October 2008

National Milk Producers Federation

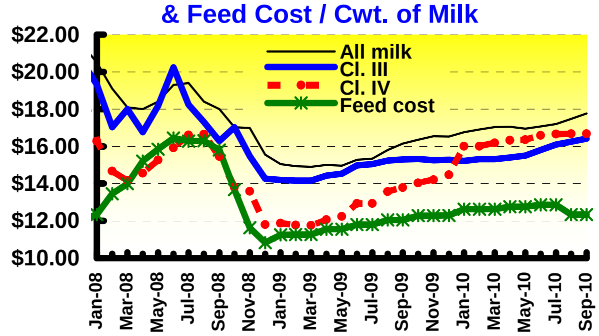
Volume 11, Number 8

Dairy Market Report

Executive Summary

- Commercial disappearance (including exports): skim solids up 1.0% in May though July, milk fat up 1.9%.
- Cheese, butter prices up, from our last report: October 28th blocks were down 24½¢ to $1.67¾/lb., barrels down 24¾¢ to $1.68½; butter up 4¢ to $1.75/lb.
- Outlook: *Falling feed prices track falling milk prices. Worldwide economic woes are undercutting export strength: U.S. sales must match world prices.*

Projected Milk Prices
& Feed Cost / Cwt. of Milk



Based on futures as of 10/28/2008; non-feed costs not shown.

Market Outlook

September milk production was up 1.7%, and the August number, originally reported at 1.1%, was revised to 1.5%. This suggests a slower U.S. supply response to weak margins in 2008 than we thought we were seeing a month ago.

In 2002, according to the Census of Agriculture, 72,537 U.S. dairy farms harvested 381 million bushels of grain corn, 58 million bushels of soybeans, 62 million bushels of other grains, and 75 million tons of hay, silage, and greenchop (including corn). In addition, they dedicated 2.2 million acres to pasture. This means (very) roughly that two-thirds of dairy feed was grown on dairy farms in 2002 (although not all that was necessarily on the same farms that used it). The many dairy farmers that grow their own feed have not felt the milk-feed margin squeeze directly in 2008, because milk prices were high. Expectations for 2009 milk prices are sinking rapidly, though, and these farmers will feel that pain.

The flip side of this is that feed prices are dropping rapidly. Corn futures are under $4.00 and soy futures are under $9.00; these could translate into real prices under $3.50 and $8.30. Milk prices are falling, but so are the feed costs upon which the feed cost adjustments to the MILC target price are based. As a result, no MILC payments are projected, based on current futures values.

There is an old story about a man with a successful hot dog stand: his son warned him to dim his lights and use cheaper meat, because there was a recession going on. After the man did as the son suggested, he told him, "You're right about that recession, son; no sooner did I cut my costs than my sales fell by half." The crisis in the world economy has a large self-fulfilling element of this kind: companies all over the economy are cutting employees and activities, and banks are reducing their lending; they are preparing for a recession, but their preparations are helping to cause it. The result is that demand for all kinds of products will be hurt by the slowing economy. Dairy products are staples in the U.S., and may see limited demand effects, especially after anticipated price reductions; but in other countries, where dairy products are a new part of their diet, sales may drop off substantially, undercutting what has been a very strong export market for U.S. products.

This has already been reflected in falling world prices for dairy products. The U.S. butter market has been largely shielded from this in recent months by the actions of the Cooperatives Working Together (CWT) program, which has already committed to support for 41 million pounds of butter and 12.8 million pounds of anhydrous milk fat in 2008, as well as 3.2 million pounds of cheese and 2.7 million pounds of whole milk powder. Given our large exports, U.S. supplies must clear on the world market, one way or another.

Finally, some 28½ million pounds of nonfat dry milk have been sold to USDA under the price support program in the last three weeks, at 80¢ per pound. The impact of these sales on the market is uncertain, but will depend heavily on how USDA disposes of the powder. dmr

The Dairy Market Report is created for Dairy Management Inc.

The Nutshell

Production v. last year:

- August Cheese ⬆ 3.0%
- August Butter ⬆ 4.4%
- Aug. NDM/SMP ⬆ 19.1%
- August Whey ⬇ 6.9%
- Aug. Milk* ⬆ 1.5%
- Sept. Milk ⬆ 1.7%

* *revised*

NASS	Aug.	Sept.
Cheddar	1.87	1.78
Whey	0.25	0.22
Butter	1.57	1.64
NDM	1.38	1.21
Milk	**Aug.**	**Sept.**
Cl. III	17.32	16.28
Cl. IV	16.64	15.45
All	18.40	18.00

Cheese and Whey

Total U.S. **cheese** production (excluding cottage cheese) was 821 million lbs. in August, up 3.0% from a year ago, and up 1.0% from July. American types totaled 339 million lbs. in August, up 8.6% from last year, and down 0.8% from July. Italian types were 332 million lbs., down 1.0% from last year and down 0.1% from July.

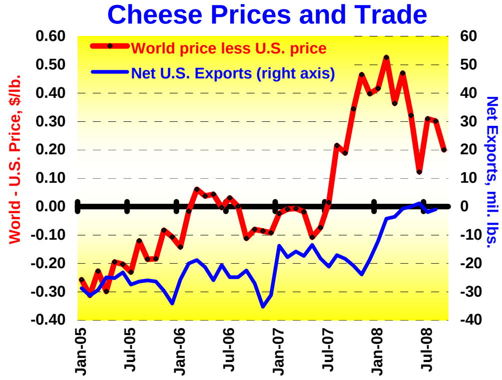
Natural American cheese stocks were 554 million lbs. as October began, up 2% from a year ago, and down 14 million pounds from September's beginning stocks. October's beginning stocks of other cheese, including Swiss, were 286 million lbs., up 2% from a year ago, and down 27 million pounds from September 1. Total cheese stocks are up 2% from a year ago, and down 40½ million pounds from September 1.

"Futures markets project cheese prices to average $1.65 in 2009, down about 20¢ from last month's futures."

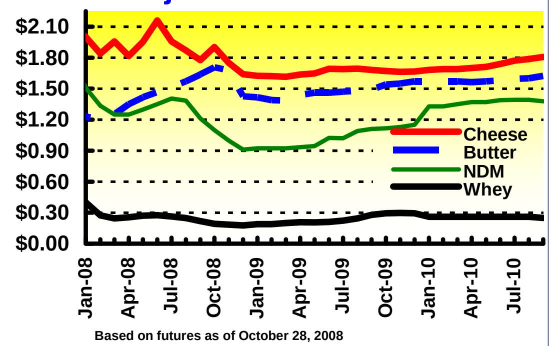
For the three months ending July 2008, commercial disappearance of American cheese was 997 million lbs., down 0.9% from a year ago; other cheese was 1.5 billion lbs., down 2.7% from last year. The total was down 2.0%.

As of October 28, CME block cheese prices are $1.67¾, down 24½¢ from our last report. Barrels are $1.68½, down 24¾¢. Class III futures markets continue to fall, and may not yet have reached their bottom. (See graph) October 28 futures project cheese prices to average $1.65 over the next six months (November through April), $1.89 for all of 2008, and $1.66 for all of 2009, down about 20¢ from last month's futures-based projections.

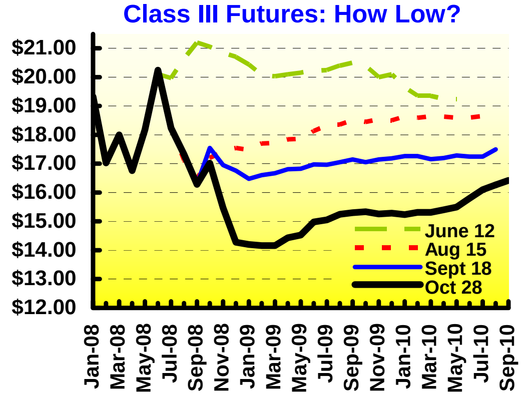
Cheese Prices and Trade



Projected Product Prices



Class III Futures: How Low?



U.S. cheese exports in August were 26 million pounds, up 47% from a year ago, and equivalent to 3.1% of U.S. production. Imports were down 23% from a year ago to 27 million pounds. This means the U.S. was a net importer of less than 1 million pounds of cheese.

The retail price of cheddar cheese was $4.81½ in September (up 7½% from last year). Processed cheese averaged $4.09 at retail in August, up 1% from a year ago.

Total production of dry **whey** for food was 83 million lbs. in August 2008, down 7% from a year ago. (See box.)

The manufacturers' price of whey was 19¢ per lb. the week of October 18, according to NASS' survey. **WPC-34 prices have continued to fall**, to about 39¢, per Dairy Market News, about 60¢ lower than nonfat dry milk spot prices, and at about a 20% discount to the Western sweet whey price of 17½¢, on a protein-equivalent basis. The CME dry whey futures project average whey prices of 20¢ for the next 6 months, and 24¢ for all of 2009. The international whey price is about 25¢ per lb., per USDA's *Dairy Market News.* **dmr**

Whey Products

Product	August Production		September 1 Maker Stocks	
	Mil. lbs.	Change v 2007	Mil. lbs.	Change v 2007
Whey, food	83.1	-6.9	57.8	-12.3
Whey, feed	4.5	-12.6	5.8	-20.9
WPC25-50	24.1	18.2	27.6	50.7
WPC50-90	10.3	-3.0	12.6	44.6
WPI90+	3.7	13.7	n/a	n/a
Total	*125.7*	*-2.3%*	*103.8*	*3.6%*

Butter

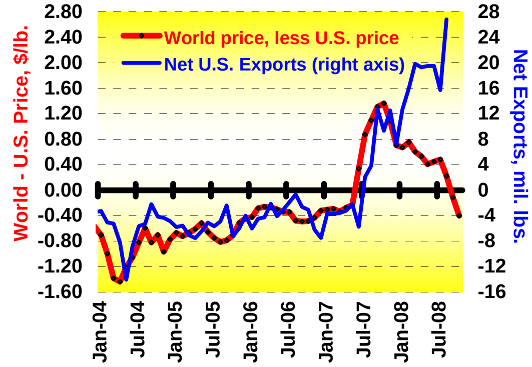
August U.S. butter production was 116 million lbs., up 4.4% from a year ago, and up 1.4% from July. October 1 stocks were 186 million lbs., 23% less than a year ago, and down 28 million lbs. from September.

Commercial disappearance (including exports) of butter in the three months ending with July was 387 million lbs., up 16% from a year ago. Disappearance of all milkfat was up 1.9% for the same three months.

The retail butter price was an estimated $3.30 per lb. in September 2008, up about 4% from 2007.

The CME butter price was up 4¢ to $1.74 on October 28. Futures project NASS butter at $1.46 for the six months through April, $1.45 for all 2008, and $1.47 for 2009.

Net butter exports were 26.8 million pounds in August, and have totaled 150 million pounds - 13½% of production - in the year to date. These exports - which would have otherwise declined as the world price converged with the U.S. price - have instead grown to record levels, thanks largely to substantial export assistance from the CWT program, which has already committed to provide export assistance for over 50 million pounds of butter and anhydrous milkfat in 2008.



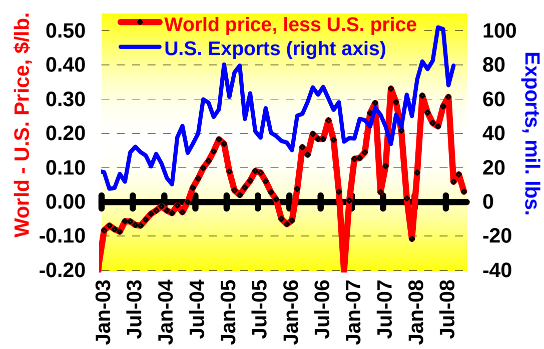
This will be even more important with world prices slipping below the U.S. price: in mid-October, USDA reports, international butter spot prices were about $1.35, while U.S. domestic prices remained above $1.70. **dmr**

Dry Milk Powders

U.S. nonfat dry milk production, including protein-standardized "skim milk powders" was 144 million lbs. in August, up 19% from a year ago. September 1 manufacturers' stocks of (only) nonfat dry milk were 157 million lbs., up 10% from last year, and up 16 million pounds from August 1.

The CME prices of grade A and extra grade nonfat dry milk were down 27¢ to $1.00, on October 28, about 4¢ above the average surveyed U.S. manufacturers' price of 98¢ the week of October 18. Large volumes are being sold into the price support program at 80¢ per pound. (See page 1.)

U.S. and world prices have converged at close to a dollar per pound, per USDA. In August 2008 exports of nonfat dry milk and skim milk powders were 80 million pounds, 135% higher than last August's total. For the year through August, exports of nonfat dry milk and skim milk powder have equaled more than half of U.S. powder production. Overall U.S. commercial disappearance of nonfat dry milk (including exports, but excluding modified "skim milk powders") in the three months ending July was 394 million lbs., up 20% from a year ago, according to USDA. For the same quarter, average daily commercial disappearance of all skim solids was up 1%. **dmr**



Yogurt, Ice Cream, and Fluid Milk

After years of strong growth, U.S. yogurt production in August was down 2.2% from last year, to 293 million lbs., thanks in large part to manufacturers' shift from 8 oz. to 6 oz. containers. For the year to date, it is up only 1.8%.

August ice cream production was down 1% from a year ago at 117 million gallons. Ice cream mix production was 43 million gallons, down 4%. For the year to date, ice cream production is down 2% and mix is down 3½%. The retail ice cream price was $4.42 per ½-gallon in September, up 13% from last year.

August fluid milk sales were up 0.3% from a year ago (calendar-adjusted), when the retail price of whole milk rose 2%, to $3.89. September's retail price was $3.77, down 2% from a year ago. **dmr**

U.S. Fluid Milk Sales

	August 2008		Year to Date	
Product	**Mil. lbs.**	**%**	**Mil. lbs.**	**%**
Whole Milk	1,268	-5.8	10,052	-5.9
Flavored Whole Milk	48	-12.8	389	-13.4
Organic Whole Milk	33	19.4	252	24.1
Reduced Fat Milk (2%)	1,549	0.4	12,084	1.6
Low Fat Milk (1%)	549	1.1	4,392	1.5
Fat-Free Milk (Skim)	683	-0.9	5,426	0.4
Flavored Fat-Reduced	232	-3.5	2,305	-0.1
Organic Fat-Reduced	109	13.7	856	22.6
Buttermilk	40	-8.0	363	5.5
Total (including "Other")	**4,522**	**-1.6**	**36,207**	**-0.5**
Total (calendar adjusted)	**4,572**	**0.3**	**36,089**	**-0.6**

Source: USDA/AMS, Dairy Market News

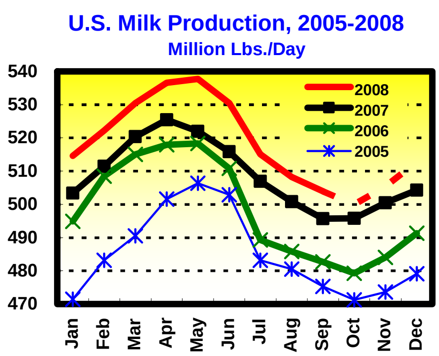
Milk and Feed

U.S. milk production in September was 15.1 billion lbs., up 1.7% from a year ago. This was a larger-than-expected increase, and NASS revised upward August's increase, from 1.1% to 1.5%. These new numbers call into question last month's optimism that supply was responding to weak feed-milk margins. As a result, we project 1½% growth in the fourth quarter, and above 2% for the full year. Any production growth in 2009 may be hard-pressed to find a home, unless USDA continues to buy large volumes under the price support program.

Another factor which may restrain this potential growth is the recent announcement of a sixth herd retirement round under the CWT program. The fifth round was recently completed and retired about 25,000 dairy cows and heifers. No target was set for round 6: this flexibility will help CWT get the biggest bang for the buck.

September's Class III price was announced at $16.28 per hundredweight, down $1.04 from August, and down $3.79 from a year ago. October will be back up to about $17.30. Class III futures prices for the next six months (November through April) averaged $14.45 per hundredweight on October 28, and project averages of $17.35 for 2008 and $14.83 for 2009 (compared with $16.91 in our last report and $18.12 in August's report.) The Class III price is the minimum price paid for cheese milk pooled on Federal orders.

The September Class IV price was $15.45 per hundredweight, down $1.19 from August, and down $6.19 from a year ago. October's Class IV is projected to be down another $1.65 to $13.80. Futures markets project Class IV milk to average



about $12.20 for the next six months, $14.90 for 2008 and $13.00 (compared to $14.90 in our last report and $16.40 in August's report) for 2009. The Class IV price is the minimum price for pooled milk used to make butter or milk powder.

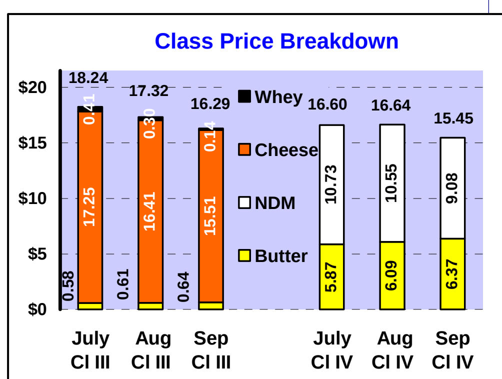
September component prices: $1.8196 per lb. (up 8¢ from August) for butterfat in Class III, Class IV, and producer milk; $3.2689 (down 38¢) for protein in Class III and producer milk; $1.0455 (down 17¢) for total nonfat solids in Class IV milk; and $0.0234 (down 3¢) for other solids in Class III and producer milk. October butterfat is projected at $1.85. October other solids are projected to be negative for the first time in 5 years. The October prices are all based on USDA's revised make allowances and butterfat yield factor.

September's Class II price was up 13¢ to $17.58 per hundredweight. This is the minimum price for pooled milk used to make soft dairy products and in most food processing. October is projected at about $16.60.

October's Class I base price is $15.53, based on butter/powder values; and November's is $17.33, based on cheese/whey values. 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.

September's all-milk price was $18.00, down 40¢ from August and down $3.70 from a year ago. We project October's all-milk price at $17.10. Futures project the next six months at $15.50, 2008 at $18.25, and 2009 at $15.65, more than two dollars below last month's projection.

Anticipated ***feed costs*** continue to fall. Near month corn futures are $3.73 per bushel, and soybean futures are $8.64 per bushel, both down dramatically. ***Larger economic issues are crashing commodity prices; milk's decline to date is modest compared to feed crops. Lower prices in 2009 will pressure U.S. producers.*** dmr



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