September 2007

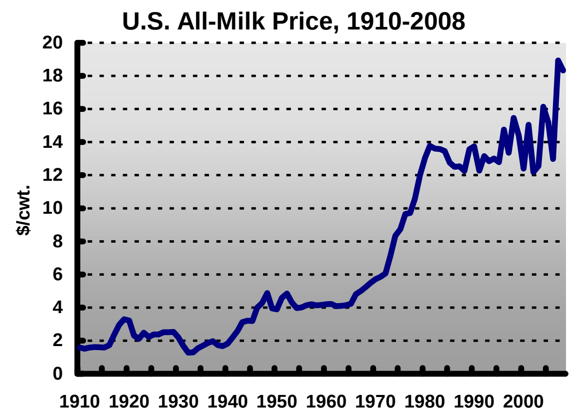
National Milk Producers Federation

Volume 10, Number 8

Dairy Market Report

Executive Summary

- U.S. skim solids commercial disappearance up 2.0% for May-July; butterfat up 3.1%.
- September 1 cheese stocks down 2%, butter stocks up 21%, from last year.
- September 28 blocks down 7¾¢ to $1.90/lb., barrels down 8¼¢ to $1.85, butter down 12½¢ to $1.31½/lb., from our last report.
- August milk production up 3.4%.
- Outlook: *Slower production growth; slow worldwide price decline.*



The Dairy Market Report is created for Dairy Management Inc.

The Nutshell

Production v. last year:

- July Cheese ⬆ 2.6%
- July Butter ⬆ 21.8%
- July NDM/SMP ⬆ 17.5%
- July Whey ⬇ 0.1%
- August Milk ⬆3.4%

Prices:

NASS	July	Aug
Cheddar	2.00	1.91
Whey	0.73	0.62
Butter	1.46	1.44
NDM	2.02	2.05
Milk	**July**	**Aug**
Cl. III	21.38	19.83
Cl. IV	21.64	21.87
All	21.70	21.70

Market Outlook

Every two or three decades, there is a fundamental shift in milk prices. (See graph above.) Past shifts have been the result of general price inflations, including the war-price inflations of the 1910's and 1940's and the loose money inflation of the 1970's. Today we may be seeing another shift, but one associated with a more limited energy-driven food and feed price inflation. USDA estimates that the August cost of milk production in California and New Mexico was up by $2 per hundredweight from last spring, with most of the increase coming from higher feed costs. In New York and Wisconsin, this increase was larger, *from $2.50 to $3.00. As feed for livestock also becomes feed for machines, demand expands and the feed prices rise. This growing demand for machine feed is re-ordering crop production and crop markets around the world, resulting in expanded crop acreage and higher feed prices.*

Two future scenarios present themselves. In the first, the world's cropland will be productive enough to sustain this demand, and after a period of adjustment feed prices will return to historical averages. In this case, milk prices will also likely return to past levels.

In the second scenario, energy demand for crops and cropland will outpace the supply, and bring it into direct long-run competition with feed and food uses. In that case, feed prices will remain high, and milk and dairy prices will stay up just to cover costs of production.

In either scenario the U.S. dairy industry has been blessed this year (and next) with strong overseas demand despite these high prices. This has been helped by rising incomes and constrained milk production in other countries. In addition a weak U.S. dollar has made U.S. products cheaper in other countries; this takes the edge off rising dairy prices for overseas customers. U.S. milk producers are responding to higher prices, but they are selling into a larger market than in the past—the U.S. market plus a healthy export market. As a result, U.S. production growth won't have as large a price impact as it has in the past, and U.S. milk production is no longer constrained by U.S. demand growth.

Dairy prices had to come down from this year's peaks, and they are. However, the modestly lower prices we see in the next 18 months include the second highest U.S. all-milk price ever (after 2007) and product prices well above historical averages. Key numbers will continue to be exports, for both U.S. dairy proteins and, perhaps increasingly, butterfat. dmr

Cheese and Whey

In July, total U.S. **cheese** production (excluding cottage cheese) was 795 million lbs., up 2.6% from a year ago. Of this, American types totaled 322 million lbs., down 1.6%, and Italian types were 335 million lb., up 4.6%. For the year to date, total cheese production was up 2.6%.

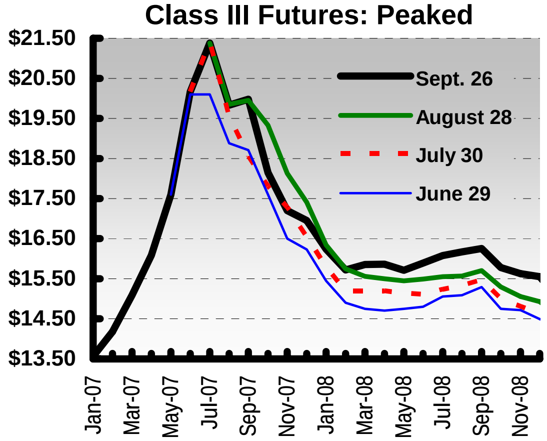
Natural American cheese stocks were 563 million lbs. on September 1, up 1% from August and down 3% a year ago. Stocks of other cheese, including Swiss, began September at 285 million lbs., up 1% from August and down 7% from last year. Total cheese stocks are down 2% from a year ago.

In time, whey prices should return to rough protein parity with nonfat dry milk.

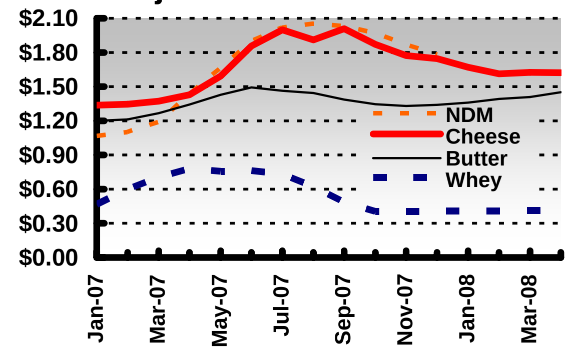
For the three months ending July 2007, commercial disappearance of American cheese was 1.00 billion lbs., up 0.6% from a year ago; other cheese was 1.52 billion lbs., up 7.0% from last year. The total was up 4.3%.

On September 26, CME prices were down from our last report: 40-lb. blocks down 7¾¢ to $1.90 per lb.; 500-lb. barrels down 8¼¢ to $1.85. Futures markets project a cheddar cheese price averaging $1.72 in the six months ending next March, $1.69 in 2007, and $1.62 in 2008. World prices for cheddar cheese are over $2.20 per lb..

Class III Futures: Peaked



Projected Product Prices



Based on futures as of September 26, 2007

The retail prices in August 2007 were $4.41 per lb. for cheddar cheese (up 3½% from last year); and $3.97 for American processed cheese (up 9%).

Whey Products				
Product	July Production		August 1 Maker Stocks	
	Mil. lbs.	Change v 2006	Mil. lbs.	Change v 2006
Whey, food	90.6	-0.1	52.5	30.2
Whey, feed	4.7	2.6	6.2	147.5
WPC25-50	22.2	-10.5	18.3	-9.6
WPC50-90	11.1	2.2	9.2	-9.1
WPI90+	2.9	10.4	n/a	n/a
Total	*131.5*	-1.6	86.2	17.7

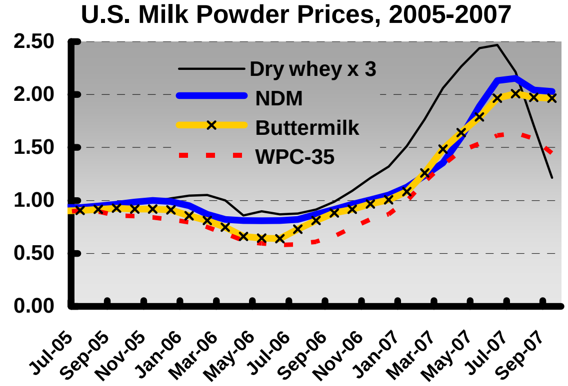
U.S. production of dry **whey** for food was 91 million lbs. in July, about even with a year ago, and up 2½% for the year to date. (See box.)

The manufacturers' price of whey was 44¢ per lb. the week of September 22, according to NASS' survey. WPC-34 prices were down to about $1.45 and Western sweet whey was down to about 40¢, per Dairy Market News.

The CME dry whey futures market now projects whey prices in the low to mid-40¢'s throughout 2008, based on limited trading volume. (Open interest in whey futures are about 77 million lbs.) The international whey price is under 50¢ per lb.

Whey prices may be "finding their bottom" in the 40's, and may be expected to stabilize in 2008 at prices that are still far above historical averages. (Whey averaged less than 24¢/lb. from 2000 to 2006.) The graph below shows recent whey prices out of line with their protein value; in time, they should return to rough parity with nonfat dry milk (3 x whey = ndm). *dmr*

U.S. Milk Powder Prices, 2005-2007



Source: Dairy Market News, USDA

Butter

July U.S. butter production was 115 million lbs., up 22% from a year ago, and 2007 to date is now up 3%.

Butter stocks started September at 261 million lbs., up 21% from a year ago. These are the largest reported September stocks in the last decade. Commercial disappearance of butter in the quarter ending with July was 336 million lbs., up 9.8% from a year ago.

August's retail butter price averaged $3.16 per lb., up 12% from last August. The CME butter price was down 12¼¢ to $1.31½ on September 28. The futures markets expect butter prices to average about $1.36 in the six months ending next March, $1.35 in 2007, and $1.49 in 2008; open interest totals over 78 million lbs.

World butter prices have risen above $1.63 per lb. As a result of rising world prices and falling U.S. prices, exports of butter, butteroil, and anhydrous milk fat are picking up substantially. After averaging 2.6 million pounds per month through June (mostly with assistance from the private Cooperatives Working Together program), July exports of these products jumped to 7 million pounds, and unassisted sales are expected to drive continued increases through the fall. dmr

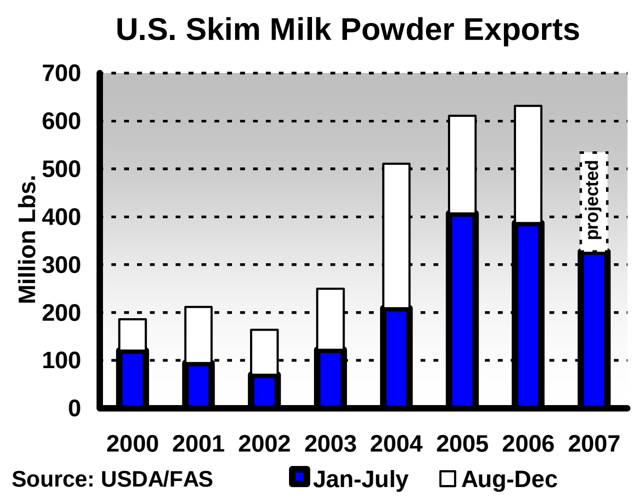
Dry Milk Powders

U.S. nonfat dry milk production, adding in protein-standardized "skim milk powders" was 140 million lbs. in July, up 17½% from a year ago; and down 9½% for the year to date, to 901 million lbs.

August 1 manufacturers' stocks of (only) nonfat dry milk were 125 million lbs., down 15% from a year ago.

The CME prices of extra grade and grade A nonfat dry milk were $1.93 and $2.11 on September 28, unchanged from last month's report. According to USDA's weekly survey, the average U.S. manufacturers' price was $2.04 the week of September 15, in line with current spot prices. Overseas powder prices are about $2.10, and U.S. exports continue at high levels, although lower than the last two years.

Overall U.S. commercial disappearance of nonfat dry milk (including exports, but excluding modified "skim milk powders") in the three months ending July was 330 million lbs., down 9.7% from a year ago, according to USDA. dmr



Yogurt, Ice Cream, and Fluid Milk

U.S. yogurt production was 288 million lbs. in July, up 8% from last July, and up 6% for 2007 to date.

U.S. ice cream production was 127½ million gallons in July, up 3% from a year ago. Ice cream mix production was 49 million gallons, down 3%. For 2007 to date, ice cream and ice cream mix production is up 3.2%. August's retail ice cream price was $3.90 per ½-gallon, up 8% from last year.

Fluid milk sales for July were down 1.1%, (down 1.3% calendar-adjusted), in a month with 21% higher retail prices. August's retail whole milk price was $3.81 per gallon, up 26% from last year.

Organic sales are now 2.6% of the U.S. total, and rBST-free fluid milk is becoming standard in large parts of the country. dmr

U.S. Fluid Milk Sales

	July 2007		Year-to-Date	
Product	**Mil. lbs.**	**%**	**Mil. lbs.**	**%**
Whole Milk	1,307	-4.2	9,332	-2.5
Flavored Whole Milk	52	-10.8	394	-3.8
Organic Whole Milk	25	35.3	174	27.5
Reduced Fat Milk (2%)	1,451	-1.1	10,356	0.9
Low Fat Milk (1%)	499	1.4	3,783	3.3
Fat-Free Milk (Skim)	649	0.2	4,716	1.5
Flavored Fat-Reduced	141	-0.7	2,067	0.9
Organic Fat-Reduced	86	33.7	601	32.7
Buttermilk	42	2.2	300	1.1
Total (including "Other")	**4,263**	**-1.1**	**31,799**	**0.6**
Total (calendar adjusted)	**4,310**	**-1.3**	**31,736**	**0.2**

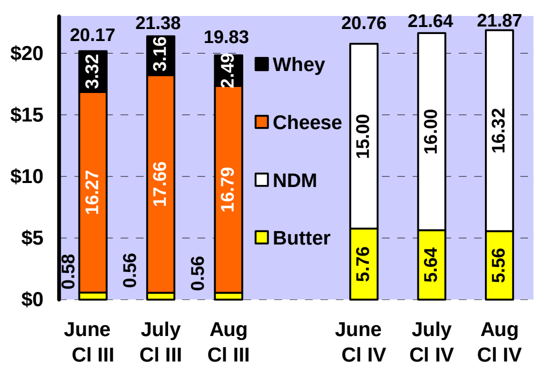
Source: USDA/AMS, Dairy Market News

Milk: Production and Prices

U.S. milk production was 15.57 billion lbs. in August, up 3.4% from a year ago, from 0.6% more cows and 2.7% more milk per cow. Of the 23 states with USDA-reported monthly production, seventeen showed year-over-year growth, including Arizona (up 11.5%) and Michigan (up 9.7%). Six states were down, including New Mexico (-3.6%) and Missouri (-5.9%). New Mexico's surprising declines have been attributed to poor weather in early 2007, several farms closing and several others moving to Texas, and (in apparent contradiction of USDA's milk-per-cow estimates) drastically reduced use of rBST. Last August, California milk production recovered substantially from July; so this August 2007 state production was up "only" 4.9% from a year ago (on 2.2% more milk per cow from 2.7% more cows.) Wisconsin production was up 4.5%.

USDA projects 2007 growth at 1.7%. We now project annual production growth of about 2%, based on year-to-year increases of more than 2½% for the rest of 2007.

Class Price Breakdown



The August Class III price was announced at $19.83 per hundredweight, up 79% from a year ago. September Class III will be announced near $20.00 on October 5.

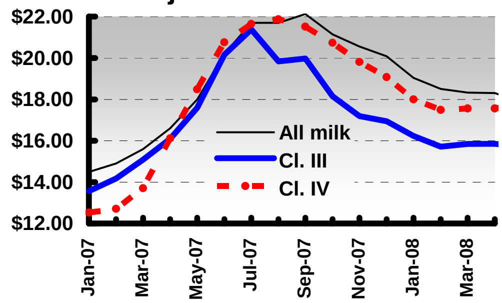
Class III futures prices for the next six months averaged $16.69 per hundredweight on September 26, and project an average of $17.52 for all of 2007 and $15.89 for 2008. USDA forecasts a 2007 average of $18.20, and $16.85 in 2008. Open interest in Class III milk futures and options was 12.1 billion lbs. The Class III price is the minimum price paid for cheese milk pooled on Federal orders.

The August Class IV price was $21.87 per hundredweight, up 105% from a year ago. September's Class IV will be near $21.65.

Futures markets project Class IV milk to average about $18.80 for the six months ending March, $18.25 for all of 2007and $17.79 for 2008. USDA forecasts the Class IV price to average $18.20 in 2007, and $18.20 in 2008. The Class IV price is the minimum price for pooled milk used to make butter or milk powder.

August component prices were as follows: $1.5872 per lb. (down 2½¢ from July) for butterfat in Class III, Class IV, and producer milk; $3.9412 (down 26½¢) for protein in Class III and producer milk; $1.8785 (up 4¢) for total nonfat solids in Class IV milk; and $0.4386 (down 12¢) for other solids in Class III and producer milk.

Projected Milk Prices



Based on futures as of September 26, 2007

August's Class II price was up 1¢ to $21.41 per hundredweight. This is the minimum price for pooled milk used to make soft dairy products and in most food processing. September's Class II price will be announced near $22.15 on October 5.

The October Class I base price was down 32¢ from September's record to $21.59, still ***74%*** above last year and still based on butter/powder values. The November price is projected at $21.20. 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.

USDA estimates September's all-milk price at a record $21.80, up 20¢ from the revised August figure and up 69% from a year ago. Prices will now begin their slow drift to earth, beginning with a projected $21.00 in October. Based on futures prices, the six months ending next March are projected at about $19.60, all of 2007 at $18.90, and 2008 at $18.30. USDA raised its 2007 all-milk price forecast again to $19.30, and is projecting 2008 at $18.80. **dmr**

Contact: Roger Cryan, V.P., Milk Mktg. & Econ.
National Milk Producers Federation
rcryan@nmpf.org
www.nmpf.org

nmpf

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