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Report Highlights:

Based on six months of available production data for 2004, total fluid milk production for calendar year 2004 is expected to be about 8.00 million metric tons (MMT), a slight increase from calendar year 2003 production of 7.78 MMT. For 2005, fluid milk production is forecast to increase to 8.10 MMT due to higher expected cows in milk numbers. As a result of higher forecast production of fluid milk, production of dairy products is expected to be higher in 2005. In 2003, the United States continued to be the largest market for Canadian fluid milk exports, with almost 62% of Canadian exports going to the U.S. Based on eight months of trade data from Statistics Canada, the U.S. is expected to replace New Zealand as Canada's primary supplier of non-fat dry milk.

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SUPPLIES

Based on six months of available production data from Statistics Canada for 2004, total fluid milk production for calendar year 2004 is expected to be about 8.00 million metric tons (MMT), a slight increase from calendar year 2003 production of 7.78 MMT. For 2005, fluid milk production is forecast to increase to 8.10 MMT due to higher cows in milk numbers. The ongoing U.S. border closure to Canadian live cattle exports, and limited slaughter capacity for cattle over 30 months of age, is resulting in producers holding onto cows that would normally have been culled, thereby contributing to the increase of cows in milk numbers.

Total cheese production for 2004 is expected to decrease by about five percent to 326,000 metric tons (MT). Production of variety cheese (60% of total cheese production) is expected to decrease by 2% from the 2003 level to 205,000 MT. Cheddar cheese production (40% of total cheese production) is also expected to decrease by 9% from 2003 levels to 121,000 MT. Total cheese production is forecast to increase to 330,000 MT in 2005, as a result of increased fluid milk production.

Butter production for 2004 is expected to increase by approximately 5% from 2003 levels to 88,000 MT. A combination of increased production and an increase in imports, offset by only a slight increase in exports, has increased total butter supplies in Canada by roughly seven percent, to 126,000 MT. For 2005, butter production is forecast to increase as a result of increased milk production available for industrial milk usage.

Nonfat dry milk production for 2004 is expected to increase from 2003 levels to 98,000 MT. The increase in production, combined with a 62% increase in beginning stocks resulted in nonfat milk supplies increasing roughly 15%. For 2005, nonfat dry milk production is forecast to increase to 100,000 MT.

CONSUMPTION

According to statistics from Agriculture and Agri-Food Canada's (AAFC) Dairy Section, in 2003, Canadian per-capita milk consumption remained relatively stable with only a slight decline from 85.4 liters of milk to 85.3 liters. Consumption of 3.25% milk accounted for 16%, 2% milk accounted for 47%, 1% milk accounted for 20%, skim milk accounted for 10%, and chocolate milk accounted for 6% of total fluid milk consumption. Consumption in each of the categories of milk in relation to 2002's consumption numbers remained relatively stable. For the first time in 23 years, skim milk consumption on a per-capita basis declined slightly. Per-capita consumption of 1% milk continued to increase, while consumption of 3.25% and 2% continued to decline. Consumption of 3.25% has declined 67% and consumption of 2% milk has declined 25% since 1980.

Despite the trend away from higher fat milk, per-capita consumption of cream in 2003 increased to 7.97 liters, a 9% increase from 2002. All categories of cream consumption increased from 2002. Increased consumption of coffee and increased consumption of desserts is part of the reason behind the rising consumption of cream. According to the statistics from AAFC, per-capita butter consumption has increased to 3.38 kilograms in 2003 from 3.30 kilograms in 2002. Again, despite the trend to lower fat products, butter consumption will most likely increase for 2004 and 2005 as a result of shifts back from margarine consumption.

Per-capita total cheese consumption in 2003 was 11.8 kilograms, up slightly from 2002. Per-capita cheddar consumption increased slightly to 3.9 kilograms in 2003 from 3.8 in 2002. Specialty cheese per-capita consumption increased marginally to 7.1 kilograms in 2003. The use of mozzarella in prepared meals and fast food and the sale of a grated variety are part of the reason for an increase in specialty cheese consumption.

Per-capita consumption of ice cream declined once again in 2003 to 9.4 liters after steadily increasing in consumption from its low of 8.7 liters in 2000. With ever increasing varieties and flavors, yogurt has been able to increase its overall appeal and consumption through the last 30 years. For 2003, yogurt per-capita consumption increased by roughly 8% to 6.23 liters per person from 5.74 liters in 2002.

TRADE

In 2003, the United States continued to be the largest market for Canadian fluid milk exports, with approximately 62% of Canadian exports going into the U.S. This was in spite of a 32% decline from 2002's level of fluid milk exports into the U.S. For 2004, the overall decline in fluid milk exports to the U.S. is expected to continue, with a forecast decline of 37% from 2003's export numbers. This is based on seven months of trade data from Statistics Canada. In spite of this trend, the U.S. will continue to remain the top export market for Canadian fluid milk exports, accounting for approximately 50% (3.4 of 6.8 MMT) of Canadian exports. Taiwan is the second largest export market for Canadian fluid exports, at 2.3 MMT, a 10% increase from 2003. Taiwan is expected to account for approximately 34% of Canadian fluid milk exports. Canadian imports of fluid milk for 2003 were 0.6 MMT, with imports from Norway comprising approximately 51% of total Canadian fluid milk imports. Fluid milk imports from the United States accounted for roughly 16% of Canada's total fluid milk imports. Based on trade data from Statistics Canada, total fluid milk imports are forecast to increase to 1.6 MMT, with the imports from U.S. accounting for approximately 73% of the total fluid imports. The elimination of the Commercial Export Milk (CEM) Program in 2003, has forced processors to offset the losses of supply from the CEM program with increased use of the Imports for Re-Export Program (IREP). Processors have been using IREP to import increased levels of raw milk, which in 2003 accounted for 20.6% of the imports carried out under IREP.

In 2003, 60% of Canadian cheese imports were from the European Union (EU-25). Cheese imports from the EU-25 in 2003 were roughly 16 MMT, a 3.5% increase from 2002. Based on year-to-date trade statistics for 2004, the European Union market share of Canadian cheese imports is expected to remain relatively constant, despite an 8% decline in total cheese imports from the EU-25. The U.S. was the second largest supplier of cheese to Canada in 2003, despite a decline in its share of Canadian cheese imports. In 2003, U.S. market share fell to 20%, down from 23% in 2002. For 2004, the U.S. market share is forecast to slip again, down to 18%. Based on trade data from Statistics Canada, total cheese imports in 2004 are expected to decline by 18% from 2003 import levels. An increase in cheddar imports is offset by an overall decrease in variety and processed cheese imports into Canada in 2004. Total Canadian cheese exports for 2004 are expected to decline by 5% from 2003 export levels as a result of the smaller export program. Cheddar and specialty cheese exports both declined 18% and 3% respectively, from 2003 export levels. The U.S. is expected to remain the top market for Canadian cheese exports in 2004, accounting for approximately 42% of Canadian cheese exports. While the U.S. remains the largest importer, the estimated volume of cheese exports into the U.S. is expected to decrease by 15%, to 4.4 MMT from 5.2 MMT in 2003. The European Union (EU-25), primarily the United Kingdom, is expected to be the second largest market for exports of Canadian cheese, accounting for 28% of Canadian cheese exports in 2004. This is a decline from 2003, when the EU-25 accounted for 38% of Canadian cheese exports. Mexico has significantly increased its imports of Canadian cheese. In 2003, Mexico imported 225,000 MT of Canadian cheese, accounting for only 2% of total Canadian cheese exports. In 2004, based on seven months of available trade data from Statistics Canada, Mexico is expected to increase imports of Canadian cheese to approximately 1.7 MMT, or 16% of Canadian cheese exports.

New Zealand continues to be the largest source of butter imports for Canada. In 2003, New Zealand accounted for 67% of Canada's total butter imports. The EU-25 and Australia will supply about 19% and five percent of Canadian butter imports respectively. In 2003, the U.S. supplied approximately 5%, or 936,000 MT of butter imports to Canada. Based on available data for 2004, overall imports are expected to increase 18% from 2003 levels, with New Zealand and the EU-25 supplying 54% and 25%, respectively. New Zealand's exports of butter to Canada will remain relatively constant, despite a decline in the percentage share of Canada's total butter imports. The U.S. exports of butter to Canada are expected to increase by 73% from 2003, to 14% of the market share of Canadian butter imports in 2004. In 2003, approximately 99% of Canadian butter was shipped into the U.S. Based on available trade data for 2004, it is expected that Canadian butter exports will increase by 37%. The percentage of Canadian butter exports to the U.S. will remain around 99%.

For non-fat dry milk (skim milk powder), New Zealand was Canada's top supplier, accounting for 63% of Canada's total imports in 2003. The U.S. market share in of Canadian imports was 37% in 2003. In 2004, New Zealand has been all but replaced by the United States as Canada's primary supplier of non-fat dry milk powder, accounting for 99% of Canadian imports. In 2004, New Zealand accounts for less than 1% of Canada's imports of skim milk powder. Overall skim milk powder imports into Canada are

expected to increase by 12% in 2004. In 2003, Mexico, Thailand and Cuba accounted for 20%, 14% and 9% of skim milk powder shipments, respectively. According to statistical data available for 2004, Egypt, Jamaica, Vietnam, Mexico and Thailand will be the major markets for Canadian skim milk powder exports. The U.S. is expected to absorb just 2% of Canadian skim milk powder exports, down from 2003 levels. With the substantial increase in production, high beginning stocks and marginal increase in consumption, Post is forecasting that Canadian exports of skim milk powder will be larger than what the statistical data indicates it should be. As Canada is complying with its WTO obligations, Canadian exports of skim milk powder will not exceed 45 MT.

POLICY DEVELOPMENT AND INDUSTRY NEWS

World Trade Organization (WTO) Framework Agreement

On July 31, 2004, a framework agreement was reached at the WTO. The reaction from commodity groups across Canada was both positive and negative. The Supply Management 5 (SM-5) group, of which dairy producers are a member, took a cautious approach to the framework. While they were pleased with the removal of the mandatory "minimum" cut in over-quota tariffs, concern remains over the existing language stating that substantial improvements in market access will be achieved through combinations of tariff quota commitments and tariff reductions, because it still leaves open the possibility for negotiations to reduce over-quota tariffs. Another concern of the SM-5 with the market access text is the mandate that the selection and treatment of sensitive products must not undermine the overall objective of the tiered approach to substantial overall tariff reduction. The SM-5 have been able up to this point to present their products as "sensitive" and therefore have stated that they should be protected and allowed to continue to operate as is. With the text clearly stating that sensitive products will not undermine the overall objective of reducing tariffs, the SM-5 could be forced to compromise more than they had planned and open their markets up to increased imports. If the Canadian trade negotiating team is unable to negotiate the a 5% market access, supply management could see a substantial increase in imports of poultry and dairy products from other countries, far beyond the 5% they are lobbying for, possibly without the protection of the over-quota tariffs they rely on so heavily to maintain the three pillars of supply management. Along with market access, the SM-5 also has serious concerns with aspects of domestic support and export competition modalities.

Currently in Canada, the quota for dairy is worth \$3 billion (Cdn) and the price of quota continues to rise. Any changes to the structure of the supply management system (i.e. compromise to any one of the pillars) could greatly devalue quota, leaving producers with no ability of ever recovering the money they invested in order to obtain quota. Producers under supply management fully expect the Government of Canada to reimburse them for any changes in the value of quota as a result of a WTO agreement that changes their system in any way. Changes in supply management could be beneficial to consumers, as it could lead to a reduction in price paid for dairy and poultry products.

Georgian Bay Milk Company

In accordance with the final agreement to settle the WTO dairy dispute between Canada, New Zealand and the United States, Canada was required to end all exports of subsidized dairy products to the U.S. and to bring all third country dairy exports within WTO export subsidy limits by August 1, 2003. In order to accomplish this task each provincial milk board imposed regulations to limit dairy production, including production by producers who do not hold quota.

In Ontario, a group of 30 farmers called the Georgian Bay Milk Company (GBMC) are producing milk without quota for export directly to the United States. Since the WTO ruling in 2002 and the introduction of new dairy regulations in 2003, the Dairy Farmers of Ontario (DFO) have effectively been trying to shut down production by GBMC. There has been an appeal to the Agriculture, Food and Rural Affairs Tribunal, interference by the provincial Ministers of Agriculture and a further appeal to the Tribunal. In its latest decision, the Tribunal denied GBMC's request to be exempt from DFO quota regulations and gave GBMC until July 31, 2004 to either exit the industry or buy quota. GBMC have refused to be pushed out of business, unless mandated by a court of law. Therefore, a judicial review is expected to be heard by the Ontario Superior Court of Justice on February 8 to 10, 2005. GBMC is permitted to continue operating under a stay until the judicial review concludes.

Dairy Farmers of Canada Seek Price Increase

The Dairy Farmers of Canada (DFC) applied to the Canadian Dairy Commission (CDC) for a second increase in the price of fluid milk in July of 2004. The DFC had just previously received a 3.5% price increase in February of 2004. The DFC claimed that a second price increase in one year was needed to mitigate the losses suffered by their producers as a result of the one case of BSE and the subsequent and ongoing border closure. The request for an increase in price drew the ire of groups like the Canadian Restaurant and Foodservice Association (CFRA), the Consumers Association of Canada, the Canadian Council of Grocery Distributors, and Food and Consumer Products Manufacturers of Canada, who felt that the increase was unnecessary and that the DFC should explore alternatives for disposing of surplus cattle, including selling them to the Georgian Bay Milk Company. As well, the CRFA felt that it was unfair for consumers and businesses to swallow another increase in dairy prices. The CDC obviously felt the price increase was not warranted at the time and denied the DFC an increase in the price of fluid milk. The DFC can apply for a price increase again in February of 2005.

STATISTICAL TABLES

Table 1: Fluid Milk PS&D

PSD Table

Country Commodity	Canada Dairy, Milk, Fluid						UOM
	2003 Revised		2004	Estimate	2005	Forecast	
Market Year Begin	USDA Official	Estimate [New]	DA Official	Estimate [New]	DA Official	Estimate [New]	MM/YYYY
	01/2003	01/2003	01/2004	01/2004	01/2004	01/2005	
Cows In Milk	1065	1065	1077	1081	0	1095	(1000 HEA
Cows Milk Production	7880	7778	7770	8000	0	8100	(1000 MT)
Other Milk Production	0	0	0	0	0	0	(1000 MT)
TOTAL Production	7880	7778	7770	8000	0	8100	(1000 MT)
Intra EC Imports	0	0	0	0	0	0	(1000 MT)
Total Imports	0	0	0	2	0	2	(1000 MT)
TOTAL Imports	0	0	0	2	0	2	(1000 MT)
TOTAL SUPPLY	7880	7778	7770	8002	0	8102	(1000 MT)
Intra EC Exports	0	0	0	0	0	0	(1000 MT)
Total Exports	9	9	5	7	0	5	(1000 MT)
TOTAL Exports	9	9	5	7	0	5	(1000 MT)
Fluid Use Dom. Consum.	2857	2830	2805	2850	0	2887	(1000 MT)
Factory Use Consum.	4690	4483	4640	4651	0	4710	(1000 MT)
Feed Use Dom. Consum.	324	456	320	494	0	500	(1000 MT)
TOTAL Dom. Consumpti	7871	7769	7765	7995	0	8097	(1000 MT)
TOTAL DISTRIBUTION	7880	7778	7770	8002	0	8102	(1000 MT)
Calendar Yr. Imp. from U	0	0	0	0	0	0	(1000 MT)
Calendar Yr. Exp. to U.S.	0	5	0	3	0	3	(1000 MT)

Table 2: Cheese PS&D

PSD Table

Country Commodity	Canada Dairy, Cheese						UOM
	(1000 MT)						
Market Year Begin	2003	Revised	2004	Estimate	2005	Forecast	MM/YYYY
	USDA Official [	Estimate [1/A	Official [	Estimate [1/A	Official [	Estimate [New]	
	01/2003		01/2004		01/2005		
Beginning Stocks	52	52	50	57	48	48	(1000 MT)
Production	345	342	340	326	0	330	(1000 MT)
Intra EC Imports	0	0	0	0	0	0	(1000 MT)
Total Imports	28	27	26	22	0	22	(1000 MT)
TOTAL Imports	28	27	26	22	0	22	(1000 MT)
TOTAL SUPPLY	425	421	416	405	48	400	(1000 MT)
Intra EC Exports	0	0	0	0	0	0	(1000 MT)
Total Exports	12	11	8	10	0	8	(1000 MT)
TOTAL Exports	12	11	8	10	0	8	(1000 MT)
Human Dom. Consumption	363	353	360	347	0	344	(1000 MT)
Other Use, Losses	0	0	0	0	0	0	(1000 MT)
Total Dom. Consumption	363	353	360	347	0	344	(1000 MT)
TOTAL Use	375	364	368	357	0	352	(1000 MT)
Ending Stocks	50	57	48	48	0	48	(1000 MT)
TOTAL DISTRIBUTION	425	421	416	405	0	400	(1000 MT)
Calendar Yr. Imp. from U	0	6	0	4	0	3	(1000 MT)
Calendar Yr. Exp. to U.S.	0	5	0	4	0	4	(1000 MT)

Table 3: Butter PS&D

PSD Table

Country Commodity	Canada Dairy, Butter						UOM
	(1000 MT)						
Market Year Begin	2003	Revised	2004	Estimate	2005	Forecast	MM/YYYY
	USDA Official [	Estimate [1/A	Official [	Estimate [1/A	Official [	Estimate [New]	
	01/2003		01/2004		01/2005		
Beginning Stocks	13	13	13	13	13	14	(1000 MT)
Production	75	84	70	88	0	90	(1000 MT)
Intra EC Imports	0	0	0	0	0	0	(1000 MT)
Total Imports	20	20	25	25	0	21	(1000 MT)
TOTAL Imports	20	20	25	25	0	21	(1000 MT)
TOTAL SUPPLY	108	117	108	126	13	125	(1000 MT)
Intra EC Exports	0	0	0	0	0	0	(1000 MT)
Total Exports	12	12	15	19	0	18	(1000 MT)
TOTAL Exports	12	12	15	19	0	18	(1000 MT)
Domestic Consumption	83	92	80	93	0	94	(1000 MT)
TOTAL Use	95	104	95	112	0	112	(1000 MT)
Ending Stocks	13	13	13	14	0	13	(1000 MT)
TOTAL DISTRIBUTION	108	117	108	126	0	125	(1000 MT)
Calendar Yr. Imp. from U	0	0	0	4	0	3	(1000 MT)
Calendar Yr. Exp. to U.S.	0	11	0	18	0	17	(1000 MT)

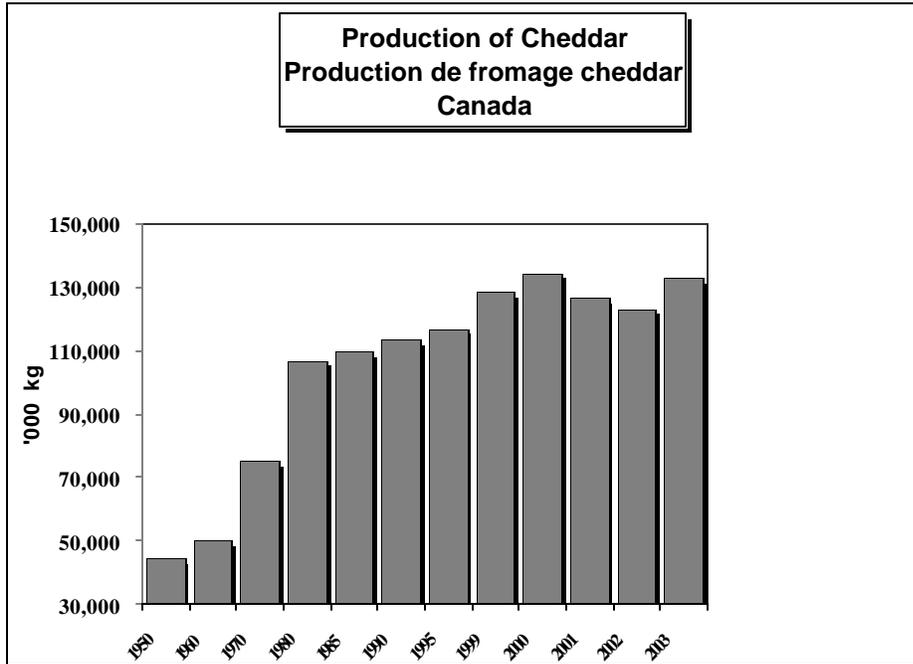
Table 4: Nonfat Dry Milk (Skim Milk Powder) PS&D

PSD Table

Country Commodity	Canada Dairy, Milk, Nonfat Dry (1000 MT)						UOM
	2003 USDA Official	Revised Estimate [A]	2004 USDA Official	Estimate Estimate [A]	2005 USDA Official	Forecast Estimate [New]	
Market Year Begin	01/2003		01/2004		01/2005		MM/YYYY
Beginning Stocks	7	8	7	21	7	27	(1000 MT)
Production	80	94	78	98	0	100	(1000 MT)
Intra EC Imports	0	0	0	0	0	0	(1000 MT)
Total Imports	2	2	1	3	0	1	(1000 MT)
TOTAL Imports	2	2	1	3	0	1	(1000 MT)
TOTAL SUPPLY	89	104	86	122	7	128	(1000 MT)
Intra EC Exports	0	0	0	0	0	0	(1000 MT)
Total Exports	36	35	32	45	0	45	(1000 MT)
TOTAL Exports	36	35	32	45	0	45	(1000 MT)
Human Dom. Consumption	43	45	44	47	0	48	(1000 MT)
Other Use, Losses	3	3	3	3	0	3	(1000 MT)
Total Dom. Consumption	46	48	47	50	0	51	(1000 MT)
TOTAL Use	82	83	79	95	0	96	(1000 MT)
Ending Stocks	7	21	7	27	0	32	(1000 MT)
TOTAL DISTRIBUTION	89	104	86	122	0	128	(1000 MT)
Calendar Yr. Imp. from U	0	0	0	3	0	1	(1000 MT)
Calendar Yr. Exp. to U.S.	0	2	0	0	0	0	(1000 MT)

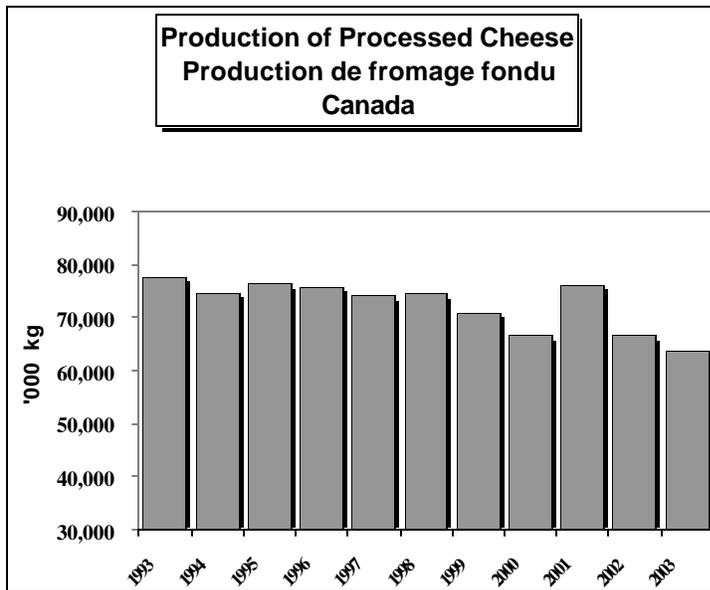
HISTORICAL CHARTS

Chart 1: Historical Cheddar Cheese Production



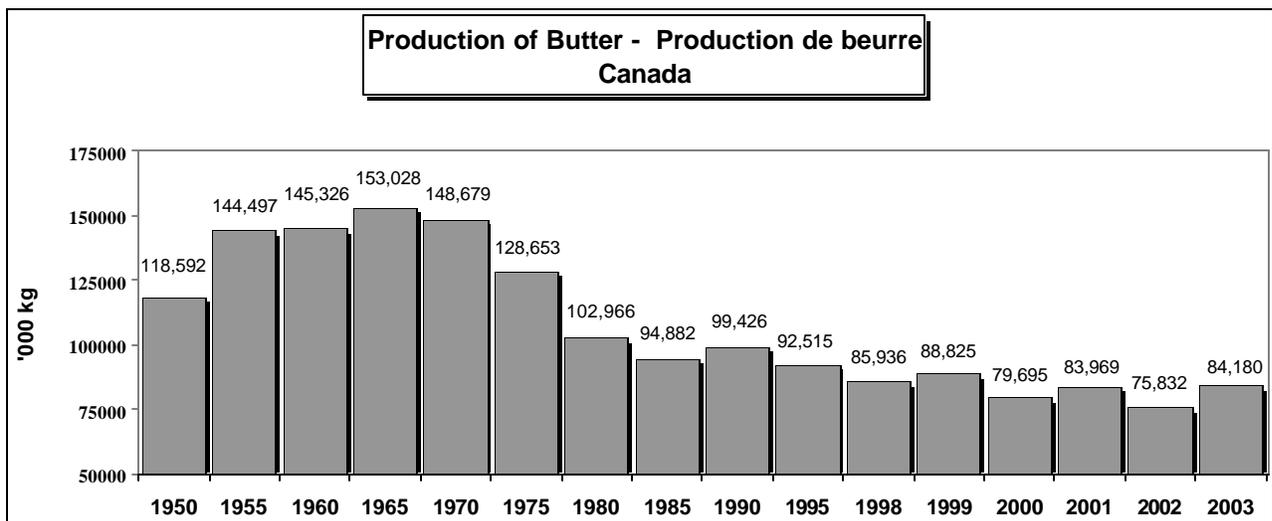
(Source: Agriculture and Agri-Food Canada, Dairy Section)

Chart 2: Historical Processed Cheese Production



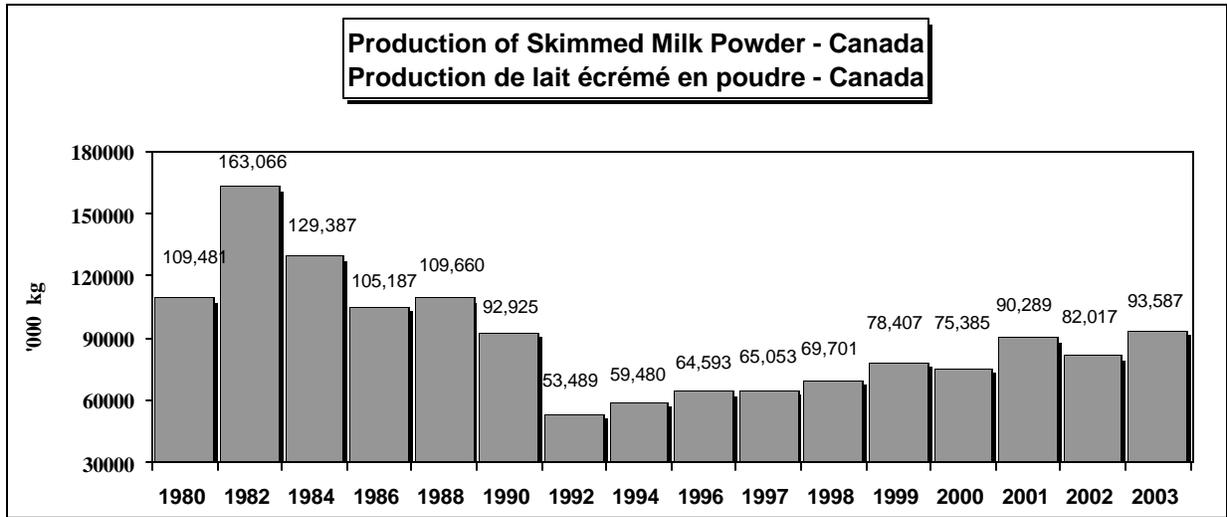
(Source: Agriculture and Agri-Food Canada, Dairy Section)

Chart 3: Historical Butter Production



(Source: Agriculture and Agri-Food Canada, Dairy Section)

Chart 4: Historical Skim Milk Powder Production



(Source: Agriculture and Agri-Food Canada, Dairy Section)

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