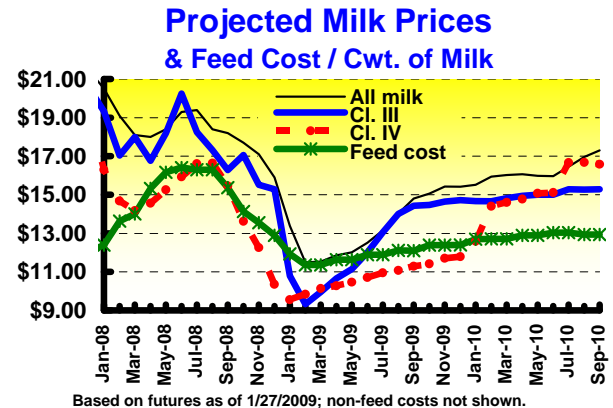




Dairy Market Report

Executive Summary

- ➔ Commercial disappearance (including exports) in September though November: skim solids down 1.0%, milk fat up 0.6%.
- ➔ Cheese and butter prices down again, from our last report: January 27th blocks were down 7¼¢ to \$1.10/lb., barrels down 14¾¢ to \$1.10; butter down 3¾¢ to \$1.10/lb.
- ➔ Outlook: U.S. prices stay near support through much of 2009 (and beyond?)



Market Outlook

The new Secretary of Agriculture has inherited 140 million pounds of nonfat dry milk, and 1.5 million pounds of butter, purchased under the dairy product price support program. In addition, the market price for cheese is below the support level, and milk producers are facing a milk price crash whose recovery is many months away. Weak U.S. dairy demand should be bolstered somewhat by lower wholesale and retail prices, but this will be offset by lower incomes in the U.S. and continued weakness in export demand as incomes fall in importing countries and production recovers in other exporting countries. As a result, U.S. prices have followed world prices down, and the U.S. price support program may set world prices throughout 2009. Recovery depends on a supply response, but this has been very slow in coming: the U.S. herd had 75,000 more milk cows in December than it did a year earlier. Barring substantial intervention, it is very hard to project supply falling enough to bring the markets into balance in the next 9 months.

The Dairy Market Report is created for Dairy Management Inc.



The Nutshell

Production v. last year:

- Nov. Cheese ↑ 1.3%
- Nov. Butter ↑ 2.2%
- Nov. NDM+SMP ↑ 26.4%
- Nov. Whey ↓ 9.7%
- December Milk ↑ 1.4%

	Nov.	Dec.
NASS Cheddar	1.75	1.75
Whey	0.19	0.17
Butter	1.64	1.24
NDM	0.87	0.84
Milk	Nov.	Dec.
Cl. III	15.51	15.28
Cl. IV	12.25	10.35
All	17.10	15.90

The **Milk Income Loss Contract (MILC)** program will begin paying out to farmers for their February milk production. We project an average MILC payment rate of \$1.10 per cwt. over the last 8 months of the fiscal year, including expected feed cost adjustments that would raise the target for the Boston Class I price above \$16.94. (See table.) There has been some confusion about the MILC sign-up. Because of this, USDA has sent new instructions to their state and county offices clarifying the rules and instructing FSA staff to allow producers to correct their start month where there may be an error based on this confusion. We will repeat some of the changes to this year's program: Beginning this year, producers with over \$500,000 in non-farm adjusted gross income will not be eligible for MILC payments; but there are no limits on farm income, which has been re-defined to include many farm-related activities. The eligible production cap has been raised from 2.4 million pounds per fiscal year to 2.985 million pounds, so a producer of less than 370,000 pounds per month is not affected in FY09. (Months with zero payment don't count.) Farmers can pick the month that they sign up as their start month: a producer who wants to pick March, for instance, can wait to sign up in March. (Changes to next year's start month will have to be made earlier.) But producers should not wait until the very last minute to sign up; they should make sure they have their paperwork lined up ahead of time. **dmr**

Year	Boston Class I		Payment Rate
	Actual	Target	
FY 2009			
October '08	18.78	18.48	0.0000
November	20.58	18.10	0.0000
December	18.68	17.68	0.0000
January '09	18.99	17.05	0.0000
February	13.97	16.94	1.3365
March	12.98	16.94	1.7840
April	13.28	16.94	1.6473
May	13.73	16.94	1.4439
June	14.28	17.02	1.2319
July	15.10	17.02	0.8638
August	16.13	17.17	0.4684
September	17.13	17.16	0.0111
FY 2010			
October '09	17.69	17.35	0.0000
November	17.81	17.35	0.0000
December	17.96	17.35	0.0000
January '10	18.05	17.55	0.0000
February	18.03	17.56	0.0000
March	18.02	17.56	0.0000
April	18.15	17.68	0.0000
May	18.28	17.68	0.0000
June	18.37	17.77	0.0000
July	18.48	17.77	0.0000
August	19.75	17.71	0.0000
September	20.10	17.71	0.0000

Projections based on futures as of 1/27/2009

Cheese and Whey

Total U.S. **cheese production** (excluding cottage cheese) was 826 million lbs. in November, up 1.3% from a year ago, and average daily production was up about 1.2% from October. For 2008 to date, production is up 1.5%. American types totaled 340½ million lbs. in November, up 4.9% from last year, and up 2.5% from October on an average daily basis. Italian types were 337 million lbs., down 2.7% from last year and up 1.1% from October on an average daily basis.

Natural American cheese **stocks** were 542 million lbs. as 2009 began, up 6% from a year ago, and up 15 million pounds from December's beginning stocks. Stock of other cheese, including Italian and Swiss, were 305 million lbs., began the year up 5% from a year ago, and up 13 million pounds from December 1. Total cheese stocks are up 6% from a year ago, and up 28 million pounds from December 1.

For the three months ending November 2008, **commercial disappearance** of American cheese was 1.05 billion million lbs., up 6.4%

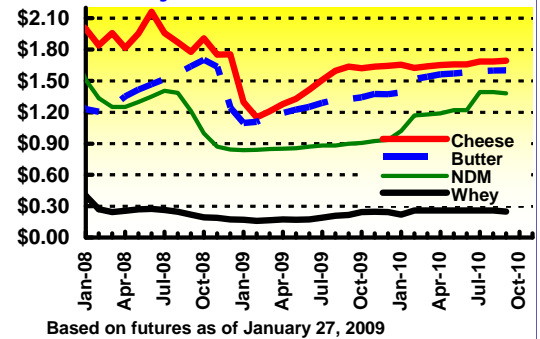
from a year ago; other cheese was 1.58 billion lbs., down 1.0% from last year. The total was up 1.8%.

As of January 27, **CME** block cheese prices are down 7¼¢, to \$1.10, from our last report. Barrels are \$1.10, down 14¼¢. Class III futures prices for the first half of 2009 have contin-

ued to follow cash cheese prices down. (See graph) January 27 futures project cheese prices to average \$1.32 over the next six months (February through July), \$1.44 for all of 2009, and \$1.67 for 2010. These probably reflect a bias toward historical averages; we expect 2009 prices to remain low longer than the futures project.

U.S. cheese **exports** in November were 19 million pounds, down 7% from a year ago, and equivalent to 2.3% of U.S. production. Imports were down 9% from a year ago to 41 million pounds. Net imports were 22 million

Projected Product Prices



lbs., compared to net exports of 1 million lbs. in June.

The **retail price** of cheddar cheese was \$4.95 in December (up 11% from last year). Processed cheese averaged \$4.14 at retail in December, up 6% from a year ago.

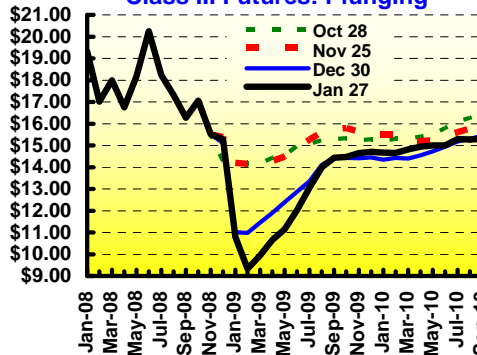
Production of dry **whey** for food was 81 million lbs. in November 2008, down 8½% from a year ago. (See box.)

The manufacturers' **price** of whey was 17¢ per lb. the week of January 17, according to NASS' survey. WPC-34 prices are higher again, at about 53¢, per USDA's **Dairy Market News**. The **CME** dry whey futures project average whey prices of 17¢ for the next 6 months, and 20¢ for all of 2009. The international whey price is about 22¢ per lb.

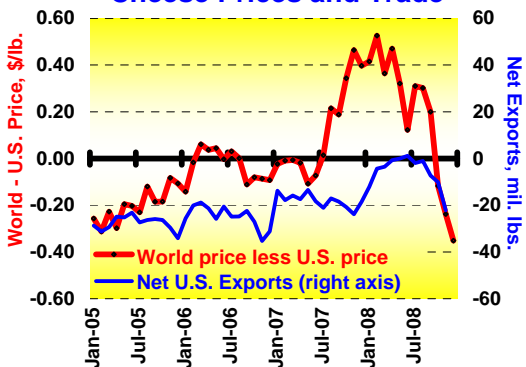
Jmr

“Class III futures prices for the first half of 2009 have continued to follow cash cheese prices down.”

Class III Futures: Plunging



Cheese Prices and Trade



Whey Products

Product	December Production		January 1 Maker Stocks	
	Mil. lbs.	Change v 2007	Mil. lbs.	Change v 2008
Whey, food	80.8	-8.5	56.5	5.5
Whey, feed	3.8	-29.2	3.4	-41.1
WPC25-50	23.0	12.0	19.7	13.0
WPC50-90	11.4	-3.1	12.1	29.1
WPI90+	3.6	7.8	n/a	n/a
Total	122.5	-5.2%	91.7	6.5%

Butter

November U.S. [butter production](#) was 134 million lbs., up 2.2% from a year ago, and up 6% from October, on an average daily basis. January 1 [stocks](#) were 119 million lbs., 23% less than a year ago, and down 1 million lbs. from December.

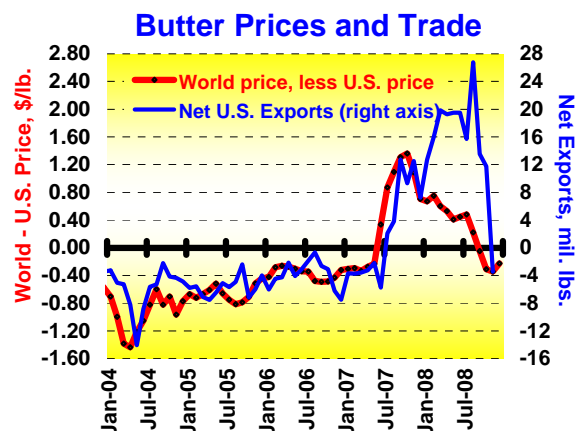
[Commercial disappearance](#) (including exports) of butter in the three months ending with November was 493 million lbs., down 1½% from a year ago. Disappearance of all milkfat was up 0.6% for the same three months.

The [retail](#) butter price was \$3.13 per lb. in December 2008, up 5%

from 2007. The [CME](#) butter price was down 3¼¢ to \$1.10¼ on January 27. Futures project NASS butter at \$1.20 for the six months through July, \$1.25 for all 2009, and \$1.56 for 2010.

The U.S. was a [net butter importer](#) in November (of 3.4 million lbs.), for the first time since June 2007. Over the 16 months in between, net U.S. butter exports totaled 222 million pounds, containing 2% of the butterfat in U.S. milk production during that period.

U.S. butter prices have declined to world levels: the U.S. spot price remains about midway between



the Oceania price (now about 86¢ per lb.) and the European price (about \$1.21, according to USDA's [international](#) report). **dmr**

Dry Milk Powders

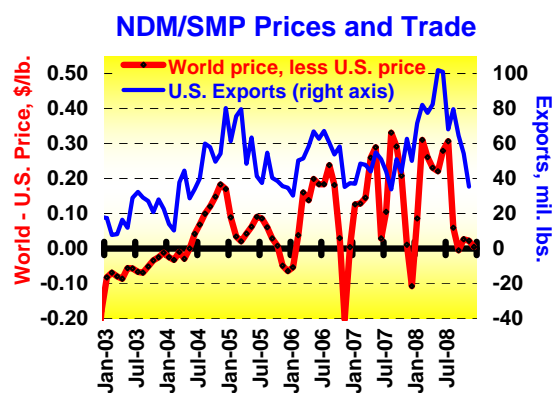
U.S. [nonfat dry milk production](#), including protein-standardized "skim milk powders" was 151 million lbs. in November, up 26% from a year ago. December 1 manufacturers' stocks of (only) nonfat dry milk were 166 million lbs., up 21½% from last year, and up 20 million pounds from November 1.

The [CME](#) price of grade A nonfat dry milk was down a 2½¢ to 83¢ per lb., on January 27, (extra grade is down ½¢ to 85¢); this is about even with the average surveyed U.S. manufacturers' [price](#) for the week of January 17. Some

140 million pounds of nonfat dry milk have been sold to USDA under the price support program since early October, all at 80¢ per lb.

These sales are replacing lost export sales, which had been absorbing half of U.S. powder production. In November 2008 exports of nonfat dry milk and skim milk powders were 35 million pounds, 44% below than last November's total. We expect further declines, as world prices have fallen to U.S. support.

Overall U.S. [commercial disappearance](#) of nonfat dry milk (including exports, but excluding modified "skim milk powders") in the three



months ending November was 256 million lbs., down 13½% from a year ago, according to USDA. For the same quarter, average daily commercial disappearance of all skim solids was down 1.0%. **dmr**

Yogurt, Ice Cream, and Fluid Milk

U.S. [yogurt production](#) in November was down 2.8% from last year, to 243 million lbs. For the year to date, it is up only 0.8%.

November [ice cream production](#) was up 1% from a year ago to 81 million gallons. Ice cream mix production was 33 million gallons, up 8½%. For the year to date, ice cream production is down 1% and mix is down 2%. The [retail](#) ice

cream price was \$4.28 per ½-gallon in December, up 5% from last year.

November [fluid milk sales](#) were up 0.5% from a year ago (calendar-adjusted), when the [retail](#) price of whole milk was down 4%, to \$3.73. December's retail price was \$3.68, down 5% from a year ago. **dmr**

U.S. Fluid Milk Sales

Product	November 2008		Year to Date	
	Mil. lbs.	%	Mil. lbs.	%
Whole Milk	1,225	-4.8	13,804	-4.8
Flavored Whole Milk	49	-7.7	545	-12.0
Organic Whole Milk	31	3.6	349	22.5
Reduced Fat Milk (2%)	1,507	-1.8	16,701	1.4
Low Fat Milk (1%)	553	-0.4	6,116	1.8
Fat-Free Milk (Skim)	665	-1.3	7,476	0.5
Flavored Fat-Reduced	327	-5.6	3,429	0.5
Organic Fat-Reduced	102	0.4	1,177	19.9
Buttermilk	44	-8.9	485	1.8
Total (including "Other")	4,555	-2.8	50,256	-0.2
Total (calendar adjusted)	4,656	0.5	50,139	-0.3

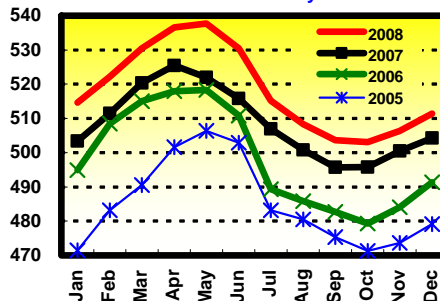
Source: USDA/AMS, Dairy Market News

Milk and Feed

U.S. [milk production](#) in December was 15.9 billion lbs., up 1.4% from a year ago. This caps off a 2.2% increase in annual production. Although December milk per cow was up only 0.5%, the herd was 75,000 cows (0.8%) larger than a year ago. In light of these numbers, USDA's projected 0.75% growth for 2009 average daily production looks low. Milk per cow can adjust downward when production becomes unprofitable; but cow numbers tend to persist, so the large herd means that heavy culling will be necessary to balance the U.S. dairy markets. The [CWT](#) program, which will announce the final results of its latest herd retirement near the end of January, has addressed a small but significant part of this imbalance. Barring another large intervention, 2009 will be a long and painful year for most dairy farmers. December's Class III price was [announced](#) at \$15.28 per hundredweight, down 23¢ from November, and down \$5.32 from a year ago. January will be below \$11.00, and could be the lowest since January 2004. Class III [futures](#) prices for the next six months (February through July) averaged \$11.03 per hundredweight on January 27, and they project averages of \$12.43 for 2009 and \$15.07 for 2010. The 2008 annual average was \$17.44, second highest ever. The Class III price is the minimum price paid for cheese milk pooled on Federal orders. The December [Class IV price](#) was \$10.35 per hundredweight, down \$1.90 from November, and *down*

\$8.83 from a year ago. January's Class IV is projected to be down another 65¢ to about \$9.70. [Futures](#) markets project Class IV milk to average about \$10.40 for the next six months, \$10.80 for 2009 (compared to \$11.27, \$12.40, \$13.00, \$14.90, and \$16.40 in our last five reports),

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



and \$15.50 for 2010. The Class IV price is the minimum price for pooled milk used to make butter or milk powder.

December component prices were: \$1.2998 per lb. (down 47¢ from November) for butterfat in Class III, Class IV, and producer milk; \$3.6390 (up 51¢) for protein in Class III and producer milk; \$0.6680 (down 3¢) for total nonfat solids in Class IV milk; and *negative* \$0.0269 (down 2¢) for other solids in Class III and producer milk. January butterfat is projected at \$1.13.

December's Class II price was down \$3.24 to \$11.21 per hundredweight. This is

the minimum price for pooled milk used to make soft dairy products and in most food processing. January is projected down to about \$10.40.

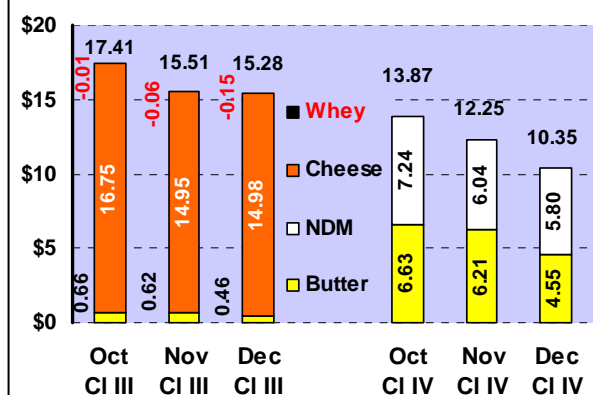
February's Class I base price is \$10.72, based on cheese values. The Class I base price plus a location differential is the minimum price processors pay at the plant for bottling milk pooled on a [Federal order](#).

January's [all-milk price](#) is projected at about \$13.40, before falling to \$11.50 in February, which would be the lowest U.S. all-milk price since June 2003. After the 2008 average of \$18.34, the futures markets project the all-milk price to average \$13.40 in 2009 and \$16.50 in 2010. These markets may be optimistic, especially regarding a recovery this fall.

Anticipated **feed costs** for 2009 remain high: near month [corn](#) and [soy](#) futures are \$3.77 and \$9.76 per bushel, respectively, and are projected to remain high through 2009.

Substantial **MILC payments** are now projected through early 2009. (See page 1.) **dmr**

Class Price Breakdown



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