>	<b>0</b>	<b>0</b>	<b>2,183</b>

Source: FAS EU offices

## 2006

Butter PS&D estimates were updated from previous reports. Output of butter and exports ended slightly below previous estimates and resulted in lower butter consumption than previously anticipated.

## 2007

Despite higher milk supplies in 2007 EU butter production is expected to remain virtually unchanged at the 2006 level, despite the fact that processors in several Member States switched to butter+ NFDM production because of the aforementioned higher profitability over cheese production. This is partly explained by the fact that the lower fat content in raw milk reported in Germany and several other Member States is limiting the butter output ([GAIN GM7038](#)<sup>5</sup>). The increasing consumer preference for low fat dairy products is increasing the amount of milk fat for butter production. Butter output is expected to remain stable EU-wide. Butter imports are expected to increase slightly. Butter imports from New Zealand under the NZ specific butter TRQ have been facing some quota fill problems due to the implementation of the new license application procedures from the new [Commission Regulation \(EC\) No 2020/2006](#)<sup>6</sup> as the consequence of a European Court of Justice verdict, which declared the former restrictive import regulation discriminating for other interested importers. The tripling of EU butter prices since January 2007 have allowed butter imports of

<sup>5</sup> <http://www.fas.usda.gov/gainfiles/200708/146292042.pdf>

<sup>6</sup> [http://eur-lex.europa.eu/LexUriServ/site/en/oj/2006/l\\_384/l\\_38420061229en00540060.pdf](http://eur-lex.europa.eu/LexUriServ/site/en/oj/2006/l_384/l_38420061229en00540060.pdf)

U.S. origin. Butter exports are expected to increase slightly as well, due to high world prices and strong demand from Egypt and Russia. EU domestic butter consumption is expected to remain stable, despite the fact that the food processing industry is looking at alternatives for high-priced butter after the EC abolished the aid for incorporation of butter at its June 14 Management Committee meeting, and high export prices encourage a reduction in stocks. The EC announced the sales of the remaining intervention butter stocks at the end of March 2007 and EU intervention stocks physically ran empty by the end of August 2007 for the first time since the inception of butter intervention in 1964. In 2007, only 437 MT of butter were sold to intervention in March from Spain<sup>7</sup>. EU butter ending stocks in 2007 are forecast down by 70,000 MT and will only consist of butter under the Private Storage Scheme.

## 2008

EU butter production is forecast to remain almost at the 2007 level, because the increase in 2008 milk production will be used mostly for cheese production again. Imports are forecast to remain stable as they are limited by TRQs. Domestic consumption is forecast to decrease despite stable household consumption. However, the food processing industry is forecast to decrease its butter use as a result of the end of EU subsidies for the incorporation of butter in bakeries and ice cream, as well as to explore the use of vegetal oil as a substitute for the high priced butter. Stable output of butter and an expected decline of export prices in 2008 are forecast to lead to a decrease in butter exports. EU butter exports are forecast to lose some of its market position because of the end of export refunds and strong competition in butter from Oceania. However, this position may be reversed if exports of butter from Australia are reduced due to drought.

## Whole Dry Milk (WDM)

Country:	EU-27								
Commodity:	Dairy, Whole Dry Milk (1000 MT)								
	2006			2007			2008		
	USDA Official	Post Old (EU-25)	Post New (EU-27)	USDA Official	Post Old (EU-25)	Post New (EU-27)	USDA Official	Post Old	Post New (EU-27)
Calendar Year Begin	01/2006			01/2007			01/2008		
Beginning Stocks	0	0	0	0	0	0	0	0	0
Production	810	810	800	805	805	770	0	0	770
Extra EU25 Imports	2	2	3	2	2	3	0	0	2
<b>TOTAL SUPPLY</b>	<b>812</b>	<b>812</b>	<b>803</b>	<b>807</b>	<b>807</b>	<b>773</b>	<b>0</b>	<b>0</b>	<b>772</b>
Extra EU25 Exports	430	430	422	430	430	395	0	0	395
Domestic Consumption	382	382	381	377	377	378	0	0	377
Other Use, Losses	0	0	0	0	0	0	0	0	0
TOTAL Dom. Consumption	382	382	381	377	377	378	0	0	377
Ending Stocks	0	0	0	0	0	0	0	0	0
<b>TOTAL DISTRIBUTION</b>	<b>812</b>	<b>812</b>	<b>803</b>	<b>807</b>	<b>807</b>	<b>773</b>	<b>0</b>	<b>0</b>	<b>772</b>

Source: FAS EU offices

<sup>7</sup> The 2003 CAP Reform limited intervention buying to between March 1, and August 31, each year.

**2006**

The decrease of whole dry milk (WDM) production in 2006 resulted from lower milk output and higher production of cheese. Reduced supplies adversely affected exports in 2006 but did not impact domestic WDM consumption.

**2007**

WDM production in 2007 is expected to decrease slightly from 2006. This outcome is expected because of the lower profitability compared to other products. The end of export refunds for WDM exports at the beginning of 2007 has resulted in a decrease in demand on the Central- and West-African market. WDM sales to Algeria and the whole Middle-East remain firm, while exports to Asian destinations is increasing as a result of a temporary lack of supplies from Oceania. The EU domestic market for WMP shows little or no elasticity. The Netherlands, France and Germany are the major producers and suppliers of WDM on the EU market.

**2008**

WMP production, consumption and trade in the EU are forecast to remain almost unchanged in 2008.

**Non-Fat Dry Milk (NFDM)**

<b>Country:</b>	<b>EU-27</b>								
<b>Commodity:</b>	<b>Dairy, Non Fat Dry Milk (1000 MT)</b>								
	<b>2006</b>			<b>2007</b>			<b>2008</b>		
	USDA Official	Post Old (EU-25)	Post New (EU-27)	USDA Official	Post Old (EU-25)	Post New (EU-27)	USDA Official	Post Old	Post New (EU-27)
<b>Calendar Year Begin</b>	<b>01/2006</b>			<b>01/2007</b>			<b>01/2008</b>		
Beginning Stocks	8	8	8	0	0	0	0	0	0
Production	975	975	955	975	975	975	0	0	980
Extra EU25 Imports	19	19	21	20	20	25	0	0	25
<b>TOTAL SUPPLY</b>	<b>1,002</b>	<b>1,002</b>	<b>984</b>	<b>995</b>	<b>995</b>	<b>1,000</b>	<b>0</b>	<b>0</b>	<b>1,005</b>
Extra EU25 Exports	88	88	88	100	100	170	0	0	155
Domestic Consumption	914	914	896	895	895	830	0	0	850
Other Use, Losses	0	0	0	0	0	0	0	0	0
TOTAL Dom. Consumption	914	914	896	895	895	830	0	0	850
Ending Stocks	0	0	0	0	0	0	0	0	0
<b>TOTAL DISTRIBUTION</b>	<b>1,002</b>	<b>1,002</b>	<b>984</b>	<b>995</b>	<b>995</b>	<b>1,000</b>	<b>0</b>	<b>0</b>	<b>1,005</b>

Source: FAS EU offices

**2006**

NFDM production was lower in 2006 than 2005 due to a decrease in milk supplies and higher production of cheese. The end of EU subsidies for the use of NFDM in feed and the end of export refunds for NFDM in the summer of 2006 resulted in a decrease in NFDM consumption and exports.

## 2007

NFDM production is expected to increase because of the high profitability of NFDM+butter production and high export prices. Production is expected to grow in EU-15 countries with adequate milk supplies, mainly Germany and Ireland, while output in NMS is expected to remain stable. France, Germany, Poland and the Benelux are the major producers of NFDM in the European Union. In EU-15 countries, human consumption of NFDM remains stable, while feed processors decreased use of NFDM to a minimum. Increased production of NFDM in EU-15 countries is expected to supply external export due to its high world market price. However, NFDM production in the EU-15 is expected to level off again towards the end of 2007 as increased cheese processing profitability is expected to divert more milk supplies to cheese production again. In the NMS, milk surpluses will be directed rather for higher cheese production than NFDM because of continuous import demand of cheese from EU-15 countries. Total EU 2007 NFDM exports are expected to double in comparison to 2006 because of decreased NFDM availability for exports from the United States and low stocks in Oceania. This is occurring despite the elimination of export refunds for NFDM and high world market prices, although NFDM prices started to decrease again in the second half of August. The return of NFDM supplies to the market from Oceania are expected to lead to a decrease in exports from Europe again towards the end of 2007. EU domestic NFDM consumption is expected to decrease, especially in the EU-15, because of lower feed use as EU subsidies for feeding NFDM were phased out. Because of good export opportunities, intervention was not used for NFDM in 2007<sup>8</sup>; hence ending stocks will remain zero.

## 2008

NFDM production is forecast to increase slightly in 2008, in line with small increases in butter production and overall growth of raw milk output. NFDM exports are forecast to continue to decrease in the spring of 2008 as a result of the competition from Oceania, which is expected to result in a decline in world market prices. If NFDM prices in the EU decrease enough, domestic consumption of NFDM is forecast to increase in 2008, with excess NFDM being soaked up by the feed industry. No stocks are anticipated to build in the EU in 2008.

## Policy

### Markets drive CAP reform...

If EU CAP reform has mainly been driven by public concerns about disproportional EC budgetary outlays for agricultural support and international political pressure to decrease the EU's trade distorting agricultural subsidies, market signals are playing an important role as well. With EU dairy prices at record levels and milk production trailing 2006, which were also below production quota, in many EU member states (MS), a Polish request to already increase milk production quota for the 2008-2009 quota year received support from 20 EU members at the European Council meeting from September 26, 2007. France, Germany and the United Kingdom objected as they prefer to wait for an EU dairy market report which is due in December. Austria, Finland and Malta, did not vote for the expansion because they fear adverse effects on their Less Favored Areas. Commissioner Fisher-Boel indicated that she wanted to wait for the market report before deciding. The Commissioner argued that a speedy decision-making procedure could still be finalized before the start of the next quota year of April 1, 2008, just as has happened with the recent set-aside derogation decision. If

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<sup>8</sup> The 2003 CAP Reform limited intervention buying to between March 1, and August 31, each year.

a positive decision is taken at the end of 2007 to increase the 2008-2009 milk quota between 3-5 percent, this should probably be seen to anticipate further milk quota increases in the Health Check. Industry observers expect that a 3 percent increase in milk production quota would lead to increased milk production of not more than 1-1.5 percent. This is because only a limited number of MS are in a position to profitably expand milk production capacity without facing environmental restrictions. The most important member states set to expand production are Poland, Spain, Italy and the Baltic states, while Denmark, Ireland, the Netherlands and some parts of Germany could also increase milk production. Bulgaria and Romania might also be listed with these countries if they were not still hampered by their restructuring problems after EU accession.

If optimal dairy processing profitability returns to cheese-making soon, contrary to the current NFDM+buttermilk best return option, this increase in EU milk production is not expected to influence international markets much. The continuing increase in European domestic consumption of cheese and fresh dairy products like yogurts is expected to absorb this increased production. Butter production might also increase to soak up extra butterfat because of the continuing consumer trend for low fat dairy products. It can be expected that such an increase in EU production will decrease prices of all dairy products.

In its September 26, 2007, meeting, the European Council adopted the so-called [Dairy Mini-package](#)<sup>9</sup> including simplification of the school milk scheme, which will allow the same aid for all fat contents; standardization on the protein content of milk powders and condensed milk; harmonization of butter quality definitions, and greater flexibility on the marketing of drinking milk with varying fat content. While this "mini-package" is not expected to generate major changes to the EU dairy market, the implied change to the butter/NFDM subsidy balance suggests some future higher disappearance of butter versus NFDM. That should help the EC to better control EU butter markets. See also GAIN [E47016](#)<sup>10</sup>.

#### **...but CAP reform also drives markets.**

If the current record prices for dairy are mainly the result of booming world demand and stagnating production in the EU and Oceania, stagnating milk production in the EU is a direct result of the Agenda 2000 and 2003 CAP reforms. These reforms lowered the safety net of intervention buying for NFDM and butter, and the resulting producer milk price, while compensating producers through decoupled payments. This led to lower processing margins for NFDM and butter and depleted intervention stocks. The lower producer milk price has stripped profitability from less performing milk producers, while giving them an opportunity to leave the market at minimal income loss. The increase in the cost of feed and other inputs is enhancing this trend. However, if CAP reform is driving inefficient producers out of the market, efficient and profitable dairy producers have little possibilities to take on extra milk quota. Quota mobility restrictions do not allow regional shifts of milk production between cost effective and less favorable areas. Also, uncertainty about the short term and longer term fate of the milk quota regime discourages farmers from investing in high priced milk quota. They know that this investment will most likely be a complete loss by 2015 at the latest. Meanwhile, the European milk producers and processors are losing competitiveness on the world market, because of unused production and processing capacity and the lack of new investments. The United Kingdom and France have already been producing below quota for several years, while the Benelux countries may face below quota production in 2007. Dairy farmers in many EU-15 MS are also frustrated by how slow high

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<http://europa.eu/rapid/pressReleasesAction.do?reference=IP/07/1404&format=HTML&aged=0&language=EN&guiLanguage=en>

<sup>10</sup> <http://www.fas.usda.gov/gainfiles/200703/146280314.pdf>

dairy product prices trickle down to raise producer milk prices. On the contrary, increased feed prices in the past year have driven more milk producers into operating losses and this provoked several moves by milk producers to break up contracted deliveries to their current processor. This has put processors under supply constraints to meet their long term delivery contracts to retailers.

### Expectations for the 2008 Health Check

[European Agriculture Commissioner Fisher-Boel](#)<sup>11</sup> on numerous occasions has hinted at her goals for the 2008 Health Check. Some of these target the EU dairy regime, although few believe that milk production quota will be abolished before their currently agreed end after 2014/15. There is widespread understanding between EU dairy market players that the EC will agree on a "soft landing" scenario for milk production quota in the 2008 Health Check by gradually increasing the quota, but it is unclear how large these quota increases should be. The EC also is expected to further liberalize the dairy market by fully decoupling the remaining coupled payments, except maybe for the suckling cow premium. Critical in this move is whether the EC will also change quota mobility rules. Until now EU MS can unilaterally decide to remove quota trading restrictions on their territory, although not many are considering it. With the beginning of quota year 2007/08, Germany has moved from 21 to only 2 geographical areas for dairy quota trading. Milk production quota exchange between EU MS is not possible at present and this is not perceived as politically feasible. The idea of reducing the superlevy on quota milk production overshoots to a lower level has also been floated. A lower and variable superlevy could be used as a brake on milk production through which the most cost efficient milk producer could continue beyond quota depending on the market situation. This could be combined with a modified intervention system as a market management tool. Another difficult problem is how the EC will make sure the dairy industry maintains a role as an agricultural activity in least favored and mountainous areas. Full decoupling will put these areas in a poor position. The answer is expected to come through enhanced and tailor made Pillar 2 Rural Development subsidies, but the problem is that this support needs to remain decoupled from dairy production. Another idea that has been floated in [Agrafacts](#)<sup>12</sup> from September 22, 2007, is to adjust the current Article 69 option of [Council Regulation \(EC\) No 1782/03](#)<sup>13</sup> to make it more flexible. With mountain dairy farming in mind, Article 69, which allows Member States to siphon off up to 10% of their SPS/coupled payments and rechannel the funds "for specific types of farming which are important for the protection or enhancement of the environment or for improving the quality & marketing of agricultural products", could be altered to allow the money to be targeted at certain production areas in a Member State rather than applicable to the whole sector in that country. The uncertainty about the outcome of the Doha negotiations makes this Health Check exercise for the dairy sector even more difficult. Any change to the dairy quota regime agreed under the Health Check will not be implemented before the 2009 milk quota year.

The following tentative agenda for the Health Check has been put in place:

- A Health Check communication is expected for November 2007.
- A dairy market outlook report should follow in December 2007.
- A formal Health Check proposal is expected in April/May 2008.
- An agreement on the Health Check is anticipated in December 2008 under the French EU Presidency.

<sup>11</sup> [http://ec.europa.eu/commission\\_barroso/fischer-boel/speeches/index\\_en.htm](http://ec.europa.eu/commission_barroso/fischer-boel/speeches/index_en.htm)

<sup>12</sup> <http://www.agrafacts.com/>

<sup>13</sup> This is the 2003 CAP Reform [http://eur-lex.europa.eu/LexUriServ/site/en/oj/2003/l\\_270/l\\_27020031021en00010069.pdf](http://eur-lex.europa.eu/LexUriServ/site/en/oj/2003/l_270/l_27020031021en00010069.pdf)

### Impact of Bluetongue disease in north-west Europe

The rapid spread of the Bluetongue Serotype 8 through Europe into the United Kingdom and northern and eastern parts of Germany could take a toll on milk production. In total, there have already been 23,500 outbreaks of the BTV-8 strain across northwest Europe by the end of September 2007. Scientists are working hard to produce a vaccine for this strain and the EC is working on the necessary legislation to implement comprehensive vaccination programs in the infected MS. Bluetongue is known to decrease productivity in cattle, but it has high mortality rates in sheep flocks. Unless susceptible animals in infected MS are vaccinated, further proliferation of this BT outbreak could lead to decreasing milk output from cows and sheep in infected areas in 2008 and beyond.

### Impact of the accession of Bulgaria and Romania

Bulgaria and Romania are striving to implement EU sanitary and hygiene legislation after their EU accession at the start of 2007. Few dairy processors have received full EU approval and both Bulgaria and Romania obtained extensions of the grace period for local meat and dairy establishments to meet the EU sanitary and hygiene standards until 2009. While Bulgaria already obtained a switch of milk quota for direct sales to increase the quota for deliveries to 90 percent of the total quota, Romanian milk quota is 2/3 for direct sales and 1/3 only for deliveries. Worse, because of the small scale production with the large majority of dairy producers only milking one or two cows, only about 1/3 of milk deliveries from both countries meets EU milk sanitary quality standards. Because processors must process quality and substandard milk separately under EU hygiene legislation, many processors only receive substandard milk, limiting them in their processing options and creating problems with marketing these products. As a result, new and rapidly growing European retailers in urban areas in Bulgaria and Romania prefer to import dairy products and not use local products. Despite government programs with European sponsorship to improve this situation, this retail trend risks suffocating local production. Expectations are that most small farms, which received a milk production quota, will not be able to upgrade their milk quality to EU sanitary standards and therefore will be shut down in 2008. While, over the long term, Bulgaria and Romania should have comparative advantages for milk production, it is clear that this is likely to take several years. See also GAIN [BU7023](#)<sup>14</sup> and [BU7026](#)<sup>15</sup>.

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<sup>14</sup> <http://www.fas.usda.gov/gainfiles/200707/146291846.pdf>

<sup>15</sup> <http://www.fas.usda.gov/gainfiles/200708/146292229.pdf>

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