

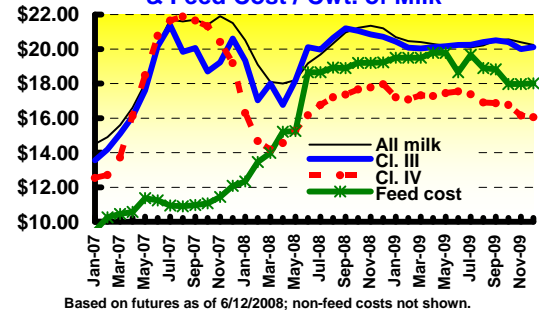


# Dairy Market Report

## Executive Summary

- ➔ Daily commercial disappearance (including exports): skim solids up 1.6% in March through May, milk fat up 2.0%.
- ➔ Cheese prices down, butter up, from our last report: August 15<sup>th</sup> blocks were down 28¢ to \$1.76/lb., barrels down 45¼¢ to \$1.70; butter up 16¾¢ to \$1.64½/lb.
- ➔ Outlook: Dairy farm margins improve as feed prices fall; milk production keeps growing. Dairy and feed prices will be lower, but still above historical norms for foreseeable future.

Projected Milk Prices, 6/11/08 & Feed Cost / Cwt. of Milk

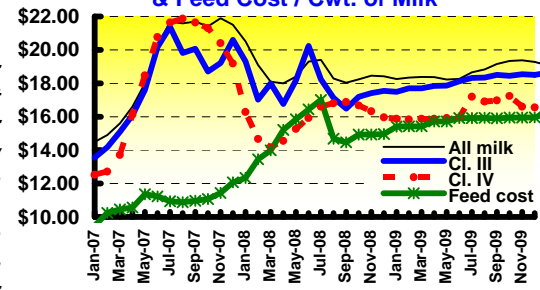


Based on futures as of 6/12/2008; non-feed costs not shown.

## Market Outlook

Price expectations have shifted dramatically. Class III milk futures have dropped from their peaks by an average of \$2 per hundredweight for 2009, and by over \$4 for some near months. (See graphs at right.) Corn and soy futures prices fell even more dramatically, as a brighter harvest outlook damped speculative fervor: this summer's flooding only affected a small share of cropland, and was accompanied by rains that have boosted yields on far more.

Projected Milk Prices, 8/15/08 & Feed Cost / Cwt. of Milk



Based on futures as of 8/15/2008; non-feed costs not shown.

The Dairy Market Report is created for Dairy Management Inc.



## The Nutshell

### Production v. last year:

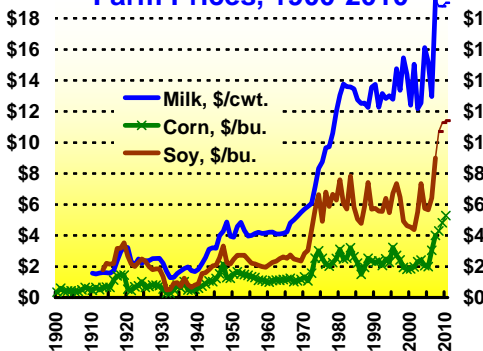
- June Cheese ↑ 1.3%
- June Butter ↑ 9.0%
- June NDM/SMP ↑ 23.4%
- June Whey ↓ 3.0%
- May Milk ↑ 3.0%
- June Milk ↑ 3.0%

NASS	June	July
Cheddar	2.16	1.96
Whey	0.28	0.26
Butter	1.47	1.52
NDM	1.35	1.41
Milk	June	July
Cl. III	20.25	18.24
Cl. IV	15.92	16.60
All	19.30	19.40

Production continues to grow from the cow number momentum of the last year's high prices. The July 1 milk cow inventory (9.25 million head) was up 1% from a year ago. The July 1 dairy heifer inventory (3.9 million) was even with a year ago (by contrast, the January heifer inventory was up 3.6% from January 2007); however, last year's was the largest July figure since 1995. This large supply of dairy herd replacements reflects the limited response to recent poor margins, and falling feed costs are reinforcing the milk production momentum of recent months. (See page 4.)

This is a continuation of a multiyear expansion to meet growing export demand. USDA projects a 2.1% increase in milk production in 2008, with three quarters of that increase taken up with new commercial export demand for dairy products. Of 2007's 2.4% increase in milk production, about half was absorbed by commercial exports. As we've stated before, this is redefining U.S. dairy markets.

Farm Prices, 1900-2010



Sources: 1900-2007: USDA/NASS; 2008-10: Futures-based projections

The latest round of herd retirements by Cooperatives Working Together was announced at about 25,000 cows making half a billion pounds of milk a year. This round is nearly completed, and its impacts should offset some of the milk production growth in August and beyond.

Despite recent drops in feed prices, they will remain above their recent historical levels. The graph at left shows a century of farm prices: in the big picture, the all-milk price has always followed feed costs. In our opinion, recent extreme price spikes signal a new long-term price plateau, as they did in 1919, 1948, and 1974. **dmr**

**Cheese and Whey**

Total U.S. **cheese production** (excluding cottage cheese) was 803 million lbs. in June, up 1.3% from a year ago, and almost even with May's 832 million, on an average daily basis. American types totaled 333 million lbs. in June, up 5.4% from last year, and down 2.2% (daily) from May. Italian types were also 333 million lbs., down 1.8% from last year and down 0.2% from May, on a daily basis.

Natural American cheese **stocks** were 581 million lbs. as July began, up 3% from a year ago. Stocks of other cheese, including Swiss, began were 324 million lbs., nearly even with a year ago. Total cheese stocks are up 2% from a year ago, and up 3% from June 1.

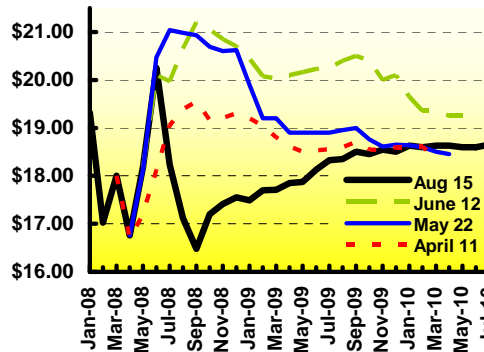
For the three months ending May 2008, **commercial disappearance** of American cheese was 977 million lbs., down 2.5% from a year ago; other cheese was 1.5 billion lbs., down 3.0% from last year. The total was down 2.8%.

Since our last report, **CME** block cheese prices fell from \$2.04 to \$1.89½ on July 9, then bounced back to \$2.08¼ on July 29 before sliding to \$1.70½ on August 7. On August 12, blocks stood at \$1.77¼ and barrels at \$1.74¼. Class III futures markets have fallen substantially, projecting cheese prices remaining near, but below, \$2.00 indefinitely.

August 15 futures markets project the NASS cheese price to average

just under \$1.90 over the next 6 months (September through February), and just over \$1.90 for all of 2008 and 2009. U.S. cheese **exports** in June were 27 million pounds, up 47% from a year ago, and equivalent to 3.3% of U.S. production. In addition, imports were down 21% to 26 million pounds,

**Class III Futures: Back to Earth**



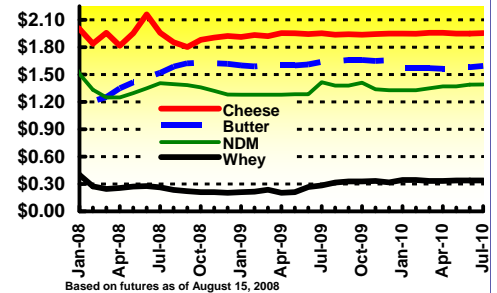
so in June the U.S. was a net cheese exporter, probably for the first time ever. (May's net imports were reported as 1760 pounds, smaller than any margin of measurement error.)

The **retail price** of cheddar cheese in June was \$4.54, up 14% from last year. Processed cheese averaged \$3.93 at retail, up 8%.

Total **production** of dry **whey** for food was 86.5 million lbs. in June 2008, down 3% from a year ago. (See box.)

The manufacturers' **price** of whey was 25¢ per lb.

**Projected Product Prices**



the week of August 9, according to NASS' survey. **WPC-34 prices have fallen precipitously**, to about 55¢, per **Dairy Market News**, almost 90¢ lower than nonfat dry milk spot prices, and only twice the Western sweet whey price of 28¢. (See graph on page 3.) The **CME** dry whey futures project average whey prices of 25¢ in 2008, 60% below the 2007 average. The international whey price is about 28¢ per lb., per USDA's **Dairy Market News**. **dmr**

**Whey Products**

Product	May Production		June 1 Maker Stocks	
	Mil. lbs.	Change v 2007	Mil. lbs.	Change v 2007
<b>Whey, food</b>	91.3	-2.2	53.5	28.9
<b>Whey, feed</b>	5.7	-3.9	4.2	-10.1
<b>WPC25-50</b>	25.0	11.4	27.4	76.6
<b>WPC50-90</b>	11.5	4.1	15.1	48.9
<b>WPI90+</b>	3.3	-1.2	n/a	n/a
<b>Total</b>	<b>136.8</b>	<b>0.5%</b>	<b>100.1</b>	<b>39.5%</b>

Product	June Production		July 1 Maker Stocks	
	Mil. lbs.	Change v 2007	Mil. lbs.	Change v 2007
<b>Whey, food</b>	86.5	-3.0	57.5	26.2
<b>Whey, feed</b>	6.0	9.2	5.1	-7.9
<b>WPC25-50</b>	23.2	7.5	28.4	56.1
<b>WPC50-90</b>	11.1	-3.3	14.6	62.8
<b>WPI90+</b>	3.3	-0.8	n/a	n/a
<b>Total</b>	<b>130.1</b>	<b>-0.7%</b>	<b>105.6</b>	<b>34.9%</b>

*"In June the U.S. was a net cheese exporter, probably for the first time ever."*

## Butter

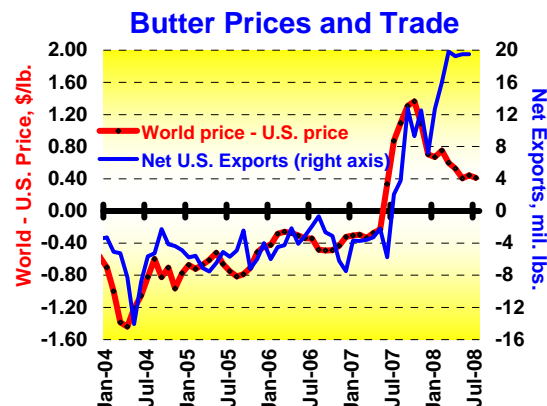
June U.S. [butter production](#) was 120 million lbs., up 9% from a year ago, but down 16% from May's 143 million pounds. July 1 butter [stocks](#) were 256 million lbs., 6% lower than a year ago.

[Commercial disappearance](#) (including exports) of butter in the three months ending with May was 389 million lbs., up 21% from a year ago. Disappearance of all milkfat was up 2.0% for the same three months.

The [retail](#) butter price was an estimated \$3.22 per lb. in June 2008, up 5% from 2007.

The [CME](#) butter price was up 16¾¢ to \$1.64½ on August 15. Futures project NASS butter at \$1.61 for the six months through February, \$1.46 for all 2008, and \$1.63 for 2009.

[Net butter exports](#) totaled 107 million pounds in the first half of 2008, compared with net [imports](#) of 22 million pounds in the first half of 2007. These exports have continued even as the price gap between the U.S. and the world narrowed to about 40¢ in June. USDA reports international butter spot prices 20¢ to 35¢ above U.S. domestic prices.



As the U.S. becomes a steadier supplier of the world market, this gap might be sufficient to maintain export volumes. **dmr**

## Dry Milk Powders

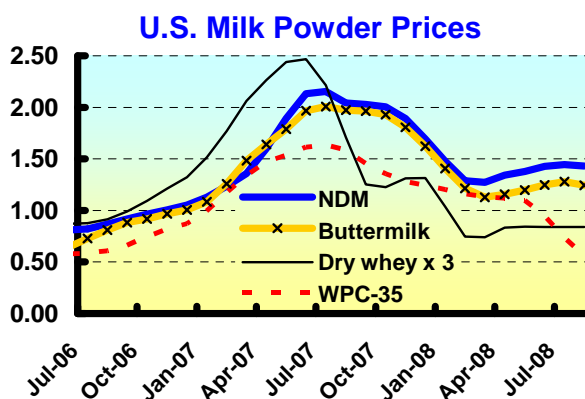
U.S. [nonfat dry milk production](#), including protein-standardized "skim milk powders" was 166 million lbs. in May, up 23% from a year ago.

June 1 manufacturers' stocks of (only) nonfat dry milk were 127 million lbs., up 22% from last year.

The [CME](#) price of grade A nonfat dry milk was down 4¢ to \$1.42½, extra grade was down 2¢ to \$1.44, on August 15, about a nickel above the average surveyed U.S. manufacturers' [price](#) of \$1.40 the week of August 9.

Skim powder prices are near \$1.60 in Oceania and \$1.50 in Western Europe, per [USDA](#). U.S. powder continues to be competitive: In June 2008 exports of nonfat dry milk and skim milk powders were 101 million pounds, double last June's total, and over 60% of production. Overall U.S. [commercial disappearance](#) of nonfat dry milk (including exports, but excluding modified "skim milk powders") in the three months ending June was 422 million lbs., up 26% from a year ago, according to USDA. For the same quarter, average

daily commercial disappearance of all skim solids was up 1.5%. **dmr**



Source: Dairy Market News, USDA

## Yogurt, Ice Cream, and Fluid Milk

U.S. [yogurt production](#) was 293 million lbs. in June, up 3.0% from last year. For the year to date, it is up 2.5% to 1.8 billion pounds.

June [ice cream production](#) was even with a year ago at 134½ million gallons. Ice cream mix production was 49 million gallons, down 0.3%. For the year to date, ice cream production is down 2½% and mix is down 4%. (May ice cream production was down

4½% from last year; mix was down 5%. June's [retail](#) ice cream price was \$4.07 per ½-gallon, up 5% from last year.

June [fluid milk sales](#) were down 0.2% from a year ago (calendar-adjusted), though the [retail](#) price of whole milk rose 10%, to \$3.77. May's retail price was \$3.76, up 15% from a year ago. **dmr**

### U.S. Fluid Milk Sales

Product	May 2008		June 2008		Year to Date	
	Mil. lbs.	%	Mil. lbs.	%	Mil. lbs.	%
Whole Milk	1,269	-4.1	1,207	-8.4	7,526	-6.2
Flavored Whole Milk	54	-5.3	45	-13.4	293	-14.4
Organic Whole Milk	31	33.6	31	24.5	189	29.1
Reduced Fat Milk (2%)	1,539	4.4	1,437	-1.0	9,035	1.4
Low Fat Milk (1%)	573	2.9	503	-1.4	3,335	1.5
Fat-Free Milk (Skim)	695	2.8	642	-2.2	4,084	0.4
Flavored Fat-Reduced	344	-2.0	170	-0.7	1,931	0.2
Organic Fat-Reduced	107	26.6	102	16.9	647	27.7
Buttermilk	45	3.1	39	-3.6	283	9.4
Total (including "Other")	4,665	1.4	4,184	-3.2	27,391	-0.5
Total (calendar adjusted)	4,599	0.3	4,254	-0.2	27,234	-0.7

Source: USDA/AMS, Dairy Market News

## Milk and Feed

U.S. [milk production](#) in June was 15.93 billion lbs., up 3% from a year ago. (May production was 16.67 billion lbs., also up 3% from a year ago.) We project continued growth. (See below.)

The CWT program announced that it will retire some 25,000 dairy cows and 300 heifers in its fifth round of herd retirements. These retirements will be nearly completed by the end of August, and should have its full impact on production in September and October.

July's Class III price was announced at \$18.24 per hundredweight, down \$2.01 from June, and down \$3.14 from a year ago. August will be down again, to about \$17.00. Class III [futures](#) prices for the next six months (September through February) averaged \$17.30 per hundredweight on August 15, and project averages of \$17.80 for 2008 and \$18.12 for 2009. The Class III price is the minimum price paid for cheese milk pooled on Federal orders.

The July Class IV price was \$16.60 per hundredweight, up 68¢ from June, but down \$5.04 from a year ago. August's Class IV is projected to be up about 20¢. [Futures](#) markets project Class IV milk to average about \$16.30 for the next six months, \$15.85 for 2008 and \$16.40 for 2009. The Class IV price is the minimum price for pooled milk used to make butter or milk powder.

July component prices: \$1.6774 per lb. (up 6¢ from June) for butterfat in Class III, Class IV, and producer

milk; \$4.0025 (down 72¢) for protein in Class III and producer milk; \$1.2358 (up 5¢) for total nonfat solids in Class IV milk; and \$0.0707 (down 1¢) for other solids in Class III and producer milk. August butterfat is projected at \$1.76.

July's Class II price was up 62¢ to \$16.81 per hundredweight. This is the minimum price for pooled milk used to make soft dairy products and in most food processing. August is projected at about \$17.50.

August's Class I base price is \$18.47, based on cheese/whey values. This is \$3.29 lower than last August and down \$2.31 from July. We project September's Class I base price at \$16.95. The Class I base price plus a location differential is the minimum price processors pay at the plant for bottling milk pooled on a [Federal order](#).

July's [all-milk price](#) was \$19.40, up 10¢ from June and down \$2.30 from a year ago. We project August's all-milk price at \$18.30. Futures project the next six months at \$18.30, 2008 at \$18.70, and 2009 at \$18.70.

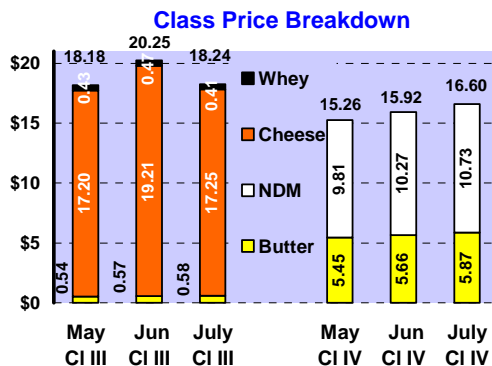
Anticipated **feed costs** are moderating. Futures for corn and soybeans fell dramatically. September corn [futures](#) peaked above \$7.70 per bushel in early July, but fell below \$4.90 on August 12. Similarly, September soybean [futures](#) peaked above \$16.30 in early July before falling below \$11.75 on August 8. Both have bounced back—to \$5.30 and \$12.11,

respectively, and could rise further to be more in line with recent cash prices. These prices are well above pre-2008 records; however, they put much less cost pressure on dairy farmers for the next year than was anticipated only 45 days ago,

A large share of dairy feed in 2008 seems to have either been grown on the dairy or contracted in advance. This has muted the supply response in 2008 to theoretical cost of production increases.

Perhaps the clearest indicator of dairy farm profitability, at least on a cash-flow basis, is that prices for milk cows are rising again: USDA reported the average back up to \$1990 per head in July, just \$30 below last October's record.

***With feed prices coming down modestly, with milk prices remaining relatively high, with large inventories of dairy herds replacements still commanding record high prices, we now anticipate little or no slowdown in milk production growth through 2008 and for as long as growing export demand can absorb it. dmr***



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