Milk Producers Council

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TO: DIRECTORS & MEMBERS **FROM: John Kaczor**

MPC FRIDAY MARKET UPDATE

CHICAGO MERCANTILE EXCHANGE
Blocks -$.0700 $2.1600
Barrels -$.0500 $2.1500

Weekly Average
Blocks -$.0665 $2.1860
Barrels -$.0490 $2.1760

CHICAGO AA BUTTER
Weekly Change N.C. $1.4800
Weekly Average +$.0175 $1.4925

NON-FAT DRY MILK
Week Ending 5/30 & 5/31

Calif. Plants	$1.3422	18,263,844
NASS Plants	$1.3389	24,929,996

DRY WHEY
NASS w/e 5/31/08 $.2709 **WEST MSTLY AVG** w/e 6/05/08 $.2800

CHEESE MARKET COMMENTS: USDA's report that cheese production in April, particularly Cheddar cheese, had reversed its recent downward trend apparently had a much greater effect on buyers and sellers than the announcement the same day of CWT's 5th herd retirement program. Prices continued to back off from their record highs. Dairy Market News reports a wide range of sentiment on the part of cheese buyers; some resisting current prices, others concerned about the availability of product now and later. The CWT program should not have an effect on cheese production this year because of the price advantage cheese plants presently have over butter-powder plants. That being the case, it would not be surprising to see another repeat of the pricing pattern that started almost a year ago – peaks and valleys. Unless, of course, Cheddar production continues to increase. Note: Cheese production in the Texas-New Mexico federal order more than doubled from February to April.

BUTTER MARKET COMMENTS: Production is starting to decrease on a seasonal basis as more milk and cream is being used for other manufactured products. Sales may be slipping also. DMN reports that manufacturers are receiving fewer new orders for export, and domestic consumption, which has been about even with last year's level, also is beginning to ease downward. Any short-term reduction in number of cows and milk production that may result from CWT's herd retirement program is expected to directly impact the production of butter. Prices on the CME this week were up and down, and finished the week where they began.

POWDER MARKET COMMENTS: Production of nonfat dry milk, skim milk, and whole milk powders continues at near record levels. The switch from nonfat to "skim" powders is continuing in response to preferences by foreign buyers. DMN reports that some cheese manufacturers have been stocking nfdm, available now at the low end of the price range, for vat fortification later in the year. California and national prices for nfdm continue to edge upward, and are again consistently below the lower end of the range of the spot market prices. This can be taken as a positive sign. Weekly sales volumes continue at levels reflecting around 100 million lbs per month. Export volume continues to be strong, as prices continue to come down.

WHEY MARKET COMMENTS: Production of dry whey and whey protein concentrate continue in line with cheese production. The market for both items is described as weak. Dry whey prices have been virtually unchanged for several weeks, and wpc prices have dropped sharply on the low end of the price range. DMN says that export volume, already weak, appears to be weakening more.

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FRED DOUMA'S PRICE PROJECTIONS…

June 06 Est	**Quota cwt. $19.53**	**Overbase cwt. $17.83**	**Cls. 4a cwt. $15.63**	**Cls. 4b cwt. $20.03**
Last Week	**Quota cwt. $19.72**	**Overbase cwt. $18.02**	**Cls. 4a cwt. $15.43**	**Cls. 4b cwt. $20.57**

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APRIL DAIRY PRODUCT PRODUCTION AND MILK USAGE: *(By J. Kaczor)* Essentially all of the 344 million lb increase in U.S. milk production in April went into butter and powder products, the lowest class of usage in all regulated markets. National fluid usage, about equal in volume to national cheese usage, decreased from year earlier levels by about the amount that cheese usage increased. Usage for yogurts, creams, cottage cheese, and frozen desserts, was about unchanged. There was only one place for the rest of it to go – to the churns and the driers. National butter production increased by 14.8% and powders increased by 22.8%.

California's pool continues to benefit from some additional Class 1 usage that results from less out-of-state bulk milk coming into bottling plants. Class 1 Pool usage of solids increased by 3.6% over last April. The shift from 4b to 4a usage also continues, as cheese production remains lower than a year ago, and the excess milk volume is being converted into butter and powders. Class 2 and 3 usages just about balanced out on a fat and skim basis.

2008'S HERD RETIREMENT PROGRAM BEGINS IMMEDIATELY: *(By J. Kaczor)* National Milk Producers Federation announced its fifth herd retirement program (HRP) this week, giving CWT members until June 30th to decide if they want to dispose of their dairy herds in one convenient transaction. Last year's program was announced on February 7th. Last February, producers were still looking over their shoulders at the 2006 wreckage of huge operating losses and rising debt caused by milk prices that were just a whisker above U.S. support levels. Although commodity prices had begun to rise in December 2006 and milk prices on the CME futures market promised higher prices through the summer, there wasn't much in the way of hard facts to support prospects for a solid recovery. Here's what we said in our 2/9/07 ***Update*** about last year's announcement:

> It looks like a smart move. Why? Because the production of milk and dairy products in the U.S. has been increasing faster than the production can be disposed of. Because the U.S. dairy herd in December was 63,000 larger than a year earlier. Because the number of dairy replacements in January was as large as the record number a year earlier. Because butter and cheese inventories are growing to record or near record levels and their recent market prices appear to be poised to repeat last year's collapse. Because a repeat of last year's prices, considering current feed costs, could be disastrous. That's why it looks like a smart move.

Last year's program was not only a smart move, it was effective. Many producers saw the HRP as a sure way to avoid the possibility of a second straight year of losses. The HRP got rid of about 53,000 cows and came close to reducing the U.S. dairy herd to the previous year's size. When it was announced, it gave producers a reasonable expectation that the growing increases in milk production would slow down and milk prices for the rest of the year would increase faster than their increases in feed and operating costs. But let's be very clear; **last year's HRP was not the reason why milk prices in all classes of usage set record high levels**, although it played an important part in the early stages of an historic year.

The situation this year shows some of the same signs of weakness that existed last year. The U.S. dairy herd in April was 134,000 larger than a year earlier. The number of dairy replacements in January was an all time high, and heifers are again coming in from Canada. Butter and nonfat dry milk inventories are high because fluid milk and cheese usages are not keeping up with milk production. On the other hand, this year there are some positive signs that point to continuing high milk prices, such as a strong cheese market, and strong export sales of nonfat dry milk and butter because of the weak U.S. currency and product shortages in other countries. Traders on the futures market are optimistic; Class III prices are holding above the $20 per cwt level out through December.

But the major concern of producers this year, of course, is the high costs of production and the prospects of more to come. The thought of $20 per cwt milk prices not being able to generate a reasonable profit is likely to generate at least as much response from producers to this year's HRP as last year. At the present time, the opportunity to switch from dairying to growing cash crops is just an extra incentive for many producers to offer a bid.

CWT has plenty of cash on hand to remove as many cows as they want, but last year's experience as well as the others before it is that the gains resulting from these programs are relatively short term despite claims to the contrary, as remaining producers expand production to take advantage of the existing demand for their output. The response time for placing a bid this year has been shortened by about ten days, the regional quotas to protect against too many producers leaving from the East and Southeast have been eliminated and, like last year, there are no predetermined goals for removal of cows or volume of milk. An interesting sidelight to this year's program is the offer to buy bred heifers. Based upon existing beef prices, bred heifers accepted by CWT could be worth about $2,000 net per head.

Some questions now come to mind. It's a bold move by CWT, but is this year's HRP a smart move? Is the time right for this program? Is it sensible to reduce the amount of butter and nonfat dry milk available for export at the time when there is a program to try to assure foreign buyers that the U.S. dairy industry is a reliable long-term source of dairy commodities? Will consumers in this weak economy continue to reduce their consumption of dairy products in response to the expected additional increase in milk prices? Time will help to answer some of these questions; the others will be left for future debate.

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