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Canada

Agricultural Situation

Dairy Products Annual

2008

Approved by:
Robin Tilsworth
U.S. Embassy

Prepared by:
Darlene Dessureault

Report Highlights:
Canadian milk production is forecast to remain in the range of 8.21-8.25 million metric tons in 2008 and 2009. The slight increase reflects need to rebuild stocks. Cheese production is forecast to decline slightly to 306,000 metric tons in 2008 and decline further in 2009 to 305,000 metric tons due to reduced consumer demand for specialty cheese during tight financial times. Milk consumption remains flat, averaging around 83 liters per person with increasing demand for lower fat milk and products. Increasing use of the Import for Re-Export Program has resulted in some increase in imports but these commodities are required to be exported after processing. Canada's new cheese compositional standards take effect on December 14, 2008 and are generally aimed at increasing the use of Canadian fluid milk. As Canadian cheese producers adapt to the new requirements use of other dairy ingredients will shift and trade will be affected but the magnitude cannot yet be evaluated.

Includes PSD Changes: No
Includes Trade Matrix: No
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Ottawa [CA1]
[CA]

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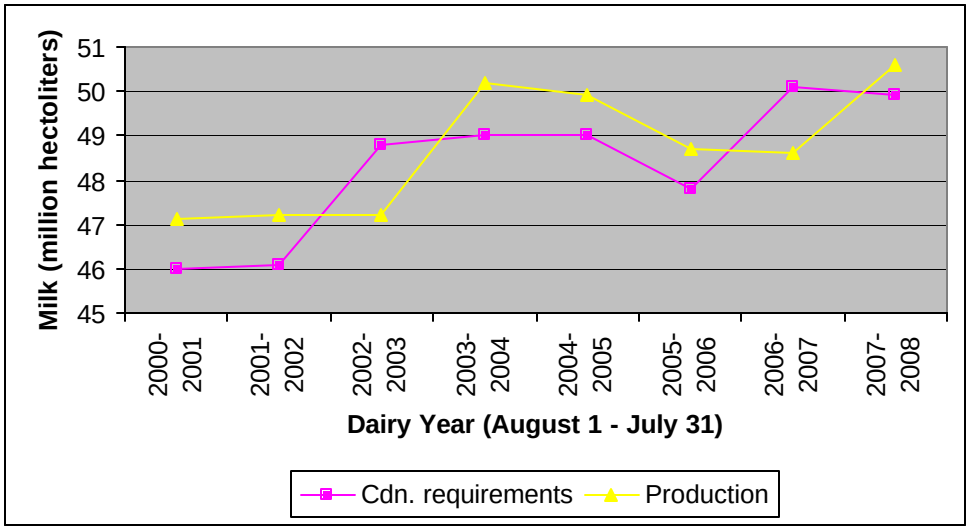
PRODUCTION

Milk production in Canada supplies two markets. The fluid milk market includes creams and flavored milks. The industrial milk market is milk used for to make products such as butter, cheese, yogurt, ice cream and milk powders. In Canada, provincial milk marketing boards maintain responsibility for setting production limits of its own fluid milk, pricing formulas, quota policies and other regulations. Industrial milk production levels are allocated using a national management tool called the Market Sharing Quota (MSQ). Quota is allocated on a butterfat basis. It is set by the Canadian Milk Supply Management Committee (CMSMC), which applies the terms of the National Milk Marketing Plan (a federal-provincial agreement) to establish each province's share of the MSQ. The provinces are then responsible for distributing shares of the quota to producers according to provincial policies and in accordance with pooling agreements.

The CMSMC sets the MSQ based on the recommendations of the Canadian Dairy Commission (CDC). The CDC monitors the trends in Canadian dairy requirements (demand) and makes recommendations on the necessary adjustments to reflect changes in demand for milk for industrial dairy products. Figure 1 illustrates the increase in Canadian dairy requirements and milk production for industrial purposes over time by dairy year. While Canadian dairy requirements for dairy year 2007-2008 (August 1 – July 31) have stayed at relatively the same level as the previous year, milk production has increased 4% compared to the previous year. This is due to the fact that in 2006-2007 the dairy requirements were being met through a release of stocks rather than an increase in production. In dairy year 2007-2008, an increase in production from the previous year's level was needed to meet the Canadian dairy requirements.

Figure 1: Canadian Dairy Requirements and Production for Industrial Milk Market



Source: Canadian Dairy Commission; www.cdc.ca/cdc/index_en.asp?caId=812&pgId=2180

Based on 6 months of production data of milk produced for the fluid milk market and for the industrial milk market, total milk production for calendar year 2008 is forecast to increase to 8.27 million metric tons (MMT) from 8.21 MMT in 2007. The increase in production from the previous year is in response to the need to rebuild stocks to prevent a shortage in the fall. For 2009, milk production is forecast to remain at relatively the same level, or perhaps decrease slightly if support prices are increased further to reflect increases in dairy producer's costs of production. Milk production for 2009 is forecast at 8.25 MMT.

Total cheese production for 2008 is expected to decrease to 306 thousand metric tons (TMT), a 1% decrease from year 2007 levels of 308 TMT. Cheese production has been adjusted to exclude fresh cheeses such as ricotta, cream cheese, and cottage cheese. Production of specialty (variety) cheese (excluding ricotta, cream cheese, and cottage cheese) is forecast to remain at 168 TMT, the same level as in 2007. Cheddar cheese production is forecast to decrease to approximately 107 TMT in 2008, a

1% decrease from year 2007 production levels. In addition to the decrease in cheddar cheese production, a decrease in mozzarella production (including for pizza) is also principally responsible for the decrease in total cheese production in 2008. This may be a reflection of higher prices changing the demand for these products both at the consumer level and at the manufacturing level. Total cheese production is forecast to decrease a further by 2% to 305 TMT in 2009 due to an expected decrease in consumer demand. Higher dairy prices and a slowing Canadian economy resulting from the world financial crisis is expected to negatively impact consumer demand. Consumers tend to decrease their consumption of specialty cheeses during such times.

The first 8 months of butter production data from Statistics Canada shows a 7% increase in butter production in year 2008 compared to the same period of time in 2007. This increase is attributed to the need to replenish butter stocks and meet the Canadian demand. Butter production in 2008 is forecasted to reach 84 TMT by the end of the year. In 2009, butter production is forecast to decline slightly as a result of reduced demand created by the slow down of the Canadian economy. Butter is considered by many consumers to be a luxury good. Butter production has declined from a high of 99,426 MT in 1990 to a low of 75,832 MT in 2002 to a new low of 75,406 MT in 2006. Between 2002 and 2008, butter production rebounded due to the increasing demand for butter for pastries and other baked products. Butter production in 2009 is expected to fall to 80 TMT in response to a decrease in consumer demand due to tougher economic times.

Non-fat dry milk production (skim milk powder (SMP)) production for 2008 is expected to increase by 11% to 83 TMT from 79 TMT in 2007 due to an increase in butter production. Lower butter production is expected in 2009 and this is expected to result in a corresponding decline of skim milk powder production in 2009. Skim milk powder production for 2009 is expected to fall to 80 TMT.

CONSUMPTION

Per Capita Consumption of Dairy Products

Per-capita milk consumption, calculated by dividing annual fluid milk sales of standard, 2%, 1%, skim and chocolate milk by the Canadian population decreased slightly in 2007 to 82.8 from 83.0 liters per person in 2006. Consumption of higher-fat milk like 3.25% and 2%, continued to decline in 2007 as consumers continue to shift consumption away from higher-fat milk in favor of 1% and skim, and as chocolate milk continues to gain in popularity. In 2007, consumption of standard and 2 % milk decreased 3% and 1%, respectively from 2006 levels. In 2007, skim milk consumption increased by 1% from 2006 levels, as did consumption of 1% milk. Chocolate milk consumption increased again in 2007, increasing 3% from 2006 levels.

In the move away from higher-fat milk, consumers are shifting primarily towards 1% milk and chocolate milk. In 2007, standard milk accounted for 14.5% of milk sales (14.9% in 2006), 2% milk accounted for 46.0% of milk sales (down from 46.2% in 2006), 1% milk accounted for 22.1% of milk sales (up from 21.8% in 2006), skim milk accounted for 10.6% of milk sales (up from 10.5% in 2006), and chocolate milk accounted for 6.9% of total fluid milk sales (up from 6.6% in 2006). Fluid milk sales reflect the changing trend in fluid milk consumption. Canada's changing demographics and the availability of other calcium-fortified beverages such as soy beverages, has reduced consumer demand for milk over the past ten years. Immigration is responsible for the population growth in Canada and milk drinking often is not part of new Canadians' cultural eating patterns. This has a negative impact on total milk consumption in Canada. Conflicting health messages regarding the consumption of milk has also led to the increased popularity of new beverage such as soy beverages that compete with milk. The dairy industry has tried to counter this with the promotion of milk as an alternative to sugary fruit and soft drinks and as a way of combating obesity-related issues. Dairy Farmers of Canada has now focused marketing efforts on highlighting the benefits of drinking a glass of chocolate milk after a hard workout.

In 2008, based on six months of sales data, total milk per capita consumption is expected to remain unchanged from 2007 levels. Sales data shows that a 6% increase in chocolate milk sales will likely be off-set by a decrease in sales of standard milk. Increases in dairy prices and people reducing their

consumption of specialty coffees and coffee products due to a slowing Canadian economy are expecting to be contributing factors to no growth.

According to the data compiled by Agriculture Canada's Dairy Section, per-capita total cheese consumption (including fresh cheese) in 2007 was 12.65 kilograms, a 2% increase from 2006. Growth in cheddar cheese consumption (2%), and specialty cheeses (2%) are principally responsible for this increase.

In 2007, data compiled by Agriculture Canada's Dairy Section reveals that per-capita butter consumption decreased for the first time in the last 10 years. Much of the decrease can be attributed to the decrease in the number of imports arriving under the Import for Re-Export Program (IREP) for use in further processing in 2007 as these imports are a part of the per-capita consumption calculation. Per capita consumption of butter in 2007 fell to 2.65 kilograms per person from 3.83 kilograms per person in 2006, a 6% decrease. The high cost of butter and greater competition from liquid oils as consumers continue to demand healthier and lower-fat alternatives to traditional products, may also be contributing to the consumer's demand for butter.

Domestic consumption of skim milk powder decreased in 2007 by 26% from year 2006 levels to 1.78 kilograms per capita. This decrease is largely due to the reduction in skim milk powder trade going on under the IREP program. The Canadian Dairy Commission has been working hard to develop new uses and markets for the surplus powder. The Dairy Marketing Program was expanded in 2004/2005 into the area of innovation; the program's main objectives are to promote awareness and increase utilization of dairy products and components by food product manufacturers. This includes finding new and innovative uses for skim milk powder in dairy and food products. The milk produced in Canada is sold to processors through a Harmonized Milk Classification System for the manufacture of products. The products are broken into 5 classes. The creation of a new milk class that encourages the use of skim milk powder has also aided in the utilization and reduction of the surplus skim milk powder. The utilization of skim milk powder in animal feed is an additional outlet that is aggressively being pursued. The consumption of skim milk powder is expected to stay high, and will face reduced competition from imports once the impact of the new TRQ on milk protein concentrates is implemented. Of note, this new TRQ will not be applicable to the United States.

Utilization of Milk

The Canadian Dairy Commission publishes the milk utilization by class (on a dairy year basis). The price paid for milk by processors varies according to the milk class 1 - 5. For dairy year 2007-2008, on the standard basis of butterfat content (3.6 kg/hectolitre), 29.6% of all the milk produced in Canada was transformed into fluid milk, cream, and milk beverages, 34.1% into cheese, 6.4% into yogurt and ice cream, 20.8% into butter, and 8.3% into further processed products destined for the domestic and export markets. More information on the Harmonized Milk classification System is available at the following website: http://www.cdc-ccl.gc.ca/cdc/index_en.asp?caId=812&pgId=2182.

Table 1: Milk Utilization by Class (Dairy Year)

Milk Class	Milk Utilization in Million HL		% Total Milk		
	2006-2007	2007-2008	2006-2007	2007-2008	% Change
1	23.9	24.3	29.64%	29.57%	0%
2	5.5	5.3	6.82%	6.42%	-5%
3(a) and 3(b)	28	28.1	34.76%	34.13%	-2%
4(a) and 4(a)1	15.1	17.1	18.72%	20.80%	11%
4(b), 4(c), 4(d), 4(m)	1.1	0.1	1.35%	0.11%	-91%
5(a), 5(b), and 5(c)	6.4	6.8	7.94%	8.30%	4%
5(d)	0.6	0.6	0.78%	0.68%	-6%
total	**80.6**	**82.2**	**100.00%**	**100.00%**	

Source: Canadian Dairy Information Center

TRADE

Export and Import Controls for Dairy Products:

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

Regulations for Imports and Exports of Dairy Products

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

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

Export and Import Permits Act:

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

Table 2: Tariff-Rate Quotas for Dairy Imports into Canada

Dairy Product Description	Access in tons	Tariff Item Number (to 6-digit)
Fluid Milk	0	0401.10, 0401.20
Cream, not concentrated, no sugar, (heavy cream)	394	0401.30
Skim Milk Powder	0	0402.10.10
Whole Milk Powder, whether or not sweetened	0	0402.21, 0402.29
Concentrated and Evaporated milk	12	0402.91, 0402.99
Yogurt	332	0403.10
Powdered Buttermilk	908	0403.90
Liquid Buttermilk, sour cream	0	0403.90
Dry Whey	3,198	0404.10
Products consisting of natural milk constituents	4,345	0404.90
Butter, fats and oil from milk	3,012	0405.10, 0405.90
Dairy Spreads	0	0405.20
Cheese	20,412	0406
Ice cream mixes	0	1806.20, 1806.90
Food prep. With milk solids	70	1901.90
Food prep. with >= 25% ms; not for retail sale	0	1901.20
Ice cream and other edible ice	484	2105.00
Milk cream and butter subs.	0	2106.90
Non alcoholic beverages containing milk	0	2202.90
Complete feeds and feed supplements	0	2309.90

Import for Re-export Program (IREP)

Imports of dairy products/ingredients to be sold on the Canadian market are limited through import quotas and prohibitively high over-access tariffs. Canadian processors can, however, import certain dairy products/ingredients for use in the manufacturing of goods destined for export (for example pastries and confectionary items, cheeses, butter) through a program administered by International Trade Canada called the Import for Re-Export Program (IREP). Due to the fact that these goods are exported, they do not compete with domestic dairy ingredients. The advantage to Canadian exporters is that they do not suffer a competitive disadvantage as they have access to dairy products/ingredients

at world price. Details of this program is available at the following website: http://www.dfait-maeci.gc.ca/eicb//notices/ser663-en.asp . The Import for Re-export Program has grown in popularity since its creation in 2003 and is expected to continue growing in popularity due the accessibility afforded to food processors under the program.

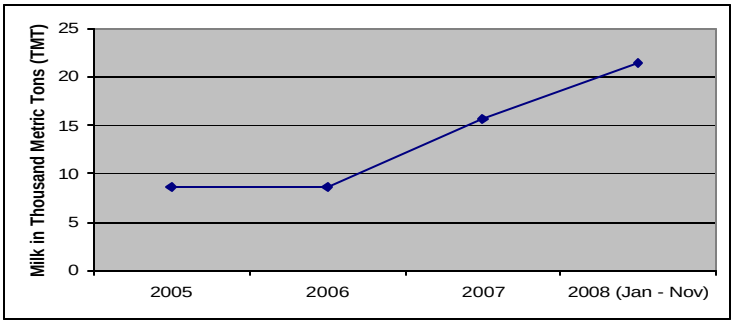
As will be discussed in further detail in the following section, for 2007, total imports of fluid milk and cream, butter, cheese, and skim milk powder were approximately 57.5 TMT (up from 56 TMT in 2006), of which imports under IREP accounted for approximately 59% (up from 56% in 2006) of total imports. The popularity of this program highlights the growing importance of the dairy ingredient market in further processing. It is key to growing the dairy industry in developed markets where dairy consumption has reached maturity. The Canadian dairy industry has in place a number of programs that compete with the IREP program in an attempt to capture this dairy ingredients market. One such program is the Special Milk Class Permit Program (class 5 of the classified dairy pricing system). The Special Milk Class Permit Program (SMCPP) was created by the Canadian Milk Supply Management Committee (CMSMC) in 1995 and is run by the Canadian Dairy Commission (CDC). The program objective is to provide eligible further processors, distributors, and animal feed manufacturers with the means to access Canadian manufactured dairy ingredients, at prices that will allow them to remain competitive in the marketplace. The prices in this class are based on US prices. Therefore, when US prices get closer to world prices, the incentive to use IREP should decrease. Despite these new efforts by dairy producers to supply these markets, IREP popularity continues to growth. This may be due to the availability of the product under the IREP program. More details on the special class program can be found on the following website: www.cdc-ccl.gc.ca/cdc/index_en.asp?caId=124&pgId=1530. Other programs used to foster the use of dairy ingredients by food processors include the CDC's Innovation Support Fund and the Domestic Dairy Product Innovation Fund.

Imports of Fluid Milk, Cheese, Butter, Skim Milk Powder

Fluid milk and Cream

The fluid milk access level for is 64,500 MT, a figure that represents estimated annual cross-border purchases by Canadian consumers. There is no commercial quota available for fluid milk. The goods are imported under ***General Import Permit No. 1 - Dairy Products for Personal Use.*** Small amounts of fluid milk are also imported under supplemental permits issued by International Canada (IT) Canada, and through the IREP program which accounts for nearly 100% of milk imports. In 2007, IT Canada issued supplemental permits for 55 MT of fluid milk and for 15,678 MT of fluid milk under the IREP program for fluid milk imports totaling 15,733 MT. Despite efforts to increase milk usage under special classes program, IREP trade continued to grow. As of mid-November 2008, IT Canada, had issued permits for 21,527 MT fluid milk under the IREP program, and 45 MT of fluid milk under supplemental permits for other purposes. As of mid-November of 2008, fluid milk imports under IREP had surpassed year 2007 milk import levels by nearly 37%. Total fluid milk imports in 2008 are expected to reach close to 23 TMT. This increase is due to the increased usage of the IREP program. In 2009, fluid milk imports are expected to fall due to an anticipated economic slowdown that may slow the growth in demand experienced over the last few years.

Figure 2: Growth of Milk Imports under the Import for Re-export Program (IREP); Years 2005-2008



Source: EMP TRQ Import Summary (Foreign Affairs and International Trade Canada)

Cream, unlike fluid milk, has a small commercial quota, which is determined on a dairy year (August-July) basis rather than an annual calendar year (CY) basis. The cream access level is 394 MT. Cream imports continue to increase due to the increased usage of the Import for Re-Export Program. In calendar year 2007, imports of cream totaled 3,637 MT. Based on 8 months of data, imports of cream in 2008 show an 11.3% increase over year 2007 levels for the same time period. Imports for cream are forecasted to increase in 2008 to 3,800 MT from 3,600 MT in 2007.

Total milk imports (fluid milk plus cream) for 2008 is expected to reach at 26.8 TMT, a 44% increase from year 2007 levels of 16 TMT. This increase is due to the increased usage of the IREP for fluid milk in 2007. IREP accounted for approximately 98% of the total milk imports in 2007. Due to market proximity and the perishable nature of fluid milk and cream, the United States is the primary source for imports of milk and cream into Canada.

Cheese

The commercial quota on cheese is 20,411,866 kilograms, and 66% of that cheese quota is specifically allocated to the European Union. In year 2007, International Trade Canada issued permits for 25,635 MT of cheese, with IREP imports accounting for 15% of that total. Year-to-date import trade data as of mid-November (excluding fresh cheeses) suggests that year 2007 cheese imports are 4% lower than they were a year ago for the same time period. As a result, cheese imports are expected to decrease to 24,600 MT in 2008. Specific, year to date IREP data was not available at the time of this report, however IREP trade usually constitutes between 12% and 15% of total cheese imports and import levels tend to stay stable due to the TRQ in place. Therefore, post predicts a similar level of cheese imports for 2009 (24,500-25,000 MT).

Due to the country specific access, the EU-25 remains the largest cheese (excluding fresh cheeses) supplier to Canada. In 2007, France and Italy together supplied 36% of the cheese imported into Canada (4,942 MT and 4,171 MT, respectively). The United States increased imports 5% in 2007 and U.S. cheese accounted for 23% of cheese imports in 2007 (5,778 MT). Year-to-date data as of mid-November shows that imports of U.S. cheese has increased by 14% in 2008 from 2007 levels and will likely account for close to 26% of cheese imports. This is likely due to a growth in IREP trade. United State's cheese exports may be negatively impacted due to new cheese standard regulations that Canada introduced a year ago and which come into effect December 14th, 2008. It is difficult to estimate how proof of compliance requirements will affect trade. For this reason, until further information is available, post predicts U.S. share of cheese imports into Canada to be close to 25% of total cheese imports into Canada in 2009.

Butter

Total butter imports are comprised of three HS codes: 0405.10.00 for butter, 0405.90.00 for fats and oils from milk, and HS 0405.20.00 (zero TRQ access) for dairy spreads, which contain butter. Similar to cream imports, the butter import access level is determined based on the dairy year, rather than the calendar year. The access quota is set at 3,274 MT and applies only to the butter and fats and oils from milk. IREP data for butter on a calendar year was not available at the time of this report.

For 2007 calendar year under HS 0405 totaled 13,255 tons, with butter accounting for 7,949 MT and oils and fats from milk accounting for 5,305 MT. Dairy spreads accounted for 0.469 MT. Seventy-five percent of the butter imports and all imports of oils and fats from milk took place under the IREP in 2007. As of mid-November 2008, total butter imported under the IREP program was 50% below total IREP butter for the same period in 2007. Due to the decreased usage of the IREP program for butter, total imports under tariff lines HS 0405 are expected to decrease to 8,000 MT in 2008 from 13,000 MT in 2007. Imports are expected to recover slightly and increase to 10,000 MT in 2009.

In 2007 New Zealand was the largest total butter supplier, supplying 46% of the imports. The United States came in third after Uruguay, supplying almost 10% of total butter imports. Under HS 0405.10 (butter), New Zealand remained Canada's largest source of butter by supplying 38% of imported butter. Uruguay and the United States supplied 22% and 14% respectively of butter imports in 2007. Through mid-November 2008 year-to-date country of origin trade data shows the U.S. butter shipments into Canada were two hundred percent higher than what was imported from the United States for the same

period the previous year, accounting for 90% of year-to-date butter imports. This increase could largely be accredited to increase costs of transportation giving the U.S. an advantage due to proximity to the Canadian market, as well as high U.S. supplies.

In 2007, the largest supplier of oils and fats deriving from milk was New Zealand, supplying 58% of the imports under HS 0405.90. The U.S. shipments accounted for 2% of imports. Through mid-November 2008, year-to-date data suggests that in 2008, U.S. product could account for as much as 30% of imported fats and oils derived from milk.

Non-fat Dry Milk (Skim Milk Powder)

In 2007, import permits for re-exports and supplementary imports were issued for 2,866 MT of skim milk powder (SMP), and almost 2 MT of SMP entered under the over access line. Total imports of SMP in 2007 equaled 2,868 MT. As of mid-November 2008, import permits for re-export of 3,707 MT of SMP were issued and 19 MT of SMP were imported under supplemental permits. SMP imports for year 2008 are expected to increase to 3,800 MT, 32% above year 2007 levels. The United States accounts for nearly 100% of Canadian skim milk powder import. Almost all trade on skim milk powder takes place under the IREP. Imports in 2009 are expected to fall to 2,000 MT as demand decreases due to the anticipated economic slow down.

Exports

The 2002 ruling by the World Trade Organization (WTO) capped subsidized exports of dairy products from Canada. As a result, Canadian dairy producers are limited in the quantity of dairy products that can be exported from Canada and this has resulted in a negative trade balance in dairy products. As the difference between Canada's domestic support prices and world prices increases, the amount that Canada can export within the WTO limits decreases.

Total milk and cream exports in 2007 totaled 3,576 TMT, with fluid milk accounting for 46% of the total. In 2008, based on year-to-date trade data through mid-November, fluid milk and cream exports are expected to decline by 30% to 2,500 MT in 2008. Milk exports (excluding cream) in 2008 are expected to fall 76% to 1,250 MT. In 2007, the United States and Taiwan each received 36% and 51%, respectively, of the milk and cream exported from Canada. Year-to-date country of origin trade data through mid-November suggests that this trend will be not be repeated in 2008 as the U.S. market may account for only 25% of milk export markets for Canada. This is likely due to high U.S. milk supplies in 2008. Milk exports for 2009 are forecast to be 3,000 MT.

Total cheese exports (excluding cream and fresh cheeses) for 2007 were 8,645 MT. Based on seven months of available data, cheddar exports in year 2008 are expected to increase to 10,350 MT. In 2008, the United States and the United Kingdom remain the two primary markets for Canadian cheese, accounting for 42% and 44% of cheese (excluding cream and fresh cheeses) exports, respectively. During the first eight months of 2008, cheese exports to the United States remained at the same levels they were at the same time period the previous year. Canada has specific market access for 4,000 MT in the U.K. markets and has three specific quotas for U.S. cheese markets: cheddar, Swiss- and Emmenthal-type cheeses, and non-specific cheeses. In 2009, cheese exports are expected to decline slightly from year 2008 levels as a weaker Canadian dollar will not be able to completely off-set a decrease in demand resulting from the economic slowdown. Cheese exports in 2009 are forecast to be 9,000 MT.

Total butter exports are comprised of three HS codes: 0405.10.00 for butter, 0405.90.00 for fats and oils from milk, and 0405.20.00 for dairy spreads, which contain butter. Total butter exports (all three lines) for 2007 totaled 12,977 MT. Dairy spreads accounted for 91% of those exports, while oils and fats derived from milk and butter and accounted for 8% and 1%, respectively. In 2007, the United States received 98% of the exports under these lines (12,737 MT), with 92% of it in the form of dairy spreads, almost 8% in the form of oils and fats from milk, and less than 1% in the form of butter. Based on seven months of data, 2008 exports are forecast to decrease to 2,000 MT, an 85% decrease from 2007 levels. This drop is largely attributable to a significant drop in dairy spreads exports. Increased supplies in the United States and the need to rebuild Canadian stocks are likely explanations for this drop. A reduced supply in the United States combined with a weaker Canadian dollar will likely

result in an increase in demand and a rebounding of Canadian dairy spread exports in 2009. Post forecasts butter exports to increase to 11,000 MT in 2009.

The 2002 WTO ruling capped Canada's exports of SMP at 44,953 MT limiting the ability of the industry to reduce the structural surplus of SMP that is inherent in an industry where the quota system is based on butterfat. Total non-fat dry milk (skim milk powder (SMP)) exports in 2007 reached 13,918 MT. In 2007, Mexico, South Africa, Egypt, and Morocco were the main destinations for Canadian exports of skim milk powder receiving 17%, 14%, 14%, and 11% of Canadian skim milk powder exports, respectively. In 2008, exports, based on seven months of export data are forecast to increase to 15 MT. This projected decline is due to depreciation of the Canadian dollar vis-à-vis the American dollar in the latter part of the year, as well as the lower price for SMP. Increased domestic demand for skim milk powder in 2009 is expected to keep export levels of skim milk powder at similar levels to those in 2008.

STOCKS

In order to ensure that supply management operates as it is designed and the Canadian market has a constant supply of product, the Canadian Dairy Commission (CDC) holds stocks of butter in storage throughout the year. This is referred to as the normal butter inventories of 12,000 MT. In addition, the CDC also purchases butter that is surplus in order to balance the system. The CDC also purchases and sells stocks of milk powders. Beginning stocks in 2008 were 11,000 MT, and, due in large part to the decrease in exports, beginning stocks for 2009 are expected to be 15,000 MT. With an increase in production of skim milk powder forecast in calendar year 2008 but with a corresponding increase in consumption in 2008 due to efforts by the CDC to find additional markets for the surplus skim milk powder, Post is expecting that stocks held by the CDC will decline in dairy year 2007/2008.

DAIRY POLICY DEVELOPMENTS

Article XXVIII Action

Negotiations under GATT Article XXVIII of the General Agreement on Tariffs and Trade (GATT) to restrict imports of milk protein concentrates (MPCs) were concluded in 2008. GATT Article XXVIII provides a mechanism for member countries to renegotiate their tariff concessions in the WTO, allowing increased tariffs and setting new tariff rate quotas. In exchange for withdrawing a concession, compensation must be given to affected members. A formula for compensation is included in the GATT provision and suggests a guarantee of access 10% above the current highest level of imports for the tariff item in question. This trade action was initiated in response to Canadian dairy industry concerns about the increasing use of these concentrates in making cheese and other dairy products. The Article XXVIII action is not applicable to the United States as a signatory of NAFTA. The measure is expected to negatively impact the future growth of MPC imports from New Zealand and Europe. As a result of these negotiation, milk protein substances with a milk protein content of 85% of more by weight and that does not originate in a NAFTA country or Chile, Costa Rica or Israel, will be subject to import controls (classified under tariff items HS 3504.00.11 and HS 3504.00.12 of the Schedule to the Customs Tariff.). For more information, please see the publication in the September 17, 2008, Canada Gazette.

Cheese Compositional Standards

In late December 2007, Canada published amendments to two existing federal regulations, the Dairy Products Regulations and the Food and Drug Regulations, in order to introduce revisions to the allowable ingredients used to make cheese. The new restrictions will likely result in an increased usage of domestic raw milk. The regulations result in this by setting a minimum level of raw milk to be used to produce various cheeses and introduce specific compositional standards by type of cheese. Imported cheese will have to meet the same regulatory standards. In recent years, there has been a notable increase by Canadian dairy product manufacturers in the use of other milk products (i.e., milk solids) to make cheese, such as skim milk powder, whey and milk protein concentrates. There was a corresponding increase in the level of Canadian imports of milk proteins destined for cheese making. Critics of the government action claim that the regulatory revisions are a trade barrier designed to increase the level of Canadian milk in domestic cheese manufacturing. The United States and U.S. dairy organizations filed comments during the regulatory proposal stage. Among other issues, the

United States objected to the introduction of a new Canadian import license scheme which threatens to add an additional layer of licensing on importers already dealing with import allocations under Canada's tariff rate quota for cheese. The new cheese regulations may also result in a displacement of dairy ingredients trade. The new restrictions risk resulting in surplus of domestic whey being produced which could displace whey that was previously imported. In the official publication of the regulatory revisions, Canada claims that the amendments take into account the comments received and are consistent with international food standards. Canada also claims that the action harmonizes the existing federal regulations governing cheese production, enhances consumer interests and allows for technological advances in cheese making. The revised Regulations come into force on December 14, 2008. A copy of the official publication of the amendments on the new Canadian compositional standards for cheese is available on the Canada Gazette (Part II, December 26, 2007, Vol. 141, No. 26) website at: http://canadagazette.gc.ca/index-e.html

In response to the new regulations on cheese compositional standards, three Canadian dairy processors have petitioned the federal court for a judicial review of the new cheese regulations. The judicial review will look at the question of whether or not proper procedure was followed in developing the regulations (the lawfulness of a decision or action made by a public body), and is not necessarily a judgment on the regulations themselves. The application is likely to be granted and the process will likely only be concluded late 2009. Saputo Inc., Kraft Canada Inc., and Parmalat Canada Inc. the three dairy processors involved in the suit, are seeking a judicial review of the amendments made to Division 8 of the Food and Drugs Regulations and to the Dairy Products Regulations which set a minimum amount of milk required to be used in cheese production. They are asking the court to find the regulations invalid and without legal effect. The dairy processors are arguing that the regulations (i) are meaningless (not enforceable), (ii) lack the requisite level of uniformity and objectivity, (iii) are an impermissible sub-delegation of the discretionary regulation-making authority vested solely in the Governor-in-Council to the Canadian Food Inspection Agency (CFIA), and (v) were promulgated for the purpose of providing an economic benefit to dairy producers at the expense of dairy processors and others. In addition, the dairy processors are challenging the authority of the government to make a federal regulation regarding the cheese standards due to the fact that the regulation of the milk in the controlled by the provinces.

Canada Published Volume and Price Triggers for Special Agricultural Safeguards

Canada has given notice of the volume and price triggers that will be used to operationalize the World Trade Organization (WTO) Special Agricultural Safeguard (SSG) for Canada's supply-managed products. The Special Agricultural Safeguard is a provision that allows additional duties to be triggered automatically when import volumes rise above a certain level, or if prices fall below a certain level. The government's notice containing the price and volume triggers for the various tariff lines is available at the following website: http://www.agr.gc.ca/itpd-dpci/technical/ssg_e.htm. The government of Canada first announced its intention to operationalize the SSG on February 7, 2008 (see GAIN report CA8006). These measures will be applicable against imports from the United States if the volume or price triggers are activated. The decision to apply the surtaxes will be done on a case by case basis and require an order in council. For more detail, please see report CA8060 available on the FAS website.

STATISTICAL TABLES

Table 1: Fluid Milk PSD

Dairy, Milk, Fluid Canada	2007			2008			2009		
	1000 MT			1000 MT			1000 MT		
	Market Year Begin: Jan 2007			Market Year Begin: Jan 2008			Market Year Begin: Jan 2009		
	Annual Data Displayed		New Post	Annual Data Displayed		New Post	Annual Data Displayed		Jan
			Data			Data			Data
Cows In Milk	1005	1005	995	1005	1000	985	0	0	980
Cows Milk Production	8145	8145	8212	8140	8140	8270	0	0	8250
Other Milk Production	0	0	0	0	0	0	0	0	0
Total Production	8145	8145	8212	8140	8140	8270	0	0	8250
Other Imports	16	16	16	16	16	23	0	0	15
Total Imports	16	16	16	16	16	23	0	0	15
Total Supply	8161	8161	8228	8156	8156	8293	0	0	8265
Other Exports	4	4	3	3	3	1	0	0	3
Total Exports	4	4	3	3	3	1	0	0	3
Fluid Use Dom. Consum.	3060	3060	3086	3018	3058	3145	0	0	3135
Factory Use Consum.	4713	4713	4748	4750	4710	4735	0	0	4715
Feed Use Dom. Consum.	384	384	391	385	385	412	0	0	412
Total Dom. Consumption	8157	8157	8225	8153	8153	8292	0	0	8262
Total Distribution	8161	8161	8228	8156	8156	8293	0	0	8265
CY Imp. from U.S.	15	15	15	15	15	22	0	0	14
CY. Exp. to U.S.	8	2	2	2	2	2	0	0	2

Table 2: Cheese PSD

Dairy, Cheese Canada	2007			2008			2009		
	1000 MT			1000 MT			1000 MT		
	Market Year Begin: Jan 2007			Market Year Begin: Jan 2008			Market Year Begin: Jan 2009		
	Annual Data Displayed		New Post	Annual Data Displayed		New Post	Annual Data Displayed		Jan
			Data			Data			Data
Beginning Stocks	62	62	62	62	62	68	0	0	70
Production	297	297	308	300	300	306	0	0	305
Other Imports	25	25	26	25	25	25	0	0	25
Total Imports	25	25	26	25	25	25	0	0	25
Total Supply	384	384	396	387	387	399	0	0	400
Other Exports	8	8	9	8	8	10	0	0	8
Total Exports	8	8	9	8	8	10	0	0	8
Human Dom. Consumption	314	314	319	317	317	319	0	0	315
Other Use, Losses	0	0	0	0	0	0	0	0	0
Total Dom. Consumption	314	314	319	317	317	319	0	0	315
Total Use	322	322	328	325	325	329	0	0	323
Ending Stocks	62	62	68	62	62	70	0	0	77
Total Distribution	384	384	396	387	387	399	0	0	400
CY Imp. from U.S.	5	5	6	0	0	6	0	0	5
CY. Exp. to U.S.	3	3	4	0	0	4	0	0	3

Table 3: Butter

Dairy, Butter Canada	2007			2008			2009		
	1000 MT			1000 MT			1000 MT		
	Market Year Begin: Jan 2007			Market Year Begin: Jan 2008			Market Year Begin: Jan 2009		
	Annual Data Displayed		New Post	Annual Data Displayed		New Post	Annual Data Displayed		Jan
			Data			Data			Data
Beginning Stocks	10	10	10	8	8	11	0	0	15
Production	77	80	79	80	83	84	0	0	80
Other Imports	13	13	13	20	20	8	0	0	10
Total Imports	13	13	13	20	20	8	0	0	10
Total Supply	100	103	102	108	111	103	0	0	105
Other Exports	16	16	13	16	16	3	0	0	11
Total Exports	16	16	13	16	16	3	0	0	11
Domestic Consumption	76	79	78	81	84	85	0	0	82
Total Use	92	95	91	97	100	88	0	0	93
Ending Stocks	8	8	11	11	11	15	0	0	12
Total Distribution	100	103	102	108	111	103	0	0	105
CY Imp. from U.S.	1	1	3	1	1	1	0	0	1
CY. Exp. to U.S.	17	17	13	17	0	2	0	0	10

Table 4: Nonfat Dry Milk

Dairy, Milk, Nonfat Dry Canada	2007			2008			2009		
	1000 MT			1000 MT			1000 MT		
	Market Year Begin: Jan 2007			Market Year Begin: Jan 2008			Market Year Begin: Jan 2009		
	Annual Data Displayed		New Post	Annual Data Displayed		New Post	Annual Data Displayed		Jan
			Data			Data			Data
Beginning Stocks	23	15	15	25	19	20	0	0	41
Production	75	75	75	76	76	83	0	0	80
Other Imports	3	3	3	3	3	4	0	0	2
Total Imports	3	3	3	3	3	4	0	0	2
Total Supply	101	93	93	104	98	107	0	0	123
Other Exports	8	8	14	8	8	15	0	0	13
Total Exports	8	8	14	8	8	15	0	0	13
Human Dom. Consumption	66	64	57	70	70	50	0	0	50
Other Use, Losses	2	2	2	1	1	1	0	0	1
Total Dom. Consumption	68	66	59	71	71	51	0	0	51
Total Use	76	74	73	79	79	66	0	0	64
Ending Stocks	25	19	20	25	19	41	0	0	59
Total Distribution	101	93	93	104	98	107	0	0	123
CY Imp. from U.S.	3	3	3	3	3	4	0	0	2
CY. Exp. to U.S.	0	0	0	0	0	0	0	0	0