

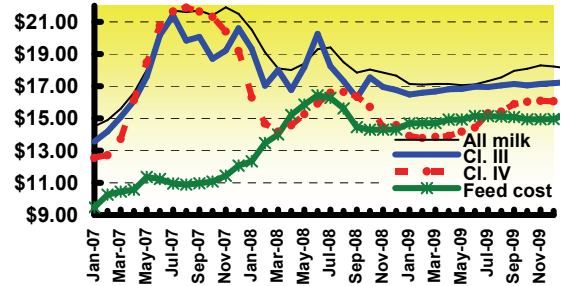
Dairy Market Report



Executive Summary

- ➔ Commercial disappearance (including exports): skim solids up 1.5% in May through June, milk fat up 2.6%.
- ➔ Cheese, butter prices up, from our last report: September 18th blocks were up 16¼¢ to \$1.92¼/lb., barrels up 23¼¢ to \$1.93¼; butter up 5½¢ to \$1.70/lb.
- ➔ Outlook: Lower milk prices squeeze producer margins; if exports are flagging, prices must fall to clear the market.

Projected Milk Prices & Feed Cost / Cwt. of Milk



Based on futures as of 9/18/2008; non-feed costs not shown.

Market Outlook

Milk production growth slowed enough in July and August to shake many assumptions about the production outlook for the next six months. This modest production growth revealed that the high year-over-year growth in May and June may have related more to an unusual seasonal pattern in 2007 than to a rising growth trend in 2008. Including the impact of the CWT herd retirement program, we now project milk production in the second half of 2008 to be about 1% above the second half of 2007, and annual production to be up about 2%.

Milk futures have continued to decline, with many analysts convinced that their bottom has not been reached. Fundamentals are weak, and many dairy prices, according to this view, are still too high.

Feed prices are somewhat lower, but the milk-feed margin has been further squeezed. In theory, this should cut the milk supply. In practice, dairy farmers are dug in for the long haul and might weather very poor margins through all of 2009. Their war chest is built up after two years of high prices, with a large milk cow and heifer inventory. Many also have their own crop production at hand to subsidize their milking operation. We think, then, that 1% growth could be sustained for some time.

In this context, it is also worth noting that the Federal Milk Income Loss Contract (MILC) program, as amended in the recent Farm Bill, adjusts its target rate up with rising feed costs. As a result, the target rate for the Class I price in Boston, which was \$16.94 under the old program, was nearly \$20 in June and is currently projected to be near or above \$19.00 for most of the next three years. If milk price futures prices drop again relative to feed costs, we may be projecting MILC payments for 2009.

The available numbers are too few yet to say firmly that exports are flagging, but anecdotal evidence suggests that it might be so, at least at current prices. Overseas demand and export growth has been the greatest contributor to recent high U.S. dairy prices. But some of those U.S. prices are now hanging above world levels. Given the substantial share of U.S. milk production (11½% in the first seven months of 2008) now going into exports, dairy producers and processors cannot afford to lose those overseas markets. Sooner or later, then, U.S. prices must fall to allow these products to clear in the global market. **dmr**

The Dairy Market Report is created for Dairy Management Inc.



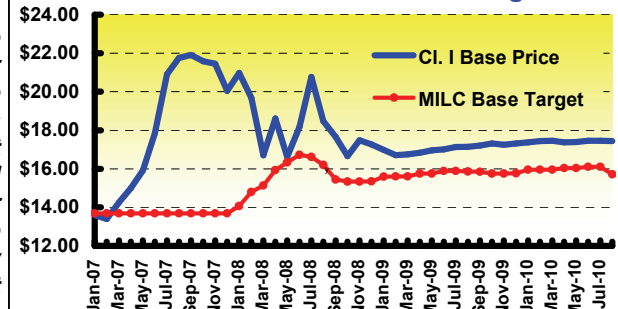
The Nutshell

Production v. last year:

- July Cheese ↑ 1.5%
- July Butter ↑ 0.1%
- July NDM/SMP ↑ 15.1%
- July Whey ↓ 5.3%
- July Milk ↑ 1.4%
- August Milk ↑ 1.1%

	July	Aug.
NASS		
Cheddar	1.96	1.87
Whey	0.26	0.25
Butter	1.52	1.57
NDM	1.41	1.38
Milk	July	Aug.
Cl. III	18.24	17.32
Cl. IV	16.60	16.64
All	19.40	18.50

Class I Base Price & MILC Target



MILC target price adjusted for feed costs, per 2008 Farm Bill; Future months projected from futures prices as of 9/18/2008.

Cheese and Whey

Total U.S. **cheese production** (excluding cottage cheese) was 812 million lbs. in July, up 1.5% from a year ago, and down 3.0% from June, on an average daily basis. American types totaled 341 million lbs. in July, up 4.9% from last year, and down 1.6% (daily) from June. Italian types were also 333 million lbs., down 1.2% from last year and down 3.4% from June, on a daily basis.

Natural American cheese **stocks** were 576 million lbs. as August began, up 2% from a year ago. Stocks of other cheese, including Swiss, were 325 million lbs., up 1% from a year ago. Total cheese stocks are up 2% from a year ago, and about even with July 1.

For the three months ending June 2008, **commercial disappearance** of American cheese was 971 million lbs., down 2.5% from a year ago; other cheese was 1.5 billion lbs., down 3.8% from last year. The total was down 3.3%.

As of September 18, **CME** block cheese prices are \$1.92¼, up 16¼¢ from our last report. Barrels are \$1.93¼, up 23¼¢. Class III

futures markets have fallen further (see graph), projecting cheese prices remaining near \$1.85 indefinitely, but some analysts believe this is still too high.

September 18 futures markets project the NASS cheese price to average just over \$1.85 over the next 6 months (October through March), about \$1.90 for all of 2008, and near \$1.85 for all of 2009. U.S. cheese **exports** in July

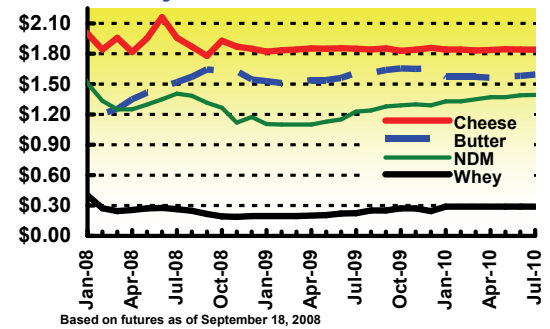
in August (up 5%).

Total **production** of dry **whey** for food was 86.0 million lbs. in July 2008, down 5.3% from a year ago. (See box.)

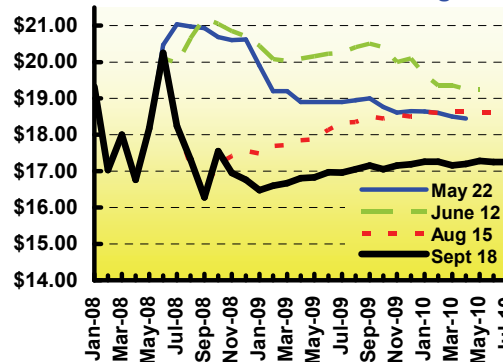
The manufacturers' **price** of whey was 23¢ per lb. the week of September 6, according to NASS' survey. **WPC-34 prices have continued to fall**, to about 42¢, per **Dairy Market News**, still about 80¢ lower than nonfat dry milk spot prices, and less than twice the Western sweet whey price of 23¢.

The **CME** dry whey futures project average whey prices of 19¢ for the next 6 months, and 23¢ for all of 2009. The international whey price is about 25¢ per lb., per USDA's **Dairy Market News**. **dmr**

Projected Product Prices



Class III Futures: Bottoming?

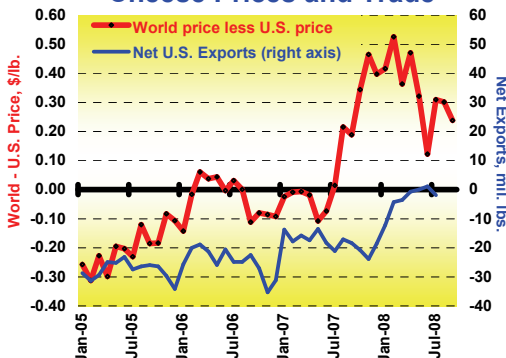


were 24 million pounds, up 63% from a year ago, and equivalent to 3.0% of U.S. production. Imports were down 28% from a year ago to 26 million pounds. This means the U.S. was a net importer of 2 million pounds of cheese, after being a net exporter (of 1.1 million pounds) for the first time in June.

The **retail price** of cheddar cheese was \$4.71 in July (up 10% from last year) and \$4.83 in August (up 9%). Processed cheese averaged \$4.18 at retail in July (up 11%) and \$4.19

“Futures markets project cheese prices remaining near \$1.85 indefinitely, but some analysts believe this is still too high.”

Cheese Prices and Trade



Whey Products				
Product	July Production		August 1 Maker Stocks	
	Mil. lbs.	Change v 2007	Mil. lbs.	Change v 2007
Whey, food	86.0	-5.3	55.6	4.0
Whey, feed	4.0	-15.1	5.4	-15.4
WPC25-50	25.1	14.2	27.2	46.3
WPC50-90	10.9	-3.1	14.2	53.4
WPI90+	3.2	-18.5	n/a	n/a
Total	129.2	-1.7%	102.4	-3.0%

Butter

July U.S. [butter production](#) was 117 million lbs., nearly even with a year ago, and down 2.7% from June. August 1 butter [stocks](#) were 248 million lbs., 9% lower than a year ago.

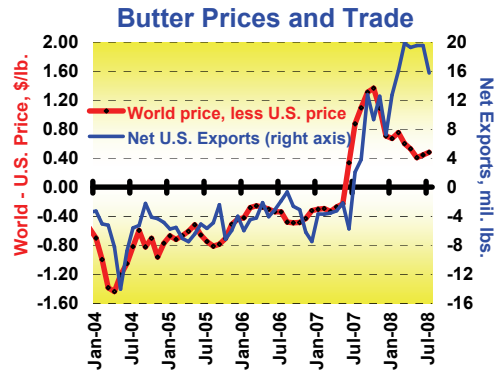
[Commercial disappearance](#) (including exports) of butter in the three months ending with June was 382 million lbs., up 27½% from a year ago. Disappearance of all milkfat was up 2.6% for the same three months.

The [retail](#) butter price was an estimated \$3.30 per lb. in July 2008, up about 8% from 2007, and \$3.27

in August, up 3% from last year. The [CME](#) butter price was up 5½¢ to \$1.70 on September 18. Futures project NASS butter at \$1.56 for the six months through March, \$1.46 for all 2008, and \$1.59 for 2009.

[Net butter exports](#) were 15.7 million pounds in July, and totaled 122 million pounds (12% of production) in the year to date. These exports are lagging a bit as the price gap between the U.S. and the world has narrowed since last fall, to about 50¢ in July. In early September, USDA reports [international](#)

butter spot prices about even with U.S. [domestic prices](#). This will test the recent success of U.S. exporters in world trade. **dmr**



Dry Milk Powders

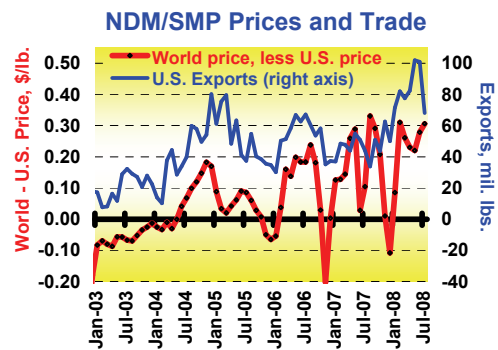
U.S. [nonfat dry milk production](#), including protein-standardized "skim milk powders" was 163 million lbs. in July, up 15% from a year ago.

July 1 manufacturers' stocks of (only) nonfat dry milk were 140 million lbs., up 12% from last year.

The [CME](#) price of grade A nonfat dry milk was down 17½¢ to \$1.25, extra grade was down 19¢, also to \$1.25, on September 18, about 8¢ below the average surveyed U.S. manufacturers' [price](#) of \$1.32½ the week of September 6.

As the dollar rises, skim powder prices overseas are down, to near \$1.45 in Oceania and \$1.35 in Western Europe, per [USDA](#). This will challenge U.S. exports. In July 2008 exports of nonfat dry milk and skim milk powders were 68 million pounds, 55% higher than last July's total, and over 40% 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 419 million lbs., up 28% from a year ago, according to USDA. For the same

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



Yogurt, Ice Cream, and Fluid Milk

U.S. [yogurt production](#) was 282 million lbs. in July, up 1.3% from last year. For the year to date, it is up 2.3% to 2.1 billion pounds.

July [ice cream production](#) was down 1% from a year ago at 123 million gallons. Ice cream mix production was 47 million gallons, down 2%. For the year to date, ice cream production is down 2% and mix is down 3½%. The [retail](#) ice cream price was \$4.17 per ½-

gallon in July, up 9% from last year; in August it was \$4.25, up 9%.

July [fluid milk sales](#) were down 0.6% from a year ago (calendar-adjusted), when the [retail](#) price of whole milk rose 6%, to \$3.96. August's retail price was \$3.89, up 2% from a year ago. **dmr**

U.S. Fluid Milk Sales

Product	July 2008		Year to Date	
	Mil. lbs.	%	Mil. lbs.	%
Whole Milk	1,258	-3.8	8,784	-5.9
Flavored Whole Milk	48	-6.7	341	-13.4
Organic Whole Milk	30	20.0	219	27.8
Reduced Fat Milk (2%)	1,500	3.4	10,535	1.7
Low Fat Milk (1%)	508	1.8	3,843	1.5
Fat-Free Milk (Skim)	659	1.3	4,743	0.5
Flavored Fat-Reduced	142	1.1	2,073	0.3
Organic Fat-Reduced	99	16.7	747	26.1
Buttermilk	40	-5.4	323	7.3
Total (including "Other")	4,294	0.7	31,685	-0.4
Total (calendar adjusted)	4,282	-0.6	31,517	-0.7

Source: USDA/AMS, Dairy Market News

Milk and Feed

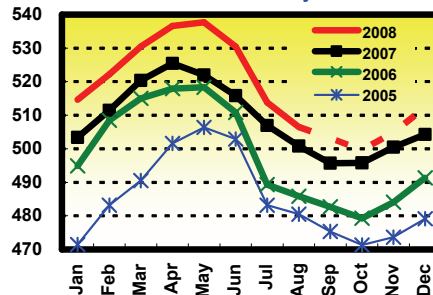
U.S. [milk production](#) in August was 15.7 billion lbs., up 1.1% from a year ago, following July's 15.94 billion lbs, up 1.4%. This slowing growth appears to be returning 2008 production to the normal seasonal pattern of recent years (see graph). In addition, the CWT program has completed its fifth round of herd retirements, including about 25,000 dairy cows and heifers. As a result, we project growth near 1% in August through December, and about 2% for the full year.

August's Class III price was announced at \$17.32 per hundredweight, down 92¢ from July, and down \$2.51 from a year ago. September will be down again, to about \$16.50. Class III [futures](#) prices for the next six months (October through March) averaged \$16.84 per hundredweight on September 18, and project averages of \$17.72 for 2008 and \$16.91 (compared with \$18.12 in our last report) for 2009. The Class III price is the minimum price paid for cheese milk pooled on Federal orders.

The August Class IV price was \$16.64 per hundredweight, up 4¢ from July, but down \$5.23 from a year ago. September's Class IV is projected to be down about 20¢. [Futures](#) markets project Class IV milk to average about \$14.40 for the next six months, \$15.40 for 2008 and \$14.90 (compared to \$16.40 in our last report) for 2009. The Class IV price is the minimum price for pooled milk used to make butter or milk powder.

August component prices: \$1.7413 per lb. (up 6¢ from July) for butterfat in Class III, Class IV, and producer milk; \$3.6497 (down 35¢) for protein in Class III and producer milk; \$1.2147 (down 2¢) for total nonfat

U.S. Milk Production, 2005-2008
Million Lbs./Day



solids in Class IV milk; and \$0.0529 (down 2¢) for other solids in Class III and producer milk. September butterfat is projected at \$1.82.

August's Class II price was up 64¢ to \$17.45 per hundredweight. This is the minimum price for pooled milk used to make soft dairy products and in most food processing. September is projected at about \$17.50.

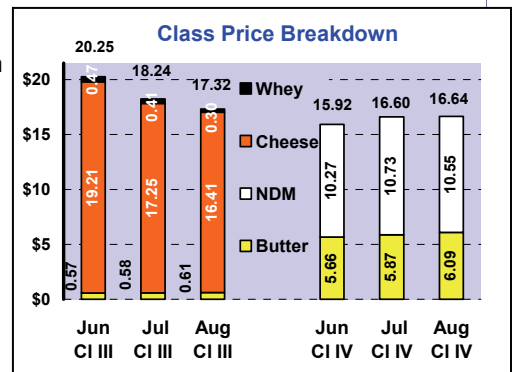
September's Class I base price is \$17.65, based on cheese/whey values. This is \$4.26 lower than last September and down 82¢ from August. We project October's Class I base price at \$16.20, including a 26¢ reduction based on the revised make allowances. The announcement for this price has been put off to Tuesday, September 23rd, to give a Federal district court judge more time to consider the suit that has already delayed

implementation of these new make allowances by a month. 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](#).

August's [all-milk price](#) was \$18.50, down 90¢ from July and down \$3.10 from a year ago. We project September's all-milk price at \$17.80. Futures project the next six months at \$17.50, 2008 at \$18.50, and 2009 at \$17.80, nearly a dollar lower than last month's projection.

Anticipated **feed costs** remain far below their July peaks, but also far above pre-2008 norms. Near month corn [futures](#) are \$5.27 per bushel, nearly unchanged from last month. Near month soybean [futures](#) are \$11.16 per bushel, down about a dollar from last month.

Feed prices may have fallen as far as they are going to for some time. Milk prices, though high, are not covering costs. July's production numbers suggest that milk supply may be slowing slightly, but a larger adjustment may take time. DMR



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