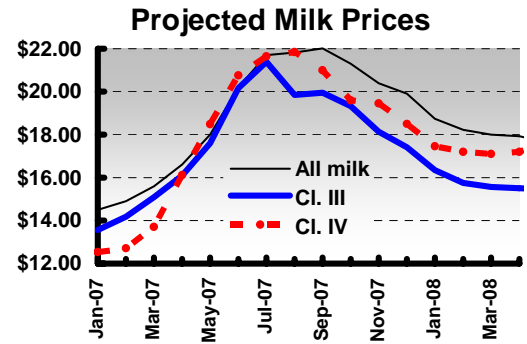


Dairy Market Report



Executive Summary

- ➔ U.S. skim solids commercial disappearance was up 2.9% for April-June; butterfat was up 1.3%.
- ➔ August cheese stocks were down 4%, butter stocks up 5%, from last year.
- ➔ On August 28, blocks were up 10¼¢ to \$1.97¾/lb., barrels up 8¼¢ to \$1.93¼, butter down 7¼¢ to \$1.43¾/lb., from our last report.
- ➔ July milk production was up 3.7%; 10+% jumps in CA & AZ.
- ➔ Outlook: *Slow 12-month price decline.*



Market Outlook

How did a large (3.7%) jump in July milk production fail to crash the dairy markets? Let us count the ways.

First, half of the U.S. production increase is attributable to an extremely large (8½%) increase in California milk per cow. This increase was driven by very good cow weather in July 2007, after extreme bovine-stressing heat in July 2006. Without this temporary boost, U.S. production is up a less startling, but still significant, 2% - 2½%. Second, recent demand numbers have been strong, especially given the high milk prices, with continued exports and a late and modest domestic demand response to higher retail prices. Third, moderating prices in the fall should further fan demand growth both at home and abroad. Finally, many have been anticipating production growth in response to high prices, and the resulting softening in the fall. So, while U.S. dairy prices have peaked, the fundamentals for the next 6 to 18 months seem too strong for a real crash; and the markets reacted accordingly.

Clearly, though, the current record milk prices, being far more than enough to evoke milk production growth from dairy farmers, are unsustainable. Cheese prices peaked, fell, and are now rebounding, as anticipated. They will decline again through the end of the year and beyond, but along what trajectory?

Signals are tough to read when expectations are in flux, as they are now. A rising market drives buyers and even manufacturers to build stocks in the expectation that they will rise in value. A falling market drives buyers to work off stocks, and wholesale demand can fall off even when final demand is strong. At a moment like this, when markets are steady or rising for the short-term, but are generally expected to fall over a longer term, changes in demand or inventory figures can be misleading, especially since many of the inventories along the supply chain aren't counted by USDA.

*Nevertheless, aside from (spot and futures) prices themselves, the key numbers this fall will be inventories and exports. U.S. prices will continue to depend on the strength of overseas demand for U.S. dairy proteins (and, to a lesser degree, butterfat); a drop-off will mean a faster price decline. Inventory changes must eventually reveal themselves, and if they begin building consistently, it will signal weaker overall demand. **dmr***

The Dairy Market Report is created for Dairy Management Inc.



The Nutshell

Production v. last year:

- June Cheese ↓ 0.8%
- June Butter ↑ 9.3%
- June NDM/SMP ↓ 3.6%
- June Whey ↑ 6.2%
- July Milk ↑ 3.7%

Prices:

| NASS | June | July |
|---------|-------|-------|
| Cheddar | 1.86 | 2.00 |
| Whey | 0.76 | 0.73 |
| Butter | 1.49 | 1.46 |
| NDM | 1.90 | 2.02 |
| Milk | June | July |
| Cl. III | 20.17 | 21.38 |
| Cl. IV | 20.76 | 21.64 |
| All | 20.20 | 21.70 |

Cheese and Whey

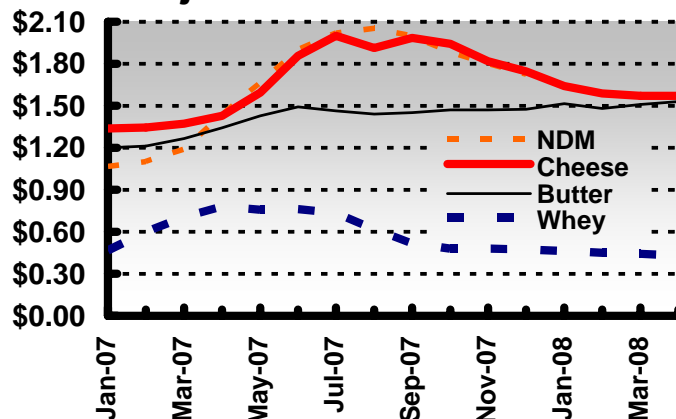
In June, total U.S. [cheese production](#) (excluding cottage cheese) was 790 million lbs., down 0.8% from a year ago. Of this, American types totaled 316 million lbs., down 4.6%, and Italian types were 338 million lb., up 2.9%. For the year to date, total cheese production was up 1.9%.

Natural American cheese [stocks](#) were 563 million lbs. on August 1, even with July and down 6% from a year ago. Stocks of other cheese, including Swiss, began August at 304 million lbs., down 2% from July and up 2% from last year. Total cheese stocks are down 4% from a year ago.

For the three months ending June 2007, [commercial disappearance](#) of American cheese was 996 million lbs., down 0.3% from a year ago; other cheese was 1.51 billion lbs., up 5.1% from last year. The total was up 2.9%.

On August 28, [CME](#) prices of 40-lb. blocks were up 10¼¢ from our last report, at \$1.97¼ per lb.; 500-lb. barrels were up 8¼¢ to

Projected Product Prices



Based on futures as of August 28, 2007

\$1.93¼. Futures markets project a cheddar cheese price averaging \$1.69 in 2007, and \$1.79 in the six

months ending next February. World prices for cheddar cheese are over \$2.00 per lb.. WPC-34 prices were down to about \$1.58 and Western sweet whey was down to about 55¢, per [Dairy Market News](#).

| Whey Products | | | | |
|---------------|-----------------|---------------|---------------------|---------------|
| Product | June Production | | July 1 Maker Stocks | |
| | Mil. lbs. | Change v 2006 | Mil. lbs. | Change v 2006 |
| Whey, food | 90.8 | 6.2 | 48.1 | 1.9 |
| Whey, feed | 3.8 | -9.5 | 3.0 | 38.5 |
| WPC25-50 | 22.3 | -10.7 | 18.2 | -9.3 |
| WPC50-90 | 11.3 | 1.2 | 8.9 | -16.3 |
| WPI90+ | 3.2 | 28.0 | n/a | n/a |
| Total | 131.5 | 3.0 | 78.2 | 1.4 |

The [CME](#) dry whey futures contract projects whey prices in the mid-40¢'s throughout 2008, although this is based on limited trading of contract months beyond December. Overall, open interest in this contract remains around 73 million lbs., equivalent to the "other solids" in about 1.2 billion lbs. of Class III milk. The international whey price is about 66¢ per lb.

months ending next February. World prices for cheddar cheese are over \$2.00 per lb..

The [retail prices](#) in July 2007 were \$4.29 per lb. for cheddar cheese (down ½% from last year); and \$3.76 for American processed cheese (up 5%).

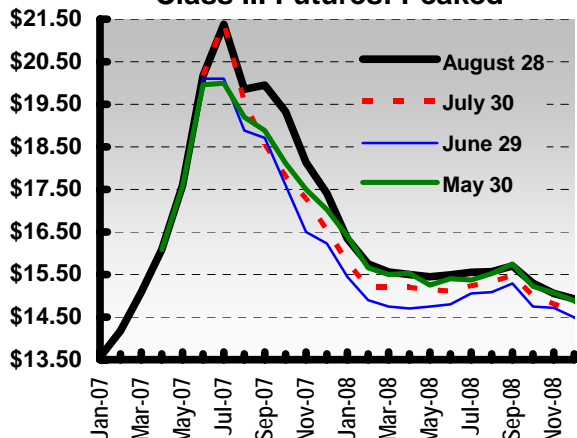
U.S. [production](#) of dry **whey** for food was 91 million lbs. in June, up 5½% from a year ago, and up 2½% for the year to date. (See box.)

The manufacturers' [price](#) of whey was 60¢ per lb. the week of August 18, according to NASS' sur-

The whey price has been declining as demand has responded to the record high prices of the last year. The futures markets reflect analysts projections of a generally lower price through 2008, while whey marketers face the challenge of regaining customers lost to those prices. Whey prices are the most unregulated among the dairy market complex, and some observers see them becoming a free-market bellwether for dairy prices overall. **dmr**

Prices have peaked, but most fundamentals remain strong for 2008.

Class III Futures: Peaked



Butter

June U.S. [butter production](#) was 110 million lbs., up 9.3% from a year ago; year-to-date production was up 1%.

Butter [stocks](#) started August at 272 million lbs., up 5% from a year ago. This nearly matches reported stocks for August 2003, the highest in the last decade, although USDA says it is now collects more of this data. [Commercial disappearance](#) of butter in the quarter

ending with May was 303 million lbs., up 1% from a year ago.

The [CME](#) butter price was down 7¾¢ to \$1.43¾ on August 28. The futures markets expect butter prices to average about \$1.39 in 2007, and \$1.48 in the six months ending next February; open interest totals over 90 million lbs.

World butter prices continue rising, approaching \$1.60 per lb. and there are reports of unassisted

commercial butter exports, after some 20 months of export assistance by the private Cooperatives Working Together program. In the 20 months prior to international prices rising above domestic prices, CWT offered export assistance for up to 62 million lbs. of butter (and equivalent anhydrous milkfat).

July's [retail](#) butter price averaged \$3.06 per lb., up 9% from last July.

dmr

Dry Milk Powders

U.S. [nonfat dry milk production](#), adding in protein-standardized "skim milk powders" was 136 million lbs. in June, down 3½% from a year ago; and down 13% for the year to date, to 760 million lbs.

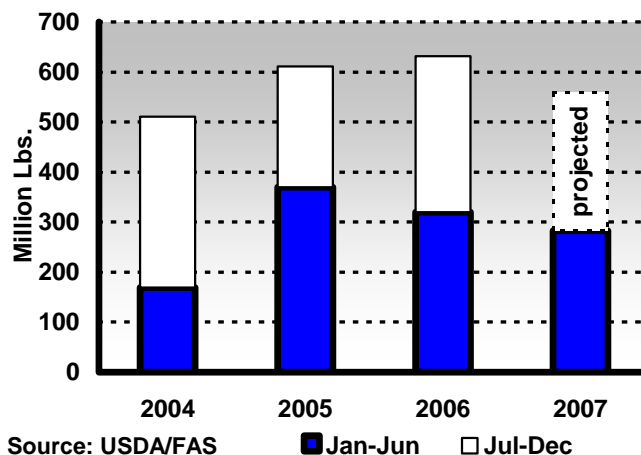
July 1 manufacturers' stocks of (only) nonfat dry milk were 107 million lbs., down 3% from a year ago.

The [CME](#) prices of extra grade and grade A nonfat dry milk were \$1.93 and \$2.11 on August 28, unchanged from last month's report. According to USDA's weekly survey, the average U.S. manu-

facturers' [price](#) was \$2.07 the week of August 18, in line with current spot prices. Overseas powder prices remain near \$2.20, and U.S. exports continue at high levels, although lower than the last two years. [Commercial disappearance](#) of nonfat dry milk (including exports, but excluding modified "skim milk powders") in the three months ending June was 330 million lbs., down 1%

from a year ago. **dmr**

U.S. Skim Milk Powder Exports



Yogurt, Ice Cream, and Fluid Milk

U.S. [yogurt production](#) was 285 million lbs. in June, down 2% from last June, but up 5½% for the year to date to 1.77 billion lbs.

U.S. [ice cream production](#) was 134½ million gallons in June, up 2% from a year ago. Ice cream mix production was 50 million gallons, up 3%. For the year to date, ice cream and ice cream mix production is up 4%. July's [retail](#) ice cream price was \$3.82 per ½-

gallon, and up 5% from last year.

[Fluid milk sales](#) for June were down 0.7%, (down 0.8% calendar-adjusted), in a month with 14% higher [retail](#) prices. July's retail whole milk price was \$3.74 per gallon, up 21% from last year. **dmr**

U.S. Fluid Milk Sales

| Product | June 2007 | | Year-to-Date | |
|----------------------------------|--------------|-------------|---------------|------------|
| | Mil. lbs. | % | Mil. lbs. | % |
| Whole Milk | 1,316 | -3.2 | 8,025 | -2.2 |
| Flavored Whole Milk | 52 | -9.2 | 342 | -2.6 |
| Organic Whole Milk | 26 | 18.1 | 149 | 26.3 |
| Reduced Fat Milk (2%) | 1,452 | 0.3 | 8,905 | 1.2 |
| Low Fat Milk (1%) | 510 | 2.2 | 3,284 | 3.6 |
| Fat-Free Milk (Skim) | 655 | 0.0 | 4,067 | 1.7 |
| Flavored Fat-Reduced | 171 | -5.9 | 1,926 | 1.0 |
| Organic Fat-Reduced | 89 | 21.6 | 515 | 32.5 |
| Buttermilk | 41 | -1.2 | 258 | 0.9 |
| Total (including "Other") | 4,321 | -0.7 | 27,537 | 0.9 |
| Total (calendar adjusted) | 4,263 | -0.8 | 27,427 | 0.4 |

Source: USDA/AMS, Dairy Market News

Milk: Production and Prices

U.S. [milk production](#) was 15.74 billion lbs. in July, *up 3.7% from a year ago*. The herd was up 0.3% and milk per cow was up 3.4%. Of the 23 states with USDA-reported monthly production, fourteen showed year-over-year growth, including Arizona (up 10.4%) and Michigan (up 7.2%). Nine states were down, including New Mexico (-9.0%) and Missouri (-8.2%). California production was up 10.6% from an exceptionally poor

weight, up \$1.21 from June and up \$10.46 from last July. August Class III will be announced near \$19.85 on August 31.

Class III [futures](#) prices for the next six months averaged \$17.82 per hundredweight on August 28, and project an average of \$17.73 for all of 2007. USDA [forecasts](#) a 2007 average of \$18.10. Volume and open interest in the Class III milk

futures and options markets was 12.4 billion lbs. The Class III price is the minimum price processors pay for cheese milk pooled on the Federal orders.

The July Class IV price rose 88¢ to \$21.64 per hundredweight, up \$11.43 from last July. August's Class IV will be near \$21.85.

[Futures](#) markets suggest that the Class IV price will average

about \$18.90 for the six months ending February, and about \$18.00 for all of 2007. USDA forecasts the Class IV price to average \$18.45 in 2007. The Class IV price is the minimum price for pooled milk used to produce butter or milk powder.

July component prices were as follows: \$1.6110 per lb. (down 3½¢ from June) for butterfat in Class III, Class IV, and producer milk; \$4.2068 (up 50¢) for protein in Class III and

producer milk; \$1.8424 (up 11½¢) for total nonfat solids in Class IV milk; and \$0.5534 (down 3¢) for other solids in Class III and producer milk.

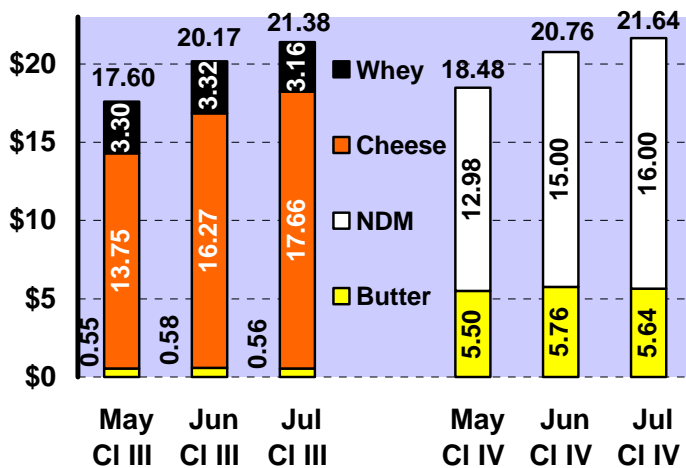
The July Class II price was up \$2.51 to \$21.40 per hundredweight. This is the minimum price for pooled milk used to make soft dairy products and in most food processing. August's Class II price will be announced near \$22.40 on August 31.

The September Class I base price was up 15¢ from August, and **up \$11.06** from last year, to \$21.91, based on butter/powder values. This is the record and, most likely, the peak; the October price is projected at \$21.50. The Class I base price plus the Class I location differential is the minimum price processors pay (at the plant) for bottling milk pooled on a [Federal order](#).

The [announced cooperative Class I milk price](#) for major cities averaged \$26.19 per hundredweight (\$2.26 per gallon) in September, \$1.75 (15¢) above the Federal order minimum, and \$10.86 (93¢) higher than a year ago.

USDA estimates July's [all-milk price](#) at \$21.70, up \$1.50 from June's revised figure, and **up \$9.90** from a year ago. This price may inch higher in August and September before declining. The six months ending next February are projected at about \$20.10, all of 2007 at \$18.90. USDA raised its 2007 all-milk price [forecast](#) again to \$19.25. **dmr**

Class Price Breakdown



July 2006, on **8.5%** higher milk per cow from 1.9% more cows. Production in Wisconsin, which often reflects national trends, was up 4.1%.

USDA's projects 2007 growth at 1.4%. We now project annual production growth of between 1½% and 2%, based on year-to-year increases of 2% to 2½% for the rest of 2007.

The July Class III price was announced at \$21.38 per hundred-

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Dairy Management Inc.™ and state, regional, and international organizations work together to drive demand for dairy products on behalf of America's dairy farmers, through the programs of the American Dairy Association®, the National Dairy Council®, and the U.S. Dairy Export Council®.



The National Milk Producers Federation (NMPF) is a farm commodity organization representing most of the dairy marketing cooperatives serving the U.S.