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2008

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Report Highlights:

Milk production and output of dairy products in the EU-27 is expected to increase in 2008 as a result of a higher overall milk production quota and growing domestic consumption of dairy products. European dairy farmers face continued reduction of farm-gate prices for milk and increasing input costs. EU-external exports in 2008 of all dairy products except whole dry milk are expected to decrease due to higher competition from other exporters and the EU's reduced competitiveness. Milk production and output of dairy products is forecast to increase in 2009 but in a slower rate than in 2008. To support its dairy industry the European Commission may re-introduce export refunds in 2009 to make EU products more competitive on the world market.

Includes PSD Changes: No
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Executive Summary

After peaking in mid-2007, domestic prices for raw milk and export prices for dairy products are falling in 2008. Lower prices for milk combined with increased costs of agricultural inputs make milk production and dairy processing less profitable. Despite lower prices, milk production in the EU-27 is expected to increase in 2008 due to the enlargement of the milk quota and growing consumption of dairy products. However, the increase in production is not expected to continue at the same rate into 2009 due to the drop in raw milk prices and lower prices for dairy products on the world market. In the spring and fall of 2008, farmers in Germany, Austria, France, Czech Republic, Poland and Bulgaria protested against the drop of milk prices and the higher costs of inputs. The inventories of European dairy herds continue to decline, however there is continued genetic improvement and higher yields from cows, and a general trend toward greater consolidation of the dairy industry.

Growing milk production and higher domestic consumption of all dairy products, except butter, is expected to increase output of dairy products in 2008 and into 2009. Production of cheese is expected to grow in 2008. However, competition from other products and a slow increase of exports is slowing the growth of cheese production more than originally predicted. A higher production of butter, combined with almost stable consumption and a significant reduction in exports in 2008, is causing an excess of butter on the EU market and resulting in growing private stocks. Due to a gap between domestic and world market prices, the absence of export restitutions, and strong worldwide competition, exports of butter, and in particular butter oil, are expected to drop in 2008. Higher world demand is causing EU-27 production and exports of whole dry milk (WDM) in 2008 to increase from the 2007 level. Growing supplies of milk are processed to WDM as cheese production almost reached its maximum potential and the profit margin on non fat dry milk (NFDM) production is lower of that of WDM production. Higher milk supplies are expected to only slightly increase NFDM production in 2008. The profitability of NFDM/butter production remains below that of manufacturing cheese and WDM. However, the worsening world market conditions for EU exporters of dairy products is forcing the industry to partially switch to products with a longer shelf life, such as butter and milk powder.

A moderate increase of milk output in 2009 will increase production of dairy products in the EU-27, with the exception of WDM. Cheese consumption in the EU is forecasted to continue to grow in 2009, in line with growing output. However, domestic consumption of cheese may be affected by the developing financial crisis in Europe. EU butter production is forecast to increase only slightly in 2009, as increased milk output will be used mostly for cheese production. NFDM production is forecast to increase in 2009 in line with higher milk supplies and increases in butter production. WMP production is forecast to decline in 2009 as additional raw milk supplies will be used mostly for the manufacturing of cheese and fresh dairy products.

Until the end of October of 2008, the Commission did not intervene on the internal or external dairy market. However, the situation may change towards the beginning of 2009 as growing supplies combined with lower competitiveness of European dairy products on the world market and stable domestic consumption will put strong pressure on the EU authorities to build intervention stocks, subsidize consumption, or re-introduce export refunds.

DISCLAIMER

The PS&D numbers in this report are not official USDA numbers. The numbers are the result of a group effort by the individual FAS EU offices to consolidate PS&D's from all 27 European Union.

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

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Milk production

Country:	EU-27								
Commodity:	Dairy, Milk (1000 Head / 1000 MT)								
	2007			2008			2009		
	USDA Official	Post Old (EU-27)	Post New (EU-27)	USDA Official	Post Old (EU-27)	Post New (EU-27)	USDA Official	Post Old	Post New (EU-27)
Calendar Year Begin	01/2007			01/2008			01/2009		
Cows In Milk	24344	24344	24178	24000	24000	23951			23950
Cows Milk Deliv. to Dairies	132600	132600	132604	133670	133670	134000			134400
Other Milk Production	4125	4125	4270	4150	4150	4259			4260
Total Milk Production	136725	136725	136874	137820	137820	138259			138660
Extra EU25 Imports	7	7	12	10	10	6			5
TOTAL SUPPLY	136732	136732	136886	137830	137830	138265			138665
Extra EU25 Exports	155	155	156	160	160	170			150
Fluid Use Dom. Consum.	34000	34000	33334	34000	34000	33569			33645
Factory Use Consum.	102577	102577	103396	103670	103670	104526			104870
Feed Use Dom. Consum.	0	0	0	0	0	0			0
Total Dom. Consumption	136577	136577	136730	137670	137670	138095			138515
TOTAL DISTRIBUTION	136732	136732	136886	137830	137830	138265			138665

Source: FAS EU offices

Please note: Since 1984, milk production in the European Union (EU) has been regulated through the milk quota system. As part of the 2003 CAP reform, the quota was increased in three installments of 0.5 percent each for the EU-15 member states from MY 2005/06 through MY 2007/08¹. In addition, the overall quota was increased by 2 percent on March 17, 2008 by the European Council in response to tight world dairy markets in 2007. (See: E48036). The EU as a whole did not reach the quota level in MY 2007/2008. However, the milk quota for MY 2007/2008 was exceeded by seven countries: Austria, Cyprus, Ireland, Italy, Germany, Luxemburg and the Netherlands. In these countries, the quota was exceeded by 1.2 million tons and the total fine (levy) which farmers from these countries will have to pay amounts to almost 350 million Euros. Half this sum will be paid by Italian farmers and one third by German farmers.

There is an EU-wide debate on how to eliminate the milk quota by 2015 as a part of CAP reform. The majority of the milk quota consists of a "wholesale" quota, which reflects milk delivered to the dairy processing industry. The remaining quota is called the "direct sales quota" which consists of milk used on farm and sold by farmers to their neighbors. This report only focuses on milk deliveries to the processing industry (within the "wholesale" quota) and its products, thus numbers on the production and consumption of direct sales of milk are not included in Production, Supply & Demand estimates. 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 and Poland. Based on data from member states, "direct sales" in the EU-27 amounted to 9.6 million tons in 2007 or seven percent of total bulk milk production. This number is expected to decline to 9.4 and 9.0 million tons in 2008 and 2009, respectively. It is expected that following the adjustment process to the EU milk quality standards, the

¹ EU regulation 1788/2003

amount of milk sold in the NMS within the "direct sales" category will gradually diminish and be transferred instead to the "wholesale" grade.

2007

High world market prices for dairy products stimulated EU-27 dairy production in 2007. Despite a growing export demand, the EU's milk production quota system limited a significant increase in production even with two consecutive 0.5 percent increases in the quota in the EU-15. Romania and Bulgaria's EU accession on January 1, 2007 increased dairy herd numbers by 9 percent and the EU milk production quota for deliveries to milk processing industries was enlarged by two million tons of cow milk, a one percent increase of total EU production.

In 2007, EU-27 milk production increased by 0.5 percent compared to 2006. This increase was due to growth of export demand and higher domestic consumption. Cow inventories decreased in 2007 due to a restructuring of the dairy industry in the NMS and further decreases in cow-herds in the EU-15 countries. Genetic improvement and higher efficiency of milk production increased the milk yields of cows, which offset the lower inventories. Raw milk production grew in the NMS and slightly decreased in the EU-15 countries.

2008

In 2008, EU-27 milk production is expected to grow over 1.0 percent despite a downward trend in world market prices for dairy products. The higher output in 2008 is mainly a result of growing domestic demand and continuing exports of dairy products. The increase of milk output was also enhanced by three consecutive 0.5 percent increases in the milk production quota for the EU-15 and a 2 percent increase of quota for the entire EU-27 (see the introductory note above). The expected increase in raw milk output will enable higher factory use and fluid milk consumption. Cow inventories are expected to continue to decline in 2008 due to a significant increase in production costs, which forces farmers across the EU to cut costs and restructure the dairy industry. However, growing animal productivity is expected to offset lower inventories. Raw milk production is expected to grow more slowly in the NMS than in the EU-15 countries. Among EU-15 nations, milk production is expected to increase in France and Italy and decrease in the United Kingdom. Eighty five percent of the increase of production occurred in the first quarter of 2008 in France. Unfavorable weather conditions in the majority of Europe and protests by German and Austrian farmers in the second quarter of 2008 limited the overall increasing trend of milk production in the EU-27. In the NMS, milk production is expected to increase mainly in Poland due to an increase in the wholesale milk quota.

In **France**, cow milk deliveries are significantly higher in 2008 than in 2007. A seven percent increase was seen in the first half of 2008, with a lower increase expected in the second half of the year. This increase is primarily due to higher prices paid to farmers, and to the increased EU milk production quotas. The higher market prices for dairy products in 2007 only impacted producer prices in France during the first half of the year. This is a result of the way the producer price for milk is calculated in France. Prices are not set on a contract basis but on a national recommendation, which is reached through a compromise by the various stakeholders of the industry. This "buffer" system, which is currently questioned, was meant to soften market fluctuations, and therefore protect farmers and dairy processors from dramatic price changes. For the first time in many years, the dairy herd has not declined in the first half of 2008 in France. This change resulted from lower slaughter than normal, due to high milk prices in the first half of 2008. Farmers have kept their dairy heifers on the farm longer than they usually do. **Italian** industry sources indicate that there will be a further increase in milk production in 2008. Feed costs in Italy are expected to be

lower in 2008 as larger feed grain crops in Italy and across the EU have increased supply and thus lowered their market price. In **the Netherlands**, and to a lesser extent **Belgium**, dairy farmers are eager to increase their milk production. The new, more liberal EC policy is expected to stimulate Benelux dairy farmers to invest in production. During 2007, the number of dairy cows in the Benelux countries increased for the first time in six years, and is expected to increase further in 2008. At the moment, however, milk prices are declining after the price surge in 2007. This will force dairy farmers, especially smaller farmers, to expand and improve their efficiency in order to compete. Industry sources estimate that Benelux milk production has the possibility to expand by two percent next season, and to increase by ten to twenty percent in the coming ten years. This increase will develop gradually and is expected to reduce EU milk prices further. In **Germany** milk deliveries for the first half year of 2008 have been only 0.5 percent below levels at the same time last year, despite the ten day dairy delivery strike at the end of May. For the second half of the year, deliveries are expected to be at similar levels as in 2007. For 2009, an increase in deliveries is expected as larger farms take advantage of the 2 percent quota increase. The decreasing trend in **Swedish** milk production has stopped and the number of borne calves is stabilizing. Current milk deliveries are about 1.5 percent higher than at the same time last year. This development is due to the good price situation. Swedish milk prices were 27% higher in May this year compared to the year before. High input prices are still a problem for Swedish dairy farmers, but are being offset by the higher milk prices. Poor returns and tight margins mean rationalization continues in the **United Kingdom** dairy sector. With farm numbers declining and the reduction in cattle numbers continuing to outstrip the trend increase in per cow productivity, milk output continues to drop. CY 2008 has also seen less than favorable weather conditions, which temporarily reduced milk productivity. Overall, UK production remains below quota and is expected to remain so for the foreseeable future. The UK proportion of total EU milk production is falling as other countries maintain, and even increase, their output. High, and rising, compound feed prices in the UK are putting increased pressure on farms operating close to or below margin. A further decline in production is therefore forecast for the out-year. It is estimated that overall milk production in **Poland** will increase in 2008 by 2.2 percent. Most of the increase in milk production will be sold to the dairy industry, while on farm consumption and direct sales of milk are expected to remain at the previous year's level. Polish dairy farmers increase size of dairy herds to improve profitability of production. It is expected that despite overall increase of milk production the number of dairy farms will decrease in 2008 by 18 percent.

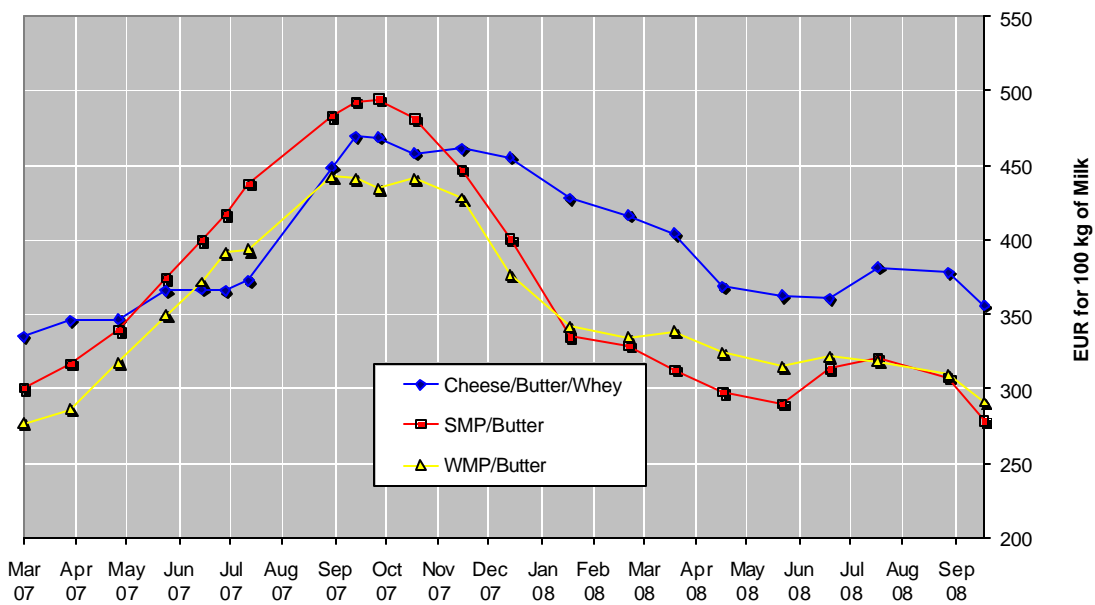
2009

EU-27 milk production is forecast to continue to grow by 0.3 percent in 2009 due to continued growth in EU domestic consumption. Increased or stable milk production is forecast in almost all EU-27 Member States except the United Kingdom and also a slight decline is forecast in France. Dairy processors have started to decrease producer milk prices in 2008 due to lower export demand which is expected to also adversely affect the profitability of dairy production in 2009. The lower farm-gate prices for milk are expected to be partly offset by reduced feed costs due to a good grain crop in 2008. 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 2009 (see policy section below). The additional milk supply is forecast to flow to both increased fluid consumption and factory use.

Dairy Products

The decrease in world market prices for dairy products since the fall of 2007 weakened the 2007 euphoria of producers and processors and forced them to a more market oriented production policy. Since the beginning of 2008, cheese has become the most profitable dairy product while processing milk into NFDM/Butter has been the least desirable combination from a profitability point of view. However, despite its high profitability, hard cheese production did not grow significantly in the first half of 2008 due to high commercial stocks build up in 2007, and limited growth of domestic consumption. Instead, the industry switched to products which are suitable for longer storage, like butter, NFDM and products, such as WDM, in demand on the world market.

EU Income of manufacturing of Cheese/Wheypowder, SMP/Butter and WMP/Butter (in EUR)



Source: EC Dairy Management Committee meeting of September 18, 2008

Cheese

Country:	EU-27								
Commodity:	Dairy, Cheese (1000 MT)								
	2007			2008			2009		
	USDA Official	Post Old (EU-27)	Post New (EU-27)	USDA Official	Post Old (EU-27)	Post New (EU-27)	USDA Official	Post Old	Post New (EU-27)
Calendar Year Begin	01/2007			01/2008			01/2009		
Beginning Stocks	0	0	0	0	0	0			0
Production	6870	6870	6760	6940	6940	6840			6870
Extra EU25 Imports	105	105	93	110	110	85			85
TOTAL SUPPLY	6975	6975	6853	7050	7050	6925			6955
Extra EU25 Exports	600	600	534	620	620	510			510
Domestic Consumption	6375	6375	6319	6430	6430	6415			6445
Other Use, Losses	0	0	0	0	0	0			0
TOTAL Dom. Consumption	6375	6375	6319	6430	6430	6415			6445
Ending Stocks	0	0	0	0	0	0			0
TOTAL DISTRIBUTION	6975	6975	6853	7050	7050	6925			6955

Source: FAS EU offices

2007

Output of cheese in 2007 was temporarily limited because of a processing profitability gap compared to the NFDM and butter combination. However, higher milk production and growing domestic consumption stimulated production at the end of the year.

2008

The increase in cheese production amounted to 2.8 percent in the first half of 2008. Cheese production grew in response to an EU-wide increase of consumption. Higher cheese output was made possible by the expected increased output of raw milk. Germany, France, Italy and the Netherlands are the major producers of cheese in the EU market. As the CAP dairy program reduces support for butter and milk powder, this also creates a greater incentive to increase cheese production. Cheese production remains profitable, but private stocks built up in 2007 stopped the growth from being bigger. Europe's dairy industry invested in cheese production capacity and processors believe that EU cheeses will remain competitive on the world market. Cheese production is increasing EU-wide in both the EU-15 and NMS.

Increased production combined with commercial stocks built up in 2007 and reduced exports are expected to satisfy higher domestic consumption of cheese. However, consumption increases in the NMS are slower than in the EU-15. Higher cheese output in NMS is exported mostly to EU-15 countries. High domestic prices make Germany an attractive destination for internal cheese exports, particularly from the Netherlands and France.

EU-27 external cheese imports are expected to decrease slightly due to higher domestic production. EU cheese exports are expected to decline by four percent in 2008 as a result of lower prices on the world market and competition from Oceania and the United States. Major export destinations are Russia, United States and Japan. The biggest exporting countries are the Netherlands, Germany, France and Italy. Exports of cheese in the fourth quarter of 2008 will depend on the relationship of profit margins for butter and WDM

processing in comparison to the margins of processing cheese. Competition from Oceania countries and growing exports of cheese from the United States are forcing traders to sell at lower prices or contract for future deliveries to prevent building up excessive stocks. Processors and exporters would like to get support from the EC by the re-introduction of cheese export restitutions in the fall of 2008 and in 2009. So far, EU authorities have declined to intervene on the market.

In **France** cheese production is increasing in 2008 as a result of an increased milk supply. However, human consumption is stagnating and private commercial stocks are expected to increase. Additional production is estimated to result in higher intra-EU exports rather than higher domestic consumption. Domestic consumption has been under pressure from high retail prices, in line with high prices for milk and other raw products. In 2009, stable production and consumption are anticipated, as the milk supply is expected to be lower. Cheese production is expected to slightly increase in **Italy** in 2008. Imports still represent a large share of total supplies of cheese in Italy, with Germany being the major supplier. Italian cheese exports are mainly directed to other EU countries, as well as the United States. The bulk of cheese exports to the U.S. are sheep milk cheese (pecorino), parmesan and grana cheese. Cheese production in **Germany** is increasing albeit at a slower pace than in previous years. Commercial stocks are full and external exports are difficult because of the Euro exchange rate. Production and consumption of cheese is expected to continue to increase in 2009. However, the trend is in lower fat cheeses, so the increased production of cheeses does not necessarily bind much additional milk fat. Imports as well as exports decreased in the first four month of 2008. The primary external EU-27 cheese suppliers to the German market are Switzerland and New Zealand. The main external export destinations are Russia, Japan, and the United States. The **Dutch** sector believes that cheese, in particular branded cheese, will be the main dairy product with which the EU can compete with on the world market. During 2008 and 2009, **Benelux** cheese production is not expected to increase as significantly as in 2006 and 2007, as production has nearly reached maximum capacity. As the gap between EU and world cheese prices narrowed, cheese imports declined during 2007. Since 2006, Benelux cheese exports to countries outside the EU increased significantly. The main growth market for Benelux cheese exports is Russia. So far, domestic cheese consumption has not been influenced by the high prices. The **Swedish** dairy industry has shifted away from cheese to products such as milk powder and butter. As a result of this development, as well as lower milk deliveries, cheese production decreased in 2007 and is expected to remain stable in 2008. Cheese production is expected to continue its upward trend in **Romania** at an average rate of 3 percent per year. Intra-EU imports are also forecasted to increase, with Germany as a leading supplier. In the first seven months of 2008 cheese production in **Poland** increased by 10 percent accompanied by 17 percent growth of whey output as a by-product. There is a long-term trend in Polish dairy industry of greater use of milk fat for production of cheese in expense of reduced butter output.

2009

Cheese consumption in the EU is forecast to continue growing in 2009 in line with growing output. However, domestic consumption of cheese may be affected by the developing financial crisis in Europe. The world market for dairy products may be also affected by the melamine scandal in China. Cheese imports are forecast to remain at a low level due to growing domestic supplies. Exports will depend on prices and the continued strength of the Euro.

Butter

Country:	EU-27								
Commodity:	Dairy, Butter (1000 MT)								
	2007			2008			2009		
	USDA Official	Post Old (EU-27)	Post New (EU-27)	USDA Official	Post Old (EU-27)	Post New (EU-27)	USDA Official	Post Old	Post New (EU-27)
Calendar Year Begin	01/2007			01/2008			01/2009		
Beginning Stocks	122	122	122	50	50	46			65
Production	2040	2040	2053	2055	2055	2060			2075
Extra EU25 Imports	88	88	91	88	88	88			88
TOTAL SUPPLY	2250	2250	2266	2193	2193	2194			2228
Extra EU25 Exports	260	260	206	220	220	125			160
Domestic Consumption	1940	1940	2014	1933	1933	2004			2018
Other Use, Losses	0	0	0	0	0	0			0
TOTAL Dom. Consumption	2200	2200	2014	2153	2153	2004			2018
Ending Stocks	50	50	46	40	40	65			50
TOTAL DISTRIBUTION	2250	2250	2266	2193	2193	2194			2228

Source: FAS EU offices

2007

Butter output was slightly higher than estimated in the previous reports. Final data for 2007 exports ended below previous estimates and resulted in higher butter consumption. However, it needs to be noted that the consumption figure includes unsubsidized commercial stocks. The European Commission announced the sales of remaining intervention butter stocks at the end of March 2007 and EU intervention stocks physically ran dry by the end of August 2007 for the first time since the introduction of butter intervention in 1964. EU butter ending stocks in 2007 were down to 46,000 MT and consisted only of butter under the Private Storage Scheme.

2008

Despite higher milk supplies in 2008, EU butter production is expected to remain almost unchanged from the 2007 level. Butter output rose by four percent in the first quarter of 2008 due to higher milk production. Decreased milk supplies and increased export demand of WDM later in the year is causing production of butter to decrease. Butter output is expected to remain stable EU-wide. Butter imports from New Zealand under the NZ specific butter TRQ decreased by almost 20 percent in the first seven months of 2008. These imports are being replaced by imports from the United States, whose exports to the EU rose over five times in comparison to the same period in the previous year. EU butter exports are expected to drop significantly in 2008 due to lower world market demand and uncompetitive prices for EU butter caused by the strong euro and the elimination of export refunds for all dairy products including butter. The EU domestic butter consumption is expected to decline in 2008. The food processing industry is looking at alternatives for high-priced butter. The European Dairy Association reports increased substitution of costly butter in pastry products and ice-cream. Support for production and consumption of butter in 2008 are expected to remain at zero. Only private storage agreements and support to non-profit organizations receive EU support. As of September 18, 2008 private storage of butter (PSA) amounted to 141,608 MT compared to 107,049 MT a year ago.

In **Germany** butter production was higher in the first half of 2008 compared to 2007 but is expected to slow in the second half of the year. For the full year production is forecast marginally higher than in 2007. Industry and household consumption declined as a response to the higher prices. Households purchased more margarine instead of butter and industry has modified their recipes and used more plant oils. In **Benelux** countries butter production is expected to recover as milk production is increasing while the production of cheese nearly reached its maximum capacity. Another factor is growing preference of consumers towards dairy products with lower milk fat content. **France** is traditionally a net importer of butter and a net exporter of butter-oil. In 2008, higher milk supply has resulted in higher dairy processing. Since cheese consumption is stagnating, production of industrial products, such as butter and powders, are growing. As butter consumption is stable (and consumption of lighter products is growing), quantities under the Private Storage Aid are likely to increase. The phasing out of the pastry and ice cream scheme is not estimated to have negatively impacted butter consumption in France as the industry had anticipated it. French exports of butter-oil are on the decline, due to the termination of export restitutions. In 2009, reduced milk supply is expected to result in lower butter processing. The decline in milk supplies for processing in **United Kingdom** has seen butter production fall at the expense of cheese in 2008. High retail prices for dairy products have also seen consumers downscaling purchases. For butter this has meant a switch towards margarines. In **Romania** butter production is forecast to be increasing at an average rate of 6% per year. Intra-EU imports will be stable, with Poland as a leading supplier. Butter production in **Poland** is expected to decline due to lower exports. Use of milk fat for manufacturing butter decreased from 43 percent in the beginning of the decade to 36 percent in 2008.

2009

EU butter production is forecast to increase only slightly in 2009 as increased milk output will be used mostly for cheese production. Imports are forecast to remain stable as they are limited by TRQs. Exports are expected to partially recover as stocks in some importing countries are likely to have been somewhat depleted. Butter prices are also expected to decrease due to higher supplies which would make EU butter more competitive on the world market. The household domestic consumption is forecast to remain stable; however, the food processing industry may continue to decrease its butter use. This is a result of the termination of EU subsidies for the incorporation of butter in bakeries and ice cream, as well as the increased use of vegetable oil as a substitute for the high-priced butter. EU butter exports in 2009 also depend on the Commission decision of re-introduction of export refunds to face strong competition in butter from the United States and Oceania.

Whole Dry Milk (WDM)

Country:	EU-27								
Commodity:	Dairy, Whole Dry Milk (1000 MT)								
	2007			2008			2009		
	USDA Official	Post Old (EU-27)	Post New (EU-27)	USDA Official	Post Old (EU-27)	Post New (EU-27)	USDA Official	Post Old	Post New (EU-27)
Calendar Year Begin	01/2007			01/2008			01/2009		
Beginning Stocks	0	0	0	0	0	0			0
Production	770	770	776	780	780	814			800
Extra EU25 Imports	3	3	2	2	2	1			1
TOTAL SUPPLY	773	773	778	782	782	815			801
Extra EU25 Exports	395	395	366	395	395	400			386
Domestic Consumption	378	378	412	387	387	415			415
Other Use, Losses	0	0	0	0	0	0			0
TOTAL Dom. Consumption	378	378	412	387	387	415			415
Ending Stocks	0	0	0	0	0	0			0
TOTAL DISTRIBUTION	773	773	778	782	782	815			801

Source: FAS EU offices

2007

The decrease of whole dry milk (WDM) production in 2007 compared to 2006 resulted from higher production of other more profitable dairy products, mainly butter and Non Fat Dried Milk (NFDM). Reduced supplies adversely affected exports in 2007 but did not impact domestic WDM consumption. Termination of export refunds for WDM exports at the beginning of 2007 also reduced WDM exports later in the year.

2008

Due to higher world demand, EU-27 production on WDM in 2008 is expected to increase from the 2007 level. Growing supplies of milk are processed to WDM as cheese production almost reached its maximum level and the profit margin on NFDM production is lower of that on WDM production. The overall level of WDM exports in 2008 is expected to grow compared to 2007. WDM sales to the Middle-East increased in the first seven months of 2008 due to a temporary lack of supply from Oceania because of a drought there early in the year. Exports to Venezuela and the Dominican Republic also increased significantly in the first half of 2008. 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.

2009

WMP production is forecast to decline in 2009. Additional raw milk supplies will be used mostly for production of cheese and fresh dairy products. Exports are expected to also decline due to lower output and competition from Australia and New Zealand.

Non-Fat Dry Milk (NFDM)

Country:	EU-27								
Commodity:	Dairy, Non Fat Dry Milk (1000 MT)								
	2007			2008			2009		
	USDA Official	Post Old (EU-27)	Post New (EU-27)	USDA Official	Post Old (EU-27)	Post New (EU-27)	USDA Official	Post Old	Post New (EU-27)
Calendar Year Begin	01/2007			01/2008			01/2009		
Beginning Stocks	0	0	0	0	0	0			0
Production	975	975	1005	990	990	1015			1050
Extra EU25 Imports	25	25	10	25	25	5			5
TOTAL SUPPLY	1000	1000	1015	1015	1015	1020			1055
Extra EU25 Exports	170	170	201	165	165	180			200
Domestic Consumption	830	830	814	850	850	840			855
Other Use, Losses	0	0	0	0	0	0			0
TOTAL Dom. Consumption	830	830	814	850	850	840			855
Ending Stocks	0	0	0	0	0	0			0
TOTAL DISTRIBUTION	1000	1000	1015	1015	1015	1020			1055

Source: FAS EU offices

2007

Increased production of NFDM in the EU-15 countries was mainly exported due to its high world market price. However, NFDM production in the EU-15 leveled off towards the end of 2007 as increased cheese processing profitability diverted more milk supplies to cheese production. In the NMS, higher milk production was directed towards higher cheese production rather than NFDM because of the continuous import demand of cheese from EU-15 countries.

2008

Higher milk supplies are expected to only slightly increase NFDM production in 2008. However, decreasing world prices accompanied by a strong euro is expected to reduce exports. The profitability of NFDM/butter production remains below that of manufacturing cheese and WDM. However, the deterioration of the world market for EU exporters of dairy products is forcing the industry to switch to products with a longer shelf life, such as butter and milk powder. Production is expected to grow in the EU-15 countries which have adequate milk supplies, mainly France and Ireland, while output in NMS is expected to decline. France, Germany, Poland and the Benelux countries are the major producers of NFDM in the European Union. Human domestic consumption of NFDM remains stable, while feed processors are decreasing the use of NFDM because of its high domestic price and the elimination of EU subsidies for feeding NFDM. At the beginning of 2008 the milk replacer sector reduced the use of expensive whey powder and NFDM, substituting it with vegetable components. The future substitution depends on fluctuations of raw material prices. Total EU NFDM exports in 2008 are expected to decrease in comparison to 2007 because of competition from the United States and Oceania. NFDM from the EU is less competitive on the world market owing to higher domestic prices, the strong value of the euro and the elimination of export refunds.

2009

NFDM production is forecasted to increase in 2009 in line with higher milk supplies and increases in butter production. If NFDM prices in the EU decrease further, domestic consumption of NFDM is forecasted to increase in 2009, with excess NFDM being soaked up by the feed industry and an increase in exports.

Policy

The EU's high cost of milk production

Increased prices for feed, energy and other inputs led to an increase in the cost of milk production in 2007, well before increased dairy commodity prices were passed on to farmers. Now EU dairy cows have a grass or (corn) silage based diet, so the increased feed cost was mainly from the opportunity cost of forgoing other highly priced grain crops. As a result, farmers were slow in increasing milk production. In 2008, when dairy commodity prices are decreasing, milk prices to farmers are decreasing with some lag time also. At the same time that farmers are encouraged by a two percent quota expansion in 2008, demand for EU dairy products on the domestic and export markets is decreasing because of high prices and the unfavorable euro exchange rate. As a consequence, margins for dairy processors have dwindled, especially for companies mainly processing for export. Because buyers are holding back purchases until prices have decreased even further, it can be questioned how much longer it will take before the EU dairy sector requests the EC for support. Because intervention buying of dairy products was terminated in the 2003 CAP reform, the most likely market support tool may be renewed export subsidies.

Falling farm-gate prices for milk in 2008 at sustained high input costs have put many farmers in a very difficult economic situation. As a result, farmers have started to protest against reduced milk prices. Protests started in May in Germany and Austria and were followed by the Czech Republic in June and Poland and France in October. Bulgarian producers have been protesting a bad year as they factor in EU hygiene restrictions on their market. As well, they have not yet begun to receive CAP payments yet. As a follow-up to the dairy strike, the German Minister of Agriculture, Seehofer, convened a milk summit to discuss what can be done to increase producer prices. A number of measures have been proposed to reduce milk deliveries, including reducing the possibility to balance quota overshoot and undersupply within a dairy company, and changing the conversion factor for milk from volume to weight from 1.2 to 1.3. The parliament will vote on these measures in October. At this point it is not clear whether or not the vote will be positive. In June, Czech farmers supported a German protest and spilled milk in the fields instead of selling it to German processors. It is estimated that around 500 thousand liters of milk was spilled.

Health Check

The upcoming Health Check (HC) proposal can be seen as the final phase of the 2003 CAP Reform. The proposal suggests decoupling most of the remaining coupled farm supports, as well as further dismantling market restriction tools, such as set-asides and intervention storage. For the EU dairy sector, the most prominent measure proposed for the HC is the "soft landing" of the milk production quota system. This "soft landing" will consist of a gradual increase in the milk quota to a point that the milk production limitation function of the milk quota system becomes obsolete. The initial impact study suggested that five consecutive two percent annual quota increases would be the best scenario. The changing dairy market situation in 2008 has led the Commission to suggest a one percent annual increase starting in 2009 for five years. The Dutch Agricultural Economic Institute reports

that after the abolishment of the milk quotas, EU milk production will only increase 2-3 percent, with the best prospects in Ireland, Northern France, the Benelux, Denmark, Germany and Poland. Accompanying measures to help Least Favored Areas (LFAs), mostly mountainous areas, better adapt to dairy reform are foreseen. There are fears that the HC might relocate animal production, especially dairy, away from disadvantaged regions. The Commission has indicated its intention in the proposal to limit this relocation through special measures for LFAs by means of a redrafted Article 68 (formerly Article 69) for this purpose. Some EU Member States, like Germany, would prefer the creation of a special dairy reform fund under Pillar I with additional EU funding, comparable to the sugar reform fund, instead or in addition to the Article 68 tool. However, the EC has already indicated its opposition to it or at least the possibility for additional Pillar I money. It is the European Council that is expected to have the final say by the end of the French EU Presidency in December 2008. The Council could still decide to create a milk reform fund, sourcing the needed money through additional modulation on a Member State basis.

Environmental restrictions and climate change

Environmental restrictions under the EU's Nitrate Directive (especially groundwater quality protection from excessive manure spreading) have already put serious brakes on pig production in the EU-15. New concerns about greenhouse gas (GHG) emissions from concentrated animal production are emerging, especially methane emissions from ruminants. The impact of animal production on climate change has become a topic of debate. EU policy makers have already pointed out that animal farming will need to do its share in the reduction of GHG emissions to achieve targets of a post-Kyoto agreement. As highly productive dairy cows have the highest methane excretion, the dairy sector is concerned. Sustainability voices in the debate call for decreased consumption of animal products, including dairy products, in Europe and the developed world as the only way this will be achievable. The debate on climate change may evolve in a way that further increases production costs for animal products.

Animal Health Situation

Bluetongue disease (BTV)

After its emergence in 2006 in Belgium and the Netherlands, Bluetongue serotype 8 (BTV-8) disease rapidly spread in widely in the EU to Sweden, the Czech Republic, Italy, Germany and the United Kingdom (UK) by 2008. While impact reports of this BTV-8 vary widely between affected Member States and economic damage has not been fully assessed yet, it is estimated to amount to hundreds of millions of Euros. Mortality and reductions in birth/fertility in cattle and sheep from the second year infection wave have been reported to be up to 15-20 and 50 percent, respectively. In the spring of 2008, affected Member States engaged in comprehensive vaccination of cattle and sheep herds to contain the disease. This should prevent even bigger losses in France, Germany and the UK. However, a recent outbreak of BTV-8 related to imported vaccinated cattle in Hungary, raised questions about the robustness of the BTV vaccinations in the September 16, 2008 Standing Committee of the Food Chain and Animal Health (SCoFAH) [meeting](#)². Other BTV virus types also seem to be progressing northwards in all Mediterranean Member States. See also [DGSANCO BTV website](#)³ and GAIN [E48076](#).

2

http://ec.europa.eu/food/committees/regulatory/scfcah/animal_health/presentations_en.htm#16092008

³ http://ec.europa.eu/food/animal/diseases/controlmeasures/bluetongue_en.htm

Bovine Spongiform Encephalopathy (BSE)

Incidences of new BSE cases continue their rapid decrease from the past years, indicating the effectiveness of the EU BSE measures. In 2007, 14 EU Member States even reported no new cases, with many other Member States recording only one or two cases. As a result, the EC has updated its action plan under the TSE Roadmap. The most important change will allow Member States to halt the systematic testing at slaughter of all cattle over 30 months of age, also known as "active monitoring", and instead continue BSE monitoring on a risk-based system.

Bovine brucellosis

In early July 2008, The Netherlands identified Bovine Brucellosis (BB) in young calves imported from the United Kingdom for veal production. Dutch and Belgian farmers implemented a self-imposed import ban on young calves from the UK. At the September 3 meeting of the Standing Committee of the Food Chain and Animal Health (SCoCAH) there was general consensus on the need to ensure that bovine tuberculosis-free (TB OF) status is properly granted to the herds, as this is the basic requirement in order to ensure safe trade; the pre-movement testing is not suitable for animals younger than 42 days of age due to the lack of sensitivity of the test when used on these animals; there is a need to have proportionate and effective measures in order to address the risk posed by these animals that cannot be tested before movement. As a result, a regime of movement restrictions was agreed to for trading animals below 42 days of age.

Additional information regarding EU import rules, food laws and trade is available at the USEU website <http://useu.usmission.gov/agri/>; E-mail: AgUSEUBrussels@usda.gov

Related reports from FAS EU offices

E48094	Livestock and Products, http://www.fas.usda.gov/gainfiles/200808/146295593.pdf	8/21/2008
E48036	EU agrees on two percent milk production quota expansion for 2008/09; http://www.fas.usda.gov/gainfiles/200804/146294153.pdf	3/31/2008

These reports can be accessed through website <http://useu.usmission.gov/agri/> or through the FAS website <http://www.fas.usda.gov/scriptsw/attacherep/default.asp>.