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Report Highlights:

For 2006, Canadian cheese production will likely be the only segment of the dairy industry to show a production increase from last year. Post forecasts slightly lower fluid milk output, moderately lower butter production and unchanged levels of skim milk powder production, albeit well below the production level of two years ago. The industry is very concerned over the Canadian International Trade Tribunal's recent ruling on milk protein concentrates and is lobbying the federal government vigorously for tighter import controls. Agriculture Minister Chuck Strahl has invited dairy producers and dairy processors to form a Working Group to negotiate solutions to the dairy ingredient issue. On the WTO front, it would appear that the supply managed dairy industry's inflexible stance on TRQs and market access issues are hindering its ability to help design creative and innovative structural transition policies that could be needed following a Doha Round agreement.

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Executive Summary: Canada's dairy industry is grappling with weak domestic demand, concern over the recent CITT tariff ruling on Milk Protein Concentrates and policy strategies in a global trade context that are hampering the Canadian government's ability to effectively pursue a meaningful and productive agricultural trade position in the Doha Round.

Dairy Outlook 2006

Milk Production

Canadian fluid milk production for calendar year 2006 is forecast to decline to 7.73 million metric tons (MMT) from 7.80 MMT in 2005, reflecting reductions in the national market share quota in late 2005, fewer dairy cows in milk production and weaker demand for dairy products. Total Canadian dairy cow numbers on January 1, 2006 slipped to 1.048 million head, 1.7% below the 1.066 million head on that day a year earlier. Of all milk cows on farms on January 1, 2006, Ontario and Quebec accounted for 72% of total.

Reflecting weak demand, per capita fluid milk consumption in Canada is on the decline. According to Citizenship and Immigration Canada, Asians dominate Canadian immigration patterns, accounting for 61% of all immigrants during the five-year period ending 2003. Agriculture and Agri-Food Canada (AAFC) reports that dairy products have not traditionally been popular among Asians and, although cheese and ice cream are gaining acceptance, soy milk is preferred to cow's milk. Canada's population is aging and AAFC studies show that fluid milk consumption tends to fall with an aging population. In recent years, cream consumption has been on the upswing because it is increasingly used as an ingredient in the growing specialty coffee and latte markets. AAFC also reports that milk consumption is positively related to changes in disposable income, and negatively related to any increases in its own price. As all food prices go up, milk consumption is negatively impacted. Milk consumption in Canada appears to suffer as overall food prices rise.

Commodity	Dairy, Milk, Fluid					
	(1000 HEAD)		(1000 M)		(1000 M)	
	2004	Revised	2005	Estimate	2006	Forecast
	USDA Official	Estimate	USDA Official	Estimate	USDA Official	Estimate
Market Year Begin	01/2004	01/2004	01/2005	01/2005	01/2006	01/2006
Cows In Milk	1057	1055	1065	1066	1059	1049
Cows Milk Production	7885	7905	7800	7797	7750	7725
Other Milk Production	0	0	0	0	0	0
TOTAL Production	7885	7905	7800	7797	7750	7725
Intra EC Imports	0	0	0	0	0	0
Total Imports	11	10	13	11	14	12
TOTAL Imports	11	10	13	11	14	12
TOTAL SUPPLY	7896	7915	7813	7808	7764	7737
Intra EC Exports	0	0	0	0	0	0
Total Exports	7	7	8	9	8	10
TOTAL Exports	7	7	8	9	8	10
Fluid Use Dom. Consum.	2826	2835	2835	2846	2796	2800
Factory Use Consum.	4580	4590	4503	4503	4500	4477
Feed Use Dom. Consum.	483	483	467	450	460	450
TOTAL Dom. Consumpt	7889	7908	7805	7799	7756	7727
TOTAL DISTRIBUTION	7896	7915	7813	7808	7764	7737
Calendar Yr. Imp. from U.	10	10	12	10	13	11
Calendar Yr. Exp. to U.S.	4	4	4	5	4	7

Cheese Production

Canadian cheese production is forecast to reach 355,000 MT in 2005, up 1.1% from the year earlier level of 345,000 MT in 2004. In Ontario, the recent announcement of the Artisan Cheese Program to encourage new small-scale cheese manufacturers is expected to result in the allocation of additional milk supplies to cheese production in that province (see page 8 for more information about the program). Imports of cheese are forecast to remain steady at 25,000 MT.

Consumption of cheese in Canada is forecast to increase during 2006, reflecting the increased demand for variety cheese, although cheddar consumption may also rebound slightly.

Commodity	Dairy, Cheese (1000 MT)					
	2004	Revised	2005	Estimate	2006	Forecast
	USDA Official	Estimate	USDA Official	Estimate	USDA Official	Estimate
Market Year Begin	01/2004		01/2005		01/2006	
Beginning Stocks	59	59	59	59	57	60
Production	305	345	307	351	308	355
Intra EC Imports	0	0	0	0	0	0
Total Imports	24	24	26	25	27	25
TOTAL Imports	24	24	26	25	27	25
TOTAL SUPPLY	388	428	392	435	392	440
Intra EC Exports	0	0	0	0	0	0
Total Exports	10	11	9	10	8	12
TOTAL Exports	10	11	9	10	8	12
Human Dom. Consumption	319	358	326	365	327	362
Other Use, Losses	0	0	0	0	0	0
Total Dom. Consumption	319	358	326	365	327	368
TOTAL Use	329	369	335	375	335	380
Ending Stocks	59	59	57	60	57	60
TOTAL DISTRIBUTION	388	428	392	435	392	440
Calendar Yr. Imp. from U.	4	5	4	5	3	5
Calendar Yr. Exp. to U.S.	4	5	3	3	2	3

Butter Production

Canadian butter production is expected to decline moderately during 2006. Post forecasts the total butter output to reach about 79,000 MT, down almost 5% from last year. Surplus butter stocks, which are currently about one-third higher than "normal", are causing considerable concern and there are reports that Canadian Milk Supply Management Committee will meet shortly to develop a strategy to deal with the situation. One observer said that many years ago, when faced with surplus butter stocks, the Canadian Dairy Commission put it on sale and reduced retail prices. There is still debate in the industry about whether the approach was effective. Opponents argued that consumers simply stocked up, put extra butter in the freezer and actually didn't buy more than they normally would have.

Commodity	Dairy, Butter					
	(1000 MT)					
	2004	Revised	2005	Estimate	2006	Forecast
	USDA Official	Estimate	USDA Official	Estimate	USDA Official	Estimate
Market Year Begin	01/2004		01/2005		01/2006	
Beginning Stocks	13	13	14	15	11	19
Production	86	84	88	83	90	79
Intra EC Imports	0	0	0	0	0	0
Total Imports	28	28	25	24	25	22
TOTAL Imports	28	28	25	24	25	22
TOTAL SUPPLY	127	125	127	122	126	120
Intra EC Exports	0	0	0	0	0	0
Total Exports	17	17	18	20	19	22
TOTAL Exports	17	17	18	20	19	22
Domestic Consumption	96	93	98	83	99	82
TOTAL Use	113	110	116	103	118	104
Ending Stocks	14	15	11	19	8	16
TOTAL DISTRIBUTION	127	125	127	122	126	120
Calendar Yr. Imp. from U.	3	3	2	1	0	1
Calendar Yr. Exp. to U.S.	17	17	19	19	19	20

Non-fat Dry Milk (Skim Milk Powder)

According to Statistics Canada preliminary data, Canadian nonfat dry milk (skim milk powder) production during 2005 fell almost 17% from the year earlier level to about 75,000 MT. Much of the decline was attributable to a decline in fluid milk production and changes in milk composition at the farm level, such as producing milk with more fat and less of other solids in order to reduce the inventory of skim milk powder (SMP). For 2006, production of SMP is forecast to be relatively unchanged.

The loss of the export market for SMP as a result of the WTO ruling in 2002 is forcing readjustments to the dairy system. In order to help reduce the structural surplus of skim milk powder, which is purchased and stored by the Canadian Dairy Commission (CDC), alternative markets for SMP are being sought and large quantities of SMP are reportedly being sold to the livestock industry to be used in animal feed, especially for use in the veal calf industry under a program entitled the Special Milk Class Permit Program, a program created by the Canadian Milk Supply Management Committee (CMSMC) in 1995.

Commodity	Dairy, Milk, Nonfat Dry (1000 MT)					
	2004	Revised	2005	Estimate	2006	Forecast
Market Year Begin	USDA Official	Estimate	USDA Official	Estimate	USDA Official	Estimate
	01/2004		01/2005		01/2006	
Beginning Stocks	23	23	41	41	36	38
Production	88	90	74	75	70	76
Intra EC Imports	0	0	0	0	0	0
Total Imports	2	2	4	4	5	7
TOTAL Imports	2	2	4	4	5	7
TOTAL SUPPLY	113	115	119	120	111	121
Intra EC Exports	0	0	0	0	0	0
Total Exports	16	16	4	6	3	12
TOTAL Exports	16	16	4	6	3	12
Human Dom. Consumption	51	54	48	73	40	73
Other Use, Losses	5	4	31	3	33	5
Total Dom. Consumption	56	58	79	76	73	78
TOTAL Use	72	74	83	82	76	90
Ending Stocks	41	41	36	38	35	31
TOTAL DISTRIBUTION	113	115	119	120	111	121
Calendar Yr. Imp. from U.S.	2	2	4	3	5	6
Calendar Yr. Exp. to U.S.	0	0	0	0	0	0

Policy Update and Industry Developments

Milk Protein Concentrates

In 2002, Dairy Farmers of Canada noticed a rapid rise in Canadian dairy protein imports classified under Chapter 35 and requested clarification from the Canada Border Services Agency (CBSA). In April 2003, CBSA reviewed its classification and re-classified Promilk 872b (milk protein concentrate with 87.5% protein content) into tariff item 04.04. Advidia (the importing company) challenged this reclassification before the Canadian International Trade Tribunal (CITT). On March 8, 2005, the CITT ruled that Promilk 872b was properly classified under tariff item 35.04 since in the view of CITT, a "protein substance not elsewhere specified" better described "milk protein concentrate" than "natural milk constituents". On January 31, 2006, the Federal Court of Appeal upheld the CITT ruling.

Canadian dairy producer representatives claim that each kilogram of imported protein concentrates displaces 2.57 kilograms of Canadian solids non-fat. With the existing technology, up to 25% of the milk protein found in Canadian industrial milk could be displaced by imports. The Dairy Farmers of Canada (DFC) told the House of Commons Standing Committee of Agriculture on May 11, 2006 that the (CITT) ruling will lead to the collapse of the domestic price structure for solids non-fat, thereby threatening the supply management in Canadian dairy production. The DFC estimates that in a relatively short timeframe, Canadian dairy producers will experience losses in the magnitude of \$500 million. The DFC is pressing the government for tighter import controls including revision to Canadian regulations that the DFC considers conflicting by presenting different definitions of what constitutes a milk product. In their effort to remain competitive, dairy product ingredient importers on the other hand are anxious to continue to import certain dairy protein ingredients at prices less than the controlled Canadian prices for certain milk solids.

Federal Agriculture Minister Chuck Strahl Calls for Dairy Working Group

Federal Agriculture Minister Chuck Strahl has invited the Dairy Farmers of Canada (DFC) and the Dairy Processors Association of Canada to form a Working Group to look at key industry concerns including compositional standards for milk utilization and ingredients (i.e., the issue of Milk Protein Concentrates (MPC) for the production of dairy products). According to dairy industry observers, Minister Strahl reportedly made strong statements urging milk producers and processors to negotiate proposed solutions. Strahl reportedly told the groups that he wanted some proposals from the group by late spring or early summer 2006.

WTO

Similar to the refrain that imports of MPC will result in the end of supply management in the Canadian dairy industry, Canadian dairy producers believe that any reduction in over quota tariffs in the Doha Round will undermine supply management. Dairy farmers define the three pillars of supply management as import control, producer pricing and production allocation (i.e., production control). Their adherence to the status quo not only hampers Canadian government WTO negotiators (who have other sector interests of Canadian agriculture to consider), it hinders the Canadian supply managed dairy industry's ability to help design creative and innovative structural transition policies that may be required following a Doha Round agreement.

Artisan Cheese Program

The Dairy Farmers of Ontario (DFO) recently announced the launch of an Artisan Cheese Program. The program is designed to encourage new small-scale cheese makers using traditional production methods and is patterned after a Quebec plan that produces more than 400 different cheeses in that province. In Ontario, each qualifying applicant would access up to 300,000 liters of milk until the total provincial volume equivalent of 3.0 million liters has been assigned. Milk received under this program may be used to manufacture all types of cheese with the exception of cheddar and mozzarella. For many would-be artisan processors, it is reported that the most difficult and costly phase will be building a plant that meets all provincial plant regulations and obtaining a license to operate a plant from the Ontario Ministry of Agriculture, Food and Rural Affairs. Industry stakeholders will review the program after four years, or sooner if the 3.0 million liter volume is reached earlier. The DFO developed the program in consultation with its customers represented by the Ontario Dairy Council, the organization of Ontario dairy processors. The Artisan program offers a second way for cheese makers to easily obtain additional milk for new, innovative cheeses. Processors would first apply to the Canadian Dairy Commission to obtain milk through the Domestic Dairy Product Innovation Program. If they don't qualify for that program, they could apply to purchase milk under the Artisan Cheese Program.

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