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Dairy and Products Annual

2010

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Report Highlights:

Milk and cheese production is expected to increase in 2010 from year 2009 levels due to an increase in Canadian dairy requirements. This increase is driven by increased usage of cheese in further processing, and a heat wave in the summer of 2010 which pushed up retail sales of ice-cream. While milk production is forecast to remain flat in 2011, cheese production is forecast to increase due to the need to re-build cheese stocks. Butter production and production of non-fat-dry milk (NFDM) is forecast to decrease in 2011. Consumption of milk and cheese has remained relatively flat in 2009; however consumption of butter and skim milk powder increased. Trade in dairy products is tightly controlled through import controls, and most trade from the United States takes place under the Import for Re-Export Program (IREP). A strong Canadian dollar which slows exports has limited IREP growth for most dairy products.

Executive Summary:

- The estimate for total milk production for calendar year 2010 is 8.35 million metric tons (MMT), representing a slight increase from year 2009 levels of 8.28 MMT. A heat wave in eastern Canada during the summer helped push up the demand for use of fluid milk in ice-cream and is in part responsible for this increase. In addition, stronger retail sale and the need to re-build cheese stocks also pushed up dairy requirements in Canada.

- The estimate for total cheese production in 2010 is 297, which represents a 2 percent increase from year 2009 levels of 291 TMT. In 2010, cheddar cheese production is expected to increase by 5 percent from the 2009 production levels. This increase is due to stronger retail sales resulting from a recovering economy, and an increased usage of cheddar cheese in processed products. The production levels of cheese in 2011 are forecast to grow to 305 TMT in response to both this continued increased demand and in response to the need to build stocks.

- Total butter production in 2010 is expected to decrease slightly to 85 TMT due to high stocks and relatively flat demand.

- The estimate for skim milk powder production for 2010 is 82 TMT and production levels are forecast to remain flat in 2011 due to the fact that no increase in butter production between years 2010 and 2011 is expected.

- Total cheese exports (excluding cream and fresh cheeses) are estimated to reach 9,000 MT in 2010 and are forecast to remain close to the same level in 2011. This is a slight decline from year 2009 levels of 9,489 MT. This slight dip in exports is due to the Canadian dairy industry's need to rebuild cheese stocks.

The Canadian Dairy Industry at a Glance:

The Canadian dairy sector functions under a supply management system, based on planned domestic production, administered pricing and dairy product import controls.

In 2009, dairy production in Canada generated total net farm receipts of $5.5 billion and generated sales of $13.6 billion, representing 15 percent of the Canadian food and beverage sector. The dairy industry ranks third in terms of value in the Canadian agricultural sector following grains and red meat.

The dairy processing sector is relatively concentrated. Today, 14 percent of Canadian plants are owned by the three largest processors in the country (Saputo, Agropur and Parmalat), processing approximately 75 percent of the milk produced in Canada. The fluid milk market represents almost 40 percent of milk utilization, while the market for manufactured dairy products such as butter, cheese, yogurt and ice cream accounts for over 60 percent of utilization.

Commodities:

Dairy, Milk, Fluid

Dairy, Cheese

Dairy, Butter

Dairy, Milk, Nonfat Dry

PRODUCTION:

Milk

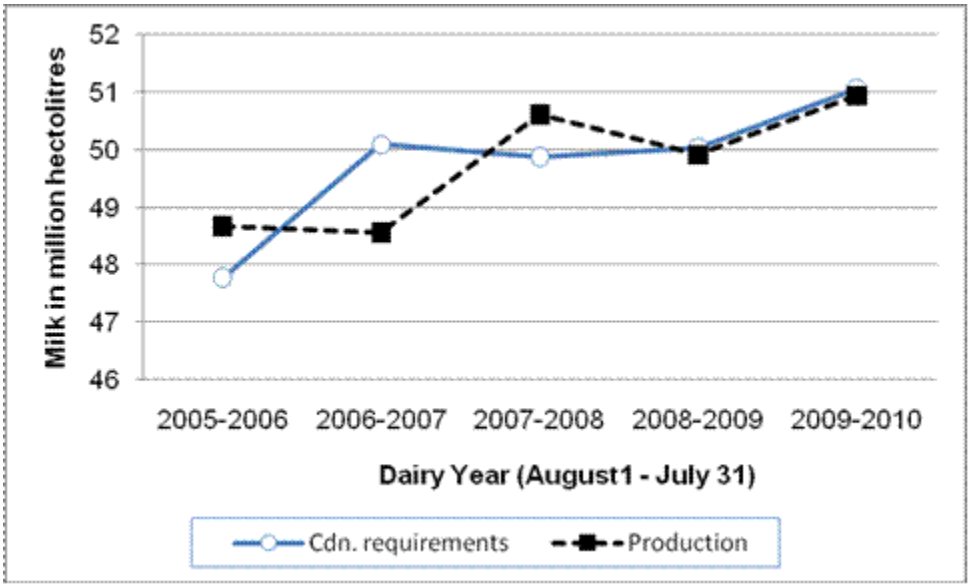
Milk production in Canada supplies two markets. The fluid milk market includes creams and flavored milks. The industrial milk market is milk used to make products such as butter, cheese, yogurt, ice cream and milk powders. The fluid milk market accounts for close to 40 percent of total producer shipments of milk.

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. The Canadian dairy requirements for dairy year 2009-2010 rose 2 percent from levels the previous year.

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



Source: Canadian Dairy Commission;
www.cdc-ccl.gc.ca/CDC/index-eng.php?id=3807

Based on 6 months of production data of milk produced for the fluid milk market and for the industrial milk market, the estimate for total milk production for calendar year 2010 is 8.35 million metric tons (MMT), representing a slight increase from year 2009 levels of 8.28 MMT. Increased manufacturing of yogurt, ice-cream and cheese, as well as a 13-month decrease in skim-off, are the leading reasons for this increase. During the summer of 2010, a heat wave in eastern Canada helped push up the demand for use of fluid milk in ice-cream. Demand for fluid milk for cheese also increased in 2010 due to stronger retail sales and the need to re-build cheese stocks. Due to the supply management system in Canada which matches supply and demand, significant changes in dairy requirements do not occur. For this reason, Post predicts year 2011 fluid milk production levels to remain at year 2010 levels of 8.35 MMT.

Since 1999, the national dairy herd has declined by 17 percent, while total milk production has increased by 2.4 percent. These adjustments reflect ongoing restructuring at the farm level. There are fewer farms but more cows on each farm. Since 1999, the number of cows per farm has risen by over 30 percent and the average Canadian dairy farm now has 7 cows. Better feeding, disease control and genetic advancements have increased the amount of milk produced per cow. The overall number of cows has decreased over the past 10 years; however the production per cow has increased by over 10 percent. The number of cows will likely remain constant in 2010.

The typical Canadian dairy farm is quite specialized, with most of its revenue coming from milk production and the sale of dairy cattle. It is a family-owned operation with a herd of about 72 cows. The farm owners are in their mid-forties and have built up considerable equity in their operation. The typical family farm is accustomed to using advanced technology in practices such as artificial insemination, breed selection and labor-saving milking systems. Computerization of feeding and herd management systems, and equipment innovations are also rapidly changing the way things are done on the farm. The industry has experienced a 36 percent decline in the number of dairy farms over the past decade. However, individual farming units have grown in size and have become more effective in operation.

Cheese

The estimate for total cheese production in 2010 is 297, which represents a 2 percent increase from year 2009 levels of 291 TMT. Cheese production has been adjusted to exclude fresh cheeses such as ricotta, cream cheese, and cottage cheese. Cheddar cheese production in 2010 is expected to increase 5 percent from the 2009 production level of 130 TMT. This increase is due to stronger retail sales resulting from a recovering economy, and an increased usage of cheddar cheese in processed products. Production of mozzarella cheese in 2010 is expected to remain close to 2009 levels of 116 TMT. The Canadian economy is expected to continue to grow slowly in 2011 resulting in an increased demand for cheese from both the consumer and the processing/manufacturing sectors. The production levels of cheese in 2011 are forecast to grow to 305 TMT in response to both this continued increased demand and in response to the need to build stocks.

Butter

Butter production in 2009 increased over 2008 production, to almost 87 TMT. Butter stocks remained high at the beginning of 2010 due to strong milk and cream sales for the industrial market in the first six months. As a result, butter production decreased in the first six months of 2010 compared to the same period of time in 2009. Total butter production in 2010 is expected to decrease slightly to 85 TMT due to high stocks and relatively flat demand. In 2011, butter production is forecast to remain at year 2010 levels. Butter is a very price sensitive dairy product for consumers, and while the economy is recovery, butter is still considered by many 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 2009, butter production rebounded due to the increasing demand for butter for pastries and other baked products.

Non-Fat Dry Milk

Non-fat dry milk production (skim milk powder (SMP)) production for 2009 decreased marginally from 2008 levels to 86 TMT. Lower butter production in 2010 and a decrease in skim-off are expected to result in a corresponding decline in skim milk powder production. The estimate for skim milk powder production for 2010 is 82 TMT and production levels are forecast to remain flat in 2011 due to the fact that no increase in butter production between years 2010 and 2011 is expected.

Product Line Trends

Faced with increased competition and rapid advances in technology, the dairy industry has had to adapt to remain competitive and find new opportunities. The Canadian dairy industry has responded with the development of a robust line of dairy products, including probiotic yogurts, ultra filtered milk, and dairy products containing Omega-3 fatty acids. While still less that 1 percent of total dairy production, organic milk production is steadily increasing in Canada, reaching over 73 million liters in 2008-2009 up 18 percent from the previous year. The number of farms producing organic milk increased from 65 in 2000-2001 to 198 in 2008-09. Moreover, there are over 665 varieties of cheese.

Prices

In December, 2009, the Canadian Dairy Commission announced its decision to hold support prices for butter and skim milk powder at current levels. The support price for skim milk powder remains at $6.1783 per kilogram and the support price for butter remains at $7.1024 per kg.

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 by 1 percent in 2009 compared to 2008 levels. Per capita consumption in 2009 was at 80.91 liters per person. Consumption of higher-fat milk like 3.25% continued to decline in 2008 as consumers continue to shift consumption away from higher-fat milk lower fat milks. Consumption of 2% milk increased marginally but was off-set by a marginal decrease in the consumption of 1% milk. The popularity of skim milk decreased by 1 percent from year 2009 levels. Most surprising was a 6 percent decrease in the consumption of chocolate milk compared to year 2008 levels. Chocolate milk had been showing a steady increase in per capita consumption over the past several years, likely due to strong marketing efforts to increase its consumption. In 2009, consumption of standard, 2%, 1%, skim, and chocolate milk was 11.14, 37.33, 18.10, 8.60, 5.73 liters per person, respectively.

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. Increases in dairy prices and people reducing their consumption of specialty coffees and coffee products a slower growing Canadian economy are expected 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 2009 was 12.37 kilograms, a slight decrease from 2008 consumption of 12.28 kilograms per person Consumption of cheddar cheese declined from 3.92 kilograms to 3.79 kilograms, while specialty cheeses decreased marginally from 7.73 to 7.72 kilograms.

Data compiled by Agriculture Canada's Dairy Section for 2009 reveals that per-capita butter consumption increased nearly 5 percent from 2008 levels. Butter consumption increased to 2.80 kilograms per person in 2009 from 2.67 kilograms per person in 2008 This dramatic increase is in large part due to a dramatic drop in 2008 of butter imported under the import for re-export (IREP) trade, which is included in the per capita consumption calculation. The demand for butter under the Import for Re-Export Program (IREP) for use in further processing decreased due to a number of factors. A world-wide economic slowdown, a strong Canadian dollar and high world butter prices all contributed to a decreased demand for IREP butter. Per capita consumption of butter in 2009 rose to 2.80 kilograms per person from 2.67 in 2008. A recovering economy has likely contributed to an increase consumer demand for butter. Nevertheless, butter sales will continue to struggle due to its high cost and as it faces greater competition from liquid oils due to consumers demanding lower-fat alternatives to traditional products.

Domestic consumption of skim milk powder also increased in 2009 to 2.55 kilograms per capita, from 1.91 kilograms per capita in 2008. 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 approximately priced at the international price level 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. Competition from imports will be limited due to a tariff rate quota on milk protein concentrates that has capped imports. The tariff rate quota (TRQ) for milk protein concentrate is not applicable to countries with which Canada has a free trade agreement.

Utilization of Milk

The Canadian Dairy Commission publishes the milk utilization by class (on a dairy year basis, August1 – July 31)). The price paid for milk by processors varies according to the milk class 1- 5. For dairy year 2009-2010, on the standard basis of butterfat content (3.6 kg/hectolitre), 29.6 percent of all the milk produced in Canada was transformed into fluid milk, cream, and milk beverages, 34.4 percent into cheese, 7.6 percent into yogurt and ice cream, 18.4 percent into butter, and 8.0 percent 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		Percent of Total Milk		Percent Change
	2008-2009	2009-2010	2008-2009	2009-2010	
1	24.4	24.7	29.50	29.62	1.23
2	5.6	6.3	6.77	7.55	12.50

3(a) and 3(b)	28.3	28.7	34.22	34.41	1.41
4(a) and 4(a)1	16.4	15.3	19.83	18.35	-6.71
4(b), 4(c), 4(d), 4(m)	1.1	1	1.33	1.20	-9.09
5(a), 5(b), and 5(c)	6.4	6.7	7.74	8.03	4.69
5(d)	0.5	0.7	0.60	0.84	40.00
Total	82.7	83.4	100.00	100.00	0.00

Source: Canadian Dairy Commission

Summary of Harmonized Milk Classification System:
1: Milk or milk beverages, cream and other fluid products
2: Ice cream, sour cream, other frozen diary products
3: Cheese
4: Butter, milk components, concentrated milks
5: Cheese and other dairy products used as ingredients.
Full descriptions available: 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)
Milk Protein Substitutes	10,000	0350.40
Fluid Milk[1]	0	0401.10, 0401.20
Cream, not concentrated, no sugar, (heavy cream)	394	401.30
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	3,274	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
Milk cream and butter subs.	0	2106.90
Non-alcoholic beverages containing milk	0	2202.90
Complete feeds and feed supplements	0	2309.90
Milk Protein Substances[2]	6,188	3504.11

[1] There is no commercial TRQ for fluid milk. However access of 64,500 tons of fluid milk is allowed and considered filled by cross-border shopping.
[2]The TRQ is not applicable to countries that have a free trade agreement with Canada.

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 are 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.

The popularity of this program highlights the growing importance of the dairy ingredient market in further processing. It is the 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 U.S. prices. Therefore, when U.S. prices get closer to world prices, the incentive to use IREP should decrease. 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 Matching Investment Fund (MIF) which in mid-2009 replaced the Innovation Support Fund and the Direction Access Fund, and the Domestic Dairy Product Innovation Fund.

Import for re-export trade is also highly influenced by what percentage of the total ingredients the imported good makes up in the product that must eventually be exported, as well as the strength of the Canadian dollar which effects Canada's export opportunities. As a result, while IREP popularity has been shown to grow over time, demand for IREP products can fluctuate from year to year.

IMPORTS OF FLUID MILK, CHEESE, BUTTER, NON-FAT DRY MILK

There are two available sources of Canadian import data for dairy products. Post has chosen to use data supplied by the Department of Foreign Affairs and International Trade (DFAIT) over the data supplied by Statistics Canada in order to minimize the risk of double counting. DFAIT is responsible for maintaining Canada's imports controls for the supply managed products.

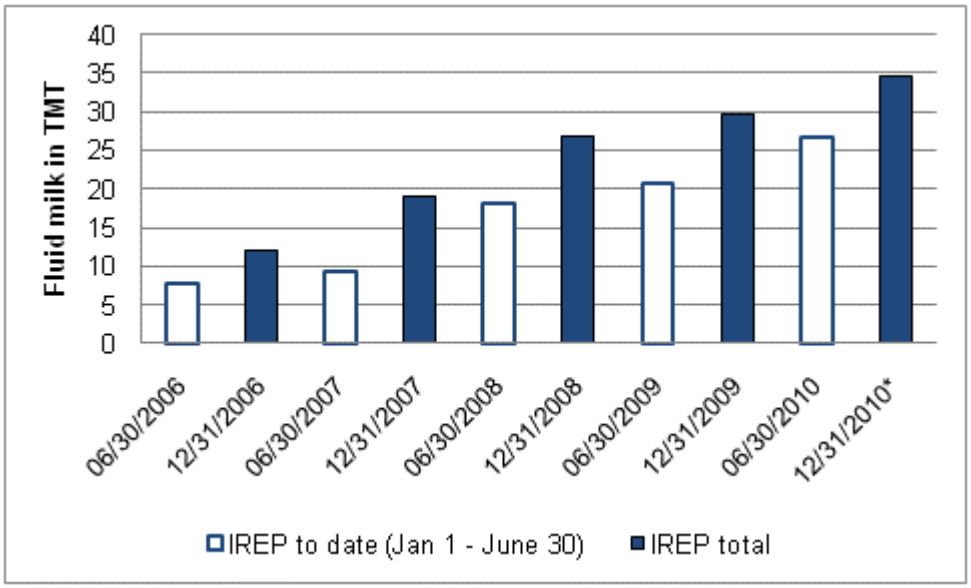
Fluid Milk

The fluid milk access level for is 64,500 MT, a figure that is considered filled through cross-border purchases by Canadian consumers. There is no commercial quota available for fluid milk. Fluid milk is 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), and through the IREP which accounts for nearly 100 percent of milk imports. 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.

Despite efforts to increase usage of Canadian fluid milk through the special classes program, IREP trade has continued to grow. In 2009, milk imports were 25,588 MT, and cream imports were 4,608 MT. Based on 6 months of import data milk and cream imports in 2010 are estimated to reach 35,000 MT. The popularity of IREP milk is likely to continue and Post forecasts milk imports under the IREP to reach 40,000 MT in 2011.

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.

Figure 2: Milk and Cream Imports under the Import for Re-export Program (IREP); Year 2006-2010, in thousand metric tons (TMT).



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

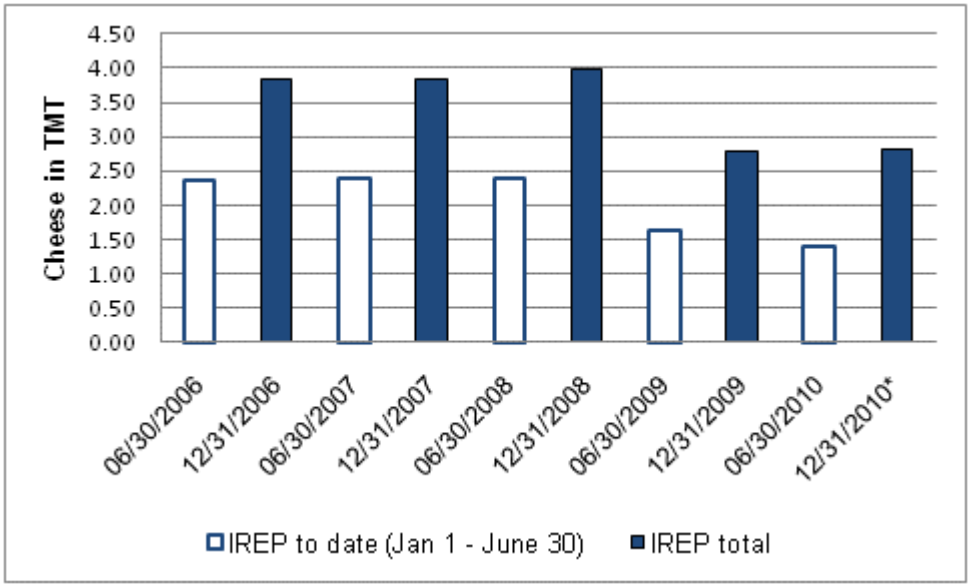
Cheese

The commercial quota on cheese is 20,411,866 kilograms, and 66 percent of that cheese quota is specifically allocated to the European Union. Cheese imports for 2009 were 23,960 MT. Since import levels tend to stay stable due to the TRQ in place, Post predicts a similar level of cheese imports for 2010 and 2011 (24,000 MT, and 25,000 MT respectively).

Due to the country specific access, the EU-27 remains the largest cheese (excluding fresh cheeses) supplier to Canada. The United States' share of imports under IREP has increased over the last several years. IREP trade in cheese overall, however, has declined in the past few years, likely due to higher world cheese prices that reduce the profit margin for using IREP cheese in processed products destined for export. In addition, United State's cheese exports may be negatively impacted due to the need to re-formulate cheese destined for the Canadian export market. New cheese compositional standards regulations that prescribe the minimum amount of fluid milk that must be used to produce cheese sold in the Canadian domestic market came into effect December 14, 2008. These regulations are being

contested in the Canadian court system and a decision on the final appeal is expected in the next few months. Whether or not these regulations will apply for cheese under the IREP remains unclear.

Figure 3: Cheese Imports under the Import for Re-export Program (IREP); Years 2006-2010, in thousand metric tons (TMT).



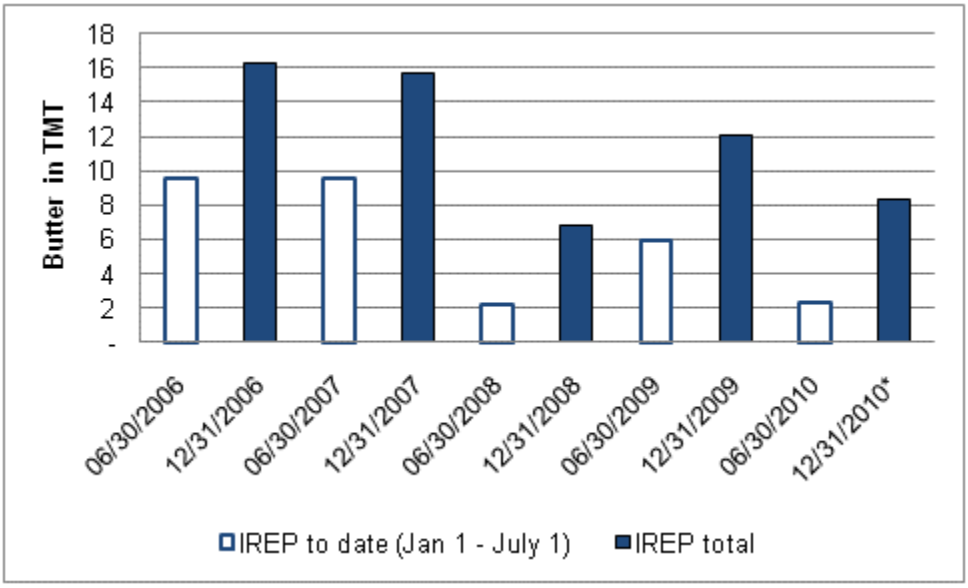
*estimate
Source: EMP TRQ Import Summary (Foreign Affairs and International Trade Canada)

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. Nearly the entire TRQ is allocated to New Zealand (2,000 MT). Butter imports are significantly influenced by what happens in the IREP trade. In 2009, the United States had the second largest share of butter imports (12 percent) due to proximity to the Canadian market. U.S. share of imports in 2009 fell to more average levels of 1,169 MT in 2009. Imports from the United Sates in 2008 were exceptionally high due to high U.S. supplies. Total butter imports in 2009 were 12,055 MT. High world prices for butter in 2010 have resulted in the Canadian Dairy Commission, the sole importer of butter for Canada, to hold off its purchases of butter. In addition, higher world prices which limit the popularity of the IREP program, combined with higher than average domestic stocks, will likely result in butter imports of close to 8 TMT. A need to rebuild butter stocks is forecast to increase butter imports to 20 TMT in 2011.

Over the last few years there has been a decreased usage of the IREP program. Higher world butter prices which decrease the profit margin, stronger fluid milk and cream sales for industrial domestic use, and a slowed demand for Canadian processed products due to a strong Canadian dollar have all negatively impact the demand for IREP butter.

Figure 4: Butter Imports under the Import for Re-export Program (IREP); Years 2006-2010, in thousand metric tons (TMT).



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

Non-fat Dry Milk (Skim Milk Powder)

In 2009, imports of skim milk powder (SMP) decreased more than 40 percent from the previous year's levels. In 2009, import permits for re-exports and supplementary imports were issued for 2,377 MT of skim milk powder compared to 4,241 MT in 2008. This downward trend continues into 2010. IREP trade in SMP has been decreasing over time. It may be a combination of a higher world prices and more aggressive efforts by the Canadian dairy industry to reduce its structural surplus by creative incentives for Canadian manufacturers to use domestic skim milk powder. The United States accounts for nearly 100 percent of Canadian skim milk powder import. Almost all trade on skim milk powder takes place under the IREP. Imports in 2011 are forecast to remain at around the 2,300 MT level due to continued weak demand.

EXPORTS OF FLUID MILK, CHEESE, BUTTER, NON-FAT DRY MILK

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.

In 2009, Canadian dairy exports were valued at approximately C$230 million, while imports amounted to C$573 million. The main products exported by Canada in 2009 were cheese (mainly cheddar), whey,

and skim milk powder. These represent 27 percent, 13 percent and 10 percent, respectively, share of total exports. Top dairy imports included various kinds of cheeses (44 percent) followed by milk protein substances (16 percent) and casein products (11 percent) (value basis).

Fluid Milk

Fluid milk and cream exports in 2009 are reported to be 3,543 MT. In 2010, based on year-to-date trade data through June, fluid milk and cream exports are expected increase slightly to 4,500 MT. Increased supply in 2011 is forecast to keep fluid milk and cream exports at year 2010 levels of 4,500 MT.

Cheese

Total cheese exports (excluding cream and fresh cheeses) are estimated to reach 9,000 MT in 2010 and are forecast to remain close to the same level in 2011. This is a slight decline from year 2009 levels of 9,489 MT. This slight dip in exports is due to the Canadian dairy industry's need to rebuild cheese stocks. In 2009, the United States and the United Kingdom remain the two primary markets for Canadian cheese, accounting for 34 percent and 31 percent of cheese (excluding cream and fresh cheeses) exports, respectively. 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.

Butter

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 2009 are 2,836 MT, which is nearly double year 2008 levels, but still significantly lower than year 2008 levels of 12,977 MT. Dairy spreads accounted for 94 percent of those exports virtually all of which go to the United States. Based on seven months of data, 2010 exports are expected to rebound more historically average levels of 10,000 MT. Post forecasts butter exports in 2011 to remain at year 2010 levels of 10,000 MT. This is due to increased demand from the United States.

Non-Fat Dry Milk

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 2009 reached 10,101 MT. In 2009 Cuba and Mexico were the main destinations for Canadian exports of skim milk powder receiving 26 percent and 11 percent, respectively. In 2010, based on eight months of export data, it is estimated that exports will decrease to 8,000 MT. Increased domestic demand for skim milk powder due to domestic incentive programs combined with an unchanged production levels due to no expected increase in butter production in 2011 is forecast to keep export levels of skim milk powder at similar levels to those in 2010.

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.

POLICY:

Cheese Compositional Standards

A decision on the appeal from the courts is still pending regarding cheese compositional standard regulations that came into force in late 2008. 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. While it remains too early to see the full trade impact of these regulations on United States dairy exports to Canada, United States cheese imports may be negatively impacted if re-formulation for the cheese destined for the Canadian domestic market is necessary. 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. It also remains unclear whether these new regulations will be applied against cheese that is part of the import for re-export trade.

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 came 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 petitioned the federal court for a judicial review of the new cheese regulations. The judicial review looked 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 not on the regulations themselves.

Saputo Inc., Kraft Canada Inc., and Parmalat Canada Inc. the three dairy processors involved in the suit, sought 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 asked 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 challenged 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.

On October 7, 2009 The Federal Court judge issued a decision on this case brought by Saputo, Kraft Canada and Parmalat Canada which challenged the government's authority in these regulations. The judge found that the government did indeed have the authority to issue the Cheese Compositional Standards Regulations made to the Food and Drug Regulations and the Dairy Products Regulations. In other words, the new Cheese Compositional Standards Regulations proposed by the federal government, including new casein and whey ratios for all cheeses have been found by the Court, in all respects, to be constitutionally and legally valid as they apply to cheese in international and inter-provincial trade, including cheese imported into Canada. This decision was appealed and a decision is expected in the fall of 2010. Industry sources expect the regulations to stand.

There has been a very strong lobby push from Canadian dairy farmers to implement compositional standards on yogurt. Should the cheese regulations stand, it is Post's expectation that the Canadian government will proceed with putting compositional standards on additional dairy products, beginning yogurt. It may be that the Canadian government is waiting on the results of the court decision before proceeding.

Health Claims

A rising interest in the health impacts of foods among both industry and consumers has prompted Health Canada to review its management of health claims on foods in Canada. Food as "medicine" is an increasing food trend in Canada, and the promotion of dairy products has been active in this trend. For example, chocolate milk has been aggressively advertised as a sports recovery drink, milk has been promoted as a tool to combat obesity in children, and probiotics have been added to dairy products (particularly yogurt) and marketed as a way of achieving digestive track health. Currently, all health claims are subject to Subsection 5(1) of the Food and Drug Act. Health Canada initiated a review of the current framework for the management of health claims on food to ensure efficiency and flexibility in the approval of health claims. Specifically, the goal is to ascertain that health claims used to market foods is based on sound science and nutrition policy so that ultimately consumers receive accurate information regarding the foods they consume. The Smart Regulation initiative and the Blueprint for Renewal set the stage for the health claim modernization project initiated in May 2006 and was followed by a discussion paper released in November 2007 followed by a public consultation processes. Farmers of Canada submitted written comments. No date has been set yet for the release of a policy on the general management of health claims labeling which may affect how health claims on dairy products are handled.

Ice Cream Promotion Program

In March, 2009 Canada instituted a new program for ice cream manufacturers that provides a discount on the price of milk/cream purchased to make ice cream. This discounted milk/cream is only available for ice cream that is to be manufactured using 100% Canadian dairy ingredients. This is part of a broader promotional program that grants diary product manufacturers who use only Canadian dairy ingredients to enter into a licensing agreement for use of the "little blue cow" logo. The discounted milk/cream for use in qualifying ice cream program is designed to render imports of butter/oil/sugar blends and domestically produced vegetable oils less competitive for use in ice cream and ice cream products.

The "little blue cow" logo is finding increasing popularity with cheese dairy processors. Many of the smaller cheese manufacturers are using the little blue cow logo. Loblaw's, one of the three largest supermarket chains in Canada, is also using the logo on its "store brand" cheese.

PRODUCTION, SUPPLY AND DEMAND DATA STATISTICS:

Fluid Milk in 1000 MT Canada	Market Year Begin: Jan 2009		Market Year Begin: Jan 2010		Market Year Begin: Jan 2011	
	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Cows In Milk (in 1000 head)	978	979	983	981		980
Cows Milk Production	8,200	8,280	8,250	8,350		8,350
Other Milk Production	0	0	0	0		0
Total Production	8,200	8,280	8,250	8,350		8,350
Other Imports	15	26	15	35		40
Total Imports	15	26	15	35		40
Total Supply	8,215	8,306	8,265	8,385		8,390
Other Exports	3	4	3	5		5
Total Exports	3	4	3	5		4
Fluid Use Dom. Consumption	3,080	3,103	3,110	3,184		3,180
Factory Use Consumption	4,725	4,805	4,740	4,806		4,816
Feed Use Dom. Consumption	407	394	412	390		390
Total Dom. Consumption	8,212	8,302	8,262	8,380		8,386
Total Distribution	8,215	8,306	8,265	8,385		8,390

Cheese in 1000 MT Canada	Market Year Begin: Jan 2009		Market Year Begin: Jan 2010		Market Year Begin: Jan 2011	
	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Beginning Stocks	59	59	46	47		42
Production	280	291	295	297		305
Other Imports	25	24	25	24		25
Total Imports	25	24	25	24		25
Total Supply	364	374	366	368		372
Other Exports	8	9	8	9		9
Total Exports	8	9	8	9		9
Human Dom. Consumption	310	318	315	317		318
Other Use, Losses	0	0	0	0		0
Total Dom. Consumption	310	318	315	317		318
Total Use	318	327	323	326		327
Ending Stocks	46	47	43	42		45
Total Distribution	364	374	366	368		372

Butter in 1000 MT Canada	Market Year Begin: Jan 2009		Market Year Begin: Jan 2010		Market Year Begin: Jan 2011	
	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Beginning Stocks	14	14	15	13		6
Production	82	87	82	85		85
Other Imports	10	12	10	8		20
Total Imports	10	12	10	8		20
Total Supply	106	113	107	106		111
Other Exports	2	3	3	10		10
Total Exports	2	3	3	10		10
Domestic Consumption	89	97	90	90		88
Total Use	91	100	93	100		98
Ending Stocks	15	13	14	6		13
Total Distribution	106	113	107	106		111

Milk, Nonfat Dry in 1000 MT Canada	Market Year Begin: Jan 2009		Market Year Begin: Jan 2010		Market Year Begin: Jan 2011	
	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Beginning Stocks	29	39	32	32		25
Production	80	86	82	82		82
Other Imports	3	2	3	2		2
Total Imports	3	2	3	2		2
Total Supply	112	127	117	116		109
Other Exports	10	10	10	10		10
Total Exports	10	10	10	10		10
Human Dom. Consumption	69	84	75	80		80
Other Use, Losses	1	1	1	1		1
Total Dom. Consumption	70	85	76	81		81
Total Use	80	95	86	91		91
Ending Stocks	32	32	31	25		18
Total Distribution	112	127	117	116		109