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Dairy and Products

Semi Annual

2009

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Report Highlights:

In January 2009, the European Commission introduced market intervention measures to prevent further decreases of farm-gate milk prices and keep EU dairy products competitive on the world market. Active intervention tools currently include export subsidies, private storage aid and intervention procurement starting in March 2009. At the same time the EC increased milk production quota gradually under the "Health Check". It appears contradictory and expensive to allow supply to increase and increase market intervention to sop up the surplus. Producers get confused signals and the expected market liberalization from the health check is wasted.

Includes PSD Changes: No
Includes Trade Matrix: No
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Executive Summary

EU-27 milk production will likely peak in mid 2009 and start to decline in the second half of the year. An overall increase of milk production will be used mostly for higher output of butter and nonfat dry milk (NFDM) which will also benefit from EC market intervention. Cheese production is expected to remain at the 2008 level while output of whole dry milk (WDM) is forecast to decrease in 2009. Consumption of dairy products in 2009 is expected to remain at the 2008 level with the exception of WDM and butter which will be used by the domestic food industry due to the decrease of exports.

Market intervention in 2009 is expected to keep EU dairy products at the world market price. The level of intervention prices and export subsidies depends strongly on the euro/US\$ exchange rate. It is unlikely that the EU will fully use its intervention limits on stocks of butter and NFDM unless the exchange rate becomes more unfavorable for EU exporters.

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 our colleagues that helped write this report. 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	24178	24178	24000	23951	23951		23950	23900
Cows Milk Deliv. to Dairies	132600	132604	132604	133670	134000	134346		134400	134500
Other Milk Production	4125	4270	4270	4150	4259	4259		4260	4260
Total Milk Production	136725	136874	136874	137820	138259	138605		138660	138760

Extra EU27 Imports	7	12	12	10	6	6		5	5
TOTAL SUPPLY	136732	136886	136886	137830	138265	138611		138665	138765
Extra EU27 Exports	155	156	156	160	170	170		150	150
Fluid Use Dom. Consum.	34000	33334	33334	34000	33569	33669		33645	33700
Factory Use Consum.	102577	103396	103396	103670	104526	104772		104870	104915
Feed Use Dom. Consum.	0	0	0	0	0	0		0	0
Total Dom. Consumption	136577	136730	136730	137670	138095	138441		138515	138615
TOTAL DISTRIBUTION	136732	136886	136886	137830	138265	138611		138665	138765

Source: FAS EU offices

2009

EU-27 milk production is expected to peak in mid 2009 and start to decline in the second half of the year due to drop of raw milk prices, reduction of export demand for dairy products and increased costs of production. In reaction to the deteriorating market situation farmers are expected to reduce dairy herds and lower milk output. Increased dairy quota resulting from the Health Check decisions (see policy section) and market intervention introduced by the European Commission (EC) in January 2009 are not expected to have a major impact on reduction of milk production which will start later in 2009. Overall milk output in 2009 is expected to be only slightly higher than in 2008, due to a delayed reaction of the EU farmers to the record drop in farm-gate prices and other oversupply problems.

The **United Kingdom (UK)** could be as much as 9 percent under (the increased) quota in MY2008/9 (April-March). At less than 13,500 MMT this will be the lowest output in the UK for nearly 40 years due to poor returns and tight margins in the UK dairy sector. Total utilization of milk for the liquid market is marginally up and cheese output is running very much in line with the previous year. It is butter production which is down. In the **Czech Republic** producer prices of raw milk dropped by around 30 percent January - December 2008. Madeta, the largest milk processor, cancelled contracts to its major milk supplier JIH starting in April. This puts over 200 milk producers in trouble and will lead to significant milk surplus, higher than new measures (intervention purchases and export subsidies) will be able to cover. JIH also sells part of its milk to German Cham. Czechs can't place all its milk on the German market, since the German dairy sector faces problems as well. **German** domestic consumers (household and food industry) reduced consumption in the second half of 2008 as a reaction to higher prices following the German milk strike. (Retail prices increased by about 10%, household consumption fell by 11 percent). Consumption is gradually increasing again as consumers (households) realize that retail prices are coming down. Reduced exports of butter and Non Fat Dry Milk (NFDM) and reduced domestic consumption have caused producer prices to decrease substantially. **Italy** successfully negotiated with the EC under the "Health Check" agreement to allow the entire 5-percent increase in its milk production quota to become effective April 2009, while the 5-percent increase for other Member States will be introduced gradually over five years. The increased quota will allow Italian producers to absorb the productive surplus, minimize future overproduction fines, and increase milk production worth 240 million Euros annually. Industry sources speculate that the EU decision to grant Italy the five-percent milk quota up front is aimed more at reducing the super levy bill than providing Italy an incentive to produce more milk. Milk production is on the decline in **France** and it will again under-utilize its production quota in MY (April-March) 2008/09 (by at least 1 million MT out of 25.1 million MT). Declining producer prices for milk and rising feed prices increased slaughter of dairy cows in the past few months, therefore increasing beef meat availability, while consumption is reduced due to the current adverse economic conditions. The financial crisis impacts dairy exports as importers are facing difficulties to obtain bank guarantees. During the end of 2008 and January 2009, **Benelux** milk production remained at a high level as farmers took

advantage of higher milk prices. Elevated milk production and weak demand created a dairy oversupply. Milk prices are expected to decline further with a downward effect on milk deliveries and production of cheese, butter and milk powders. Dutch cheese production has already stagnated mainly due to limited exports. In **Poland**, 2009 milk deliveries are expected to be slightly higher than in 2008 but many farmers, especially those with small scale production have declared that they will resign from milk production because of unprofitable economic conditions.

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	0
Production	6760	6760	6760	6840	6840	6840		6870	6850
Extra EU27 Imports	93	93	83	85	85	93		85	85
TOTAL SUPPLY	6853	6853	6843	6925	6925	6933		6955	6935
Extra EU27 Exports	534	534	534	510	510	490		510	480
Domestic Consumption	6319	6319	6309	6415	6415	6443		6445	6455
Other Use, Losses	0	0	0	0	0	0		0	0
TOTAL Dom. Consumption	6319	6319	6309	6415	6415	6443		6445	6455
Ending Stocks	0	0	0	0	0	0		0	0
TOTAL DISTRIBUTION	6853	6853	6843	6925	6925	6933		6955	6935

Source: FAS EU offices

2009

Cheese is expected to remain the most predictable dairy product on the unstable EU market. Cheese consumption in the EU is forecast to continue growing in 2009 just as output is growing slowly and exports are down. Domestic consumption may be affected later in 2009 and 2010 by the developing financial crisis in Europe. Cheese imports are forecast to remain at a low level due to growing domestic supplies and reduced purchasing power of European consumers. Exports will depend mostly on the exchange rate of Euro and US\$.

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	46	46		65	53
Production	2040	2053	2053	2055	2060	2072		2075	2110
Extra EU27 Imports	88	91	93	88	88	65		88	80
TOTAL SUPPLY	2250	2266	2268	2193	2194	2183		2228	2243

Extra EU27 Exports	260	206	216	220	125	151		160	150
Domestic Consumption	1940	2014	2006	1933	2004	1979		2018	2013
Other Use, Losses	0	0	0	0	0	0		0	0
TOTAL Dom. Consumption	1940	2014	2006	1933	2004	1979		2018	2013
Ending Stocks	50	46	46	40	65	53		50	80
TOTAL DISTRIBUTION	2250	2266	2268	2193	2194	2183		2228	2243

Source: FAS EU offices

2009

EU butter production is forecast to increase in 2009 as increased milk output absorbs most of the butterfat from higher milk output. Imports are forecast to decline due to reduced demand from the food processing industry, however, EU import quota will be almost fulfilled. Exports are expected to remain at the reduced 2008 level thanks to export refunds. Butter prices are expected to decrease due to higher supplies and export refunds which would make EU butter more competitive on the world market. The level of export refunds set by the EC in January 2009 is not enough for most EU exporters who claim that EC market intervention is not yet effective.

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	0
Production	770	776	776	780	814	860		800	775
Extra EU27 Imports	3	2	2	2	1	1		1	1
TOTAL SUPPLY	773	778	778	782	815	861		801	776
Extra EU27 Exports	395	366	366	395	400	484		386	386
Domestic Consumption	378	412	412	387	415	377		415	390
Other Use, Losses	0	0	0	0	0	0		0	0
TOTAL Dom. Consumption	378	412	412	387	415	377		415	390
Ending Stocks	0	0	0	0	0	0		0	0
TOTAL DISTRIBUTION	773	778	778	782	815	861		801	776

Source: FAS EU offices

2009

WMP production is forecast to decrease in 2009. Additional raw milk supplies will be used mostly to produce fresh dairy products, butter and NFDM. Exports are expected to drop due to lower output, reduced demand on the world market 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	0
Production	975	1005	1005	990	1015	990		1050	1050
Extra EU27 Imports	25	10	10	25	5	8		5	5
TOTAL SUPPLY	1000	1015	1015	1015	1020	998		1055	1055
Extra EU27 Exports	170	201	202	165	180	179		200	180
Domestic Consumption	830	814	813	850	840	819		855	825
Other Use, Losses	0	0	0	0	0	0		0	0
TOTAL Dom. Consumption	830	814	813	850	840	819		855	825
Ending Stocks	0	0	0	0	0	0		0	50
TOTAL DISTRIBUTION	1000	1000	1015	1015	1020	998		1055	1055

Source: FAS EU offices

2009

NFDM production is forecast to increase in 2009 in line with slightly higher milk supplies and increases in butter production. The EC can procure NFDM for intervention stocks up to 109,000 MT to stabilize the market. To maintain the previous year's level of exports and domestic consumption, intervention stocks are not expected to grow to the upper limit. Introduction of export refunds in January 2009 for NFDM made EU NFDM competitive on the world market. The EC likely will combine export refunds and purchases of NFDM for intervention stocks at the levels to keep EU export prices at the world market level. It is difficult to predict how the exchange rate between Euro and US\$ will evolve later in 2009 which will have major impact on the competitiveness of NFDM exported from the EU. Expect to see subsidies rise into the spring, but have no impact on EU prices. Taking commodity off the market with intervention might eventually have a price impact, but only slight.

Policy

1. European Commission Opens Export Subsidies for Dairy Products

On January 22, 2009 the Commission Management Committee decided to open export subsidies (ES) for dairy products, the first since 2007. The detailed list of current export subsidy levels and eligible destinations is available in Commission Regulation No 140/2009 at

<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:049:0003:0006:EN:PDF>

Export refunds were activated for butter, skimmed milk powder (SMP), whole milk powder (WDM), cheese and other dairy products. Refunds for butter and SMP are fixed by tender or can be awarded via a bidding system. The frequency of the tenders will be increased from once to twice a month in order to improve the efficiency of the system. The following are annual value and volume limits (July 1 –June 30) for EC export subsidy for dairy under the Uruguay Round disciplines: cheese (€345.7 million and 331,700 MT), butter and butteroil (€945.8 million and 411,600 MT), SMP (€298.0 million and 323,400 MT) and "Other" dairy products (€724.1 million and 1,008,900 MT). (These new unilateral EU WTO limits were used for the EC EU-25 notification to WTO).

January 22, 2009, tender bids for 5,612 MT of skim milk powder (SMP) and 2,299 MT of butter were accepted. The total non-tender rate for whole dry milk (WMP) was set at 260

euros/ton and Cheddar cheese 220 euros/ton (source: Dairy Market Outlook, February 2009). The fixed export refunds SMP (170 Euros per ton), placed EU export prices from certain countries (the Netherlands, Germany) in the range of world market prices. However, other EU member states, like France or Belgium, remained uncompetitive on the SMP market. Introduction of the export subsidy for butter (450 euros per ton) lowered EU export prices. This level would not make EU dairy competitive on the world market. The Management Committee on February 19 increased the subsidy to butter to 550 euros per ton. Further increase of export subsidy will depend on euro/US\$ exchange rate and trends in world market prices for butter and NFDM.

2. European Commission reintroduces Private Storage Aid (PSA) for Butter.

In November 2008, the Commission reintroduced private storage aid (PSA) for butter effective January 1, 2009. Eligible butter also includes butter produced in December 2008. Private storage for butter usually starts on March 1 and is used by the EC as a tool to remove from the market spring/summer surplus of butter and release it in winter when supplies are lower. A flat rate of 15.62 euro/ton plus 0.44 euro/ton/day is used for the 2009 PSA scheme to cover financing and cold storage costs. In the first 3 weeks of January, 18,398 tons were put into the 2009 PSA scheme, at a rate of 6,000 tons a week. As of January 22, 2009, total PSA stocks of butter amounted to 46,122 tons. Under the 2008 PSA scheme, 160,000 tons of butter was offered for storage (36,000 tons more than in 2007) which must be released on the market by mid-March 2009.

3. Intervention Procurement of Butter and NFDM.

The intervention purchases for 30,000 MT of butter and 109,000 MT of SMP will open as of March 1 and extend through August 31. Production for intervention could begin on 7 February for butter and 31 January for NFDM. The current buying is fixed at 169.80 euro/100 kilograms for NFDM and 221.75 euro/100 kilograms for butter. Once intervention limits are reached the EU may continue purchases through a tendering system. To be effective, any export subsidies during this period will have to cover the difference between the world price and the EU intervention prices.

4. Reaction of EU Member States to the reintroduction of ES.

In the **UK** the trade are questioning the reintroduction of export refunds by the EU. UK commentators note that the world market is already weak and the revival of export subsidies will only further undermine world prices. [The German Farmers Union welcomed the measures as a necessary tool to stabilize the milk market and thus ultimately fix the decline in producer prices for milk.](#) The dairy processing industry views the measures as an important psychological signal that will encourage buyers (retailers and food industry) to place their orders rather than waiting for even lower prices. This would stabilize the milk price, albeit at a low level. [Regarding the actual effect on exports the dairy processing industry is more cautious and will wait to see if EU/Germany dairy will be competitive on the world market even with the refunds.](#) Regarding intervention and butter PSA they are even more skeptical as they fear that the stored volumes might have a price depressing effect once they are released from storage later in the year. Although prices are currently going down in **Sweden** and there is an over-supply on the EU/Swedish market, the Swedish industry is expecting positive long-term development driven by increased demand from India and China. It sees the reintroduction of export restitutions as a needed for a short-term injection in the EU market but welcomes a more market oriented agricultural policy in the long run, including the elimination of export subsidies. **France** was not part of the member

states calling for re-instating export subsidies. The French dairy industry believes this decision was taken for political, not economic reasons, in response to the difficult situation of dairy farmers in NMS, due to low producer prices. New exports subsidies won't increase EU exports significantly as they will only push world market prices down, and New Zealand products are likely to continue to be more competitive than EU products on world markets anyway. However, EU exports of SMP to Russia may be helped by export subsidies, as there is little competition with New Zealand SMP on this market. **Denmark** reacted to support market liberalization and the Danish dairy industry voted against the reintroduction of dairy export restitutions and intervention. They see the new measures as very short term instruments and would like to see structural adjustments in dairy herds in other states and would have liked market forces to make the necessary adjustments. The industry is displeased with the relatively heavy administration burden connected with intervention and restitutions.

5. Impact of the Health Check on EU's Dairy Sector.

In anticipation of the phasing-out of dairy quotas, five annual increases of the dairy quota of 1 percent are provided for the MY 2009/10 to 2013/14¹. Also, an adjustment in the coefficient from 0.18 to 0.09 of the fat adjustment for the individual milk deliveries for those producers with milk fat contents over their reference fat level was agreed. Further measures are to abolish Private Storage Aid (PSA) for cheese, as well as the disposal aid scheme for butter intended for pastry and ice cream and for direct consumption. The yearly amounts for intervention storage were maintained at 30,000 MT for butter and 109,000 MT for skimmed milk powder (SMP). The options of PSA for butter and SMP and disposal aid for SMP in feed are also maintained. Because milk production likely will further concentrate in the most competitive areas as a result of these measures, individual Member States (MS) are allowed to provide special support for dairy producers in Least Favored Areas (LFAs), mostly mountainous areas, through the Rural Development Program.

New milk production quota increases come on the heels of a two percent increase, which was granted EU wide for 2008/09, and three consecutive 0.5 percent increases in the EU-15 from 2006/07 to 2008/09 as previously agreed in the 2003 CAP Reform.

The milk production quota increases in the Health Check are voluntary, as well as the 2008/09 two percent increase. Not all MS are anticipated to implement these increases from the start. Indeed, France and the United Kingdom, under filling their quota in recent years, are expected to improve their quota fill rate before implementing the agreed quota extensions.

Related reports from FAS EU offices

E48116	2008 Dairy and products, Annual , http://www.fas.usda.gov/gainfiles/200810/146296179.pdf	10/20/2008

¹ As an exception, Italy is allowed to frontload the quota increases into a single 5 percent increase in 2009/10.