



Milk Producers Council

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TO: Directors & Members

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MPC FRIDAY MARKET UPDATE

CHICAGO CHEDDAR CHEESE

Blocks +\$.0150 \$1.8700
Barrels +\$.0150 \$1.8350

Weekly Average, Cheddar Cheese

Blocks +\$.0470 \$1.8655
Barrels +\$.0360 \$1.8270

CHICAGO AA BUTTER

Weekly Change +\$.0425 \$1.7925
Weekly Average +\$.0505 \$1.7775

DRY WHEY

Dairy Market News w/e 08/17/12 \$.5500
National Plants w/e 08/11/12 \$.5291

NON-FAT DRY MILK

Week Ending 8/10 & 8/11

Calif. Plants \$1.2174 8,391,361
Nat'l Plants \$1.2467 17,487,632

Prior Week Ending 8/3 & 8/4

Calif. Plants \$1.1844 5,751,520
Nat'l Plants \$1.2144 12,927,686

CHEESE MARKET COMMENTS: Today's report on July milk production was somewhat surprising with respect to the number of cows compared to June. According to USDA there were 12,000 fewer milk cows in July than in June. That follows reductions of 11,000 in May and 21,000 in June (see report following). Trading was light to moderate on the CME this week; 16 carloads of barrels changed hands. Blocks and barrels each gained a net \$.015 per lb after losses today of \$.03 for blocks and \$.02 for barrels – the week ended similar to last week. The weekly average for both edged upward a bit. *Dairy Market News* is being told cheese inventories are adequate for continuing steady sales, although many plants say they would like to be able to build stocks. A slowing milk supply containing less butterfat and protein hinders those wishes, although prices for NFDM and condensed skim makes vat fortification a no-brainer. CME class III milk futures posted solid gains this week, averaging \$.46 per cwt; prices for the last quarter of the year are above \$20 per cwt; all others through next April are above \$19 per cwt. Cheese futures advanced by an average of \$.05 per lb; October's \$1.98 per lb is the high for the year.

BUTTER MARKET COMMENTS: Butter sales are slower as the market is transitioning from summer sales mode to return to school mode. Butter production is currently slow. Cream is in short supply and some plants, for quick profits, are choosing to sell it rather than to make butter. Stocks are adequate for current sales, but continue to fall; many plants would like theirs to be higher. Buyers continue to buy for current needs and to build their inventories where they can. Prices this week on the CME gained \$.0425 per lb, again with no trades. CME butter futures this week kept pace with the spot market, gaining an average of \$.04 per lb.

POWDER MARKET COMMENTS: Hallelujah prices for nonfat powder appeared this week in the global auction (for skim milk powder) and on the CME (for nonfat dry milk). Dairy America received bids this week to ship SMP in September for \$1.50 per lb and in October for \$1.55 per lb. Bidders on the CME advanced the price for Grade a powder by \$.17 per lb (to \$1.65) and Extra Grade by \$.185 per lb (to \$1.625). It continues to puzzle why a seller or two does not bite. Buyers continue to disagree about whether the recent price increases are warranted, but it is clear, according to *DMN*, that supplies are tight and prices are moving higher. Active re-sales (the good kind, at higher prices) are occurring in the East, offers to sell are quickly taken or are lost in the central region, and spot prices in the west are "sharply higher." The "mostly" price series reflect the markets' tone – \$1.335-\$1.44 in the central/east and \$1.25-\$1.45 in the west. Manufacturers' prices for shipments last week edged upward by about \$.0325 per lb; volumes continue to be light. Buttermilk powder production is also limited. Most sales occur under contract; there is relatively little available for spot sales. BMP prices trail NFDM prices by \$.08 to \$.20 per lb, depending on the region.

WHEY PRODUCTS MARKET COMMENTS: AMS reports prices for shipments of dry whey last week averaged \$.5291 per lb, up \$.0089 per lb from the week before. The low end of the "mostly" price ranges in the

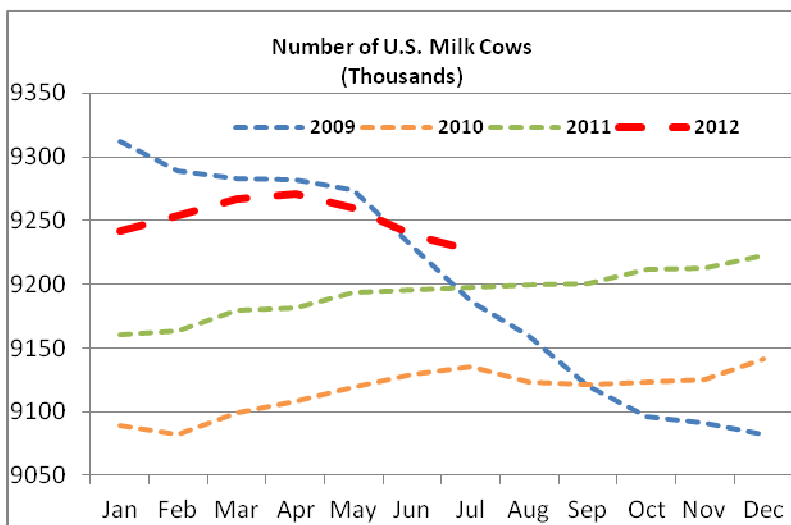
northeast and west are higher this week, and higher than the weighted average prices for those regions. Supplies are limited. Most DW sales are under existing contracts. The “mostly” price range for WPC-34 this week is unchanged at \$1.09-\$1.1525 per lb, representing a huge bargain for whey protein users compared to DW or NFDM prices. What is wrong with these products? *DMN* says fair volumes of product are being offered above contracted volumes in order to avoid the spot market. Dry whey futures were up slightly, peaking with December’s \$.6345 per lb.

FRED DOUMA’S PRICE PROJECTIONS...

Aug 17 Est:	Quota cwt. \$17.35	Overbase cwt. \$15.64	Cls. 4a cwt. \$15.07	Cls. 4b cwt. \$16.63
Last Week:	Quota cwt. \$17.25	Overbase cwt. \$15.55	Cls. 4a cwt. \$14.86	Cls. 4b cwt. \$16.57

MARKET COMMENT: (by *J. Kaczor*) The latest update on the drought says 45.5% of the U.S. is suffering from severe, extreme, or exceptional drought. A month ago the figure was 37.2%. Two months ago it was 19.1%. It is now considered the worst in fifty years. Today, Rabobank said they believe corn and wheat prices will continue to increase into the middle of next year. Ironically, that may happen because Rabobank says users simply are not cutting back enough to offset the lower production resulting from the drought. A “severe decline in usage” is required, according to Rabobank, but users appear to be holding off on making decisions that may be regretted later. Notable industry trade magazines have been printing articles advising milk producers to first take inventory of everything they have or may need, and consider various alternatives to simply walking away. The prospect of higher milk prices sooner rather than later, and next year’s crops, is likely part of the process. Easy to say, but hard to do for so many who need to purchase feed later this year.

Milk production in July was 221 million lbs higher than last July, an increase of 0.7% from a year ago. The number of milk cows was 12,000 fewer than in June, but 29,000 more than a year ago. Production per cow, expected to be lower because of the heat and feed costs, was up by 7 lbs for the month. The chart shown here updates the number of milk cows reported by USDA. The direction continues downward, but at a slower rate than expected. Because the duration of the drought and the intensity of temperatures continued into July and August, fewer cows and less production per cow is expected when August’s report is issued.



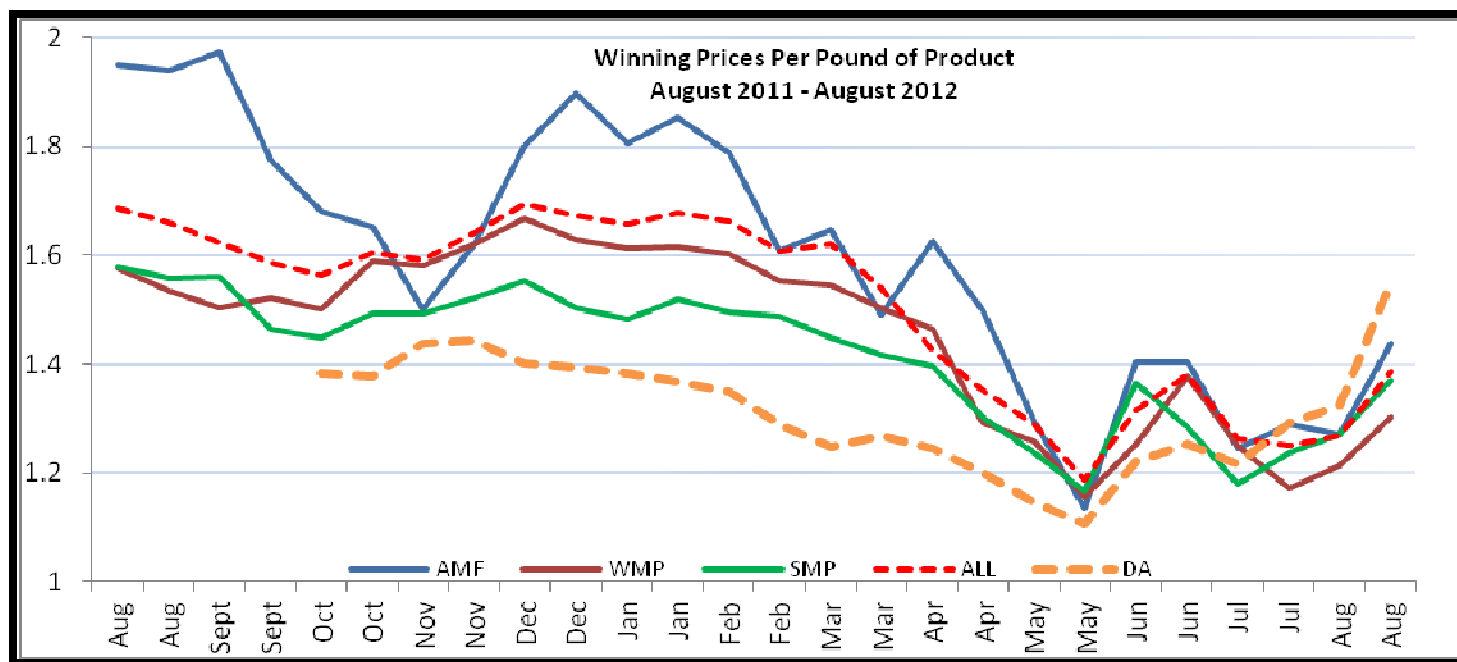
Milk production in the top 23 states increased to 94.1% of the total. Two states, California and Idaho, were reported to have expanded herds (1,000 each) during July, and only three others reduced the number of cows, by a total of 9,000. Total production compared to the same month a year earlier continues to edge lower: February’s output was 4.4% higher than in 2011 (adjusted for the extra day this year), and subsequent months were lower by 4.2%, 3.4%, 1.8%, 0.9%, and 0.7%. Interesting and amazing fact considering weather in the West was not considered to be much of a factor during the month: four of the six states with less production in July are located in the West; they include Washington, Oregon, California, and New Mexico. California, having added 1,000 cows during the month, had 13,000 more cows than last July, but production per cow was 35 lbs lower; milk production was 36 million lbs less than a year ago, a decrease of 1.0%.

PRICES ON GLOBAL DAIRY TRADE MOVE SHARPLY HIGHER; WHAT HAPPENS NEXT? (by *J. Kaczor*) Dairy product prices jumped higher in this week’s global dairy auction. The weighted average price for

all products for all six delivery periods running from September through February increased to \$1.385 per lb from the \$1.269 per lb average for the August 1st auction. Pretty significant. The improvement was shared by all products. Since August 1st one additional bidder was added; there are now 703 of them. In this auction 168 bidders participated to some extent (27 fewer than the previous) and 103 stayed in long enough to be awarded some of the 95.7 million lbs of products that were offered. The bidding required 17 rounds, the most ever.

The total volume sold in the two August auctions was 33 million lbs more than last August (without any product from Arla Foods or Murray Goulburn), and is expected to reach a record high two weeks from now when as Fonterra continues to increase its offerings and Arla Foods and Murray Goulburn steps back in with their products. If Fonterra increases its offerings proportionate to its increase in milk supply, look for a 5.5% increase over the next twelve months.

The chart below shows the changes in winning prices for the three major product categories in the auction for the past thirteen months, along with the weighted average winning price for all products. It also shows the estimated winning prices for Dairy America’s skim milk powder which are included in the “all product” average prices. The “all product” average price should give a general idea of changes in total revenue for Fonterra, although results for the three other sellers do have an effect. Additional SMP was first offered by Dairy America last October, Arla Foods this April, and Murray Goulburn’s lactose in April.



Fonterra’s fiscal year runs from June to May. That period saw the “all product” price drop from an initial \$1.98 per lb (June 2011) to \$1.19 per lb this May. The payout to Fonterra’s milk suppliers for that period was a near record high. Fonterra’s initial milk price announced this May for the current year reflected to some extent the low prices dairy product prices then offered but also anticipated continuing strong international demand from its Asian-focused customer base. This week’s auction results are seen as supportive for the announced price, and provides great relief to milk producers in Australia and New Zealand. Early observations from New Zealand economists cite the monstrous U.S. drought as the likely reason for the strong upward movement in prices.

A few other things in the chart are worth pointing out. The first is the continuing price volatility, particularly for anhydrous milkfat; which lost two-thirds of its price over the 14 months ending this May. It has bounced by a lot but each bounce is followed soon with movements downward. Next, the overall downward drift in prices, the “all product” price, reflects a combination of anticipated short-term product surpluses from sharply higher milk outputs in the three major exporting parts of the world, along with concerns about lagging economic recoveries in Europe and the United States which could affect the ability of major dairy importing nations to maintain their level of dairy product purchases. Then, there is the strange recurrence of SMP prices being higher than WMP

prices. The still unexplained spike in SMP this June has been fully corrected so that is not the reason for what most manufacturers would consider an upside down price relationship between the two products. It is especially odd because Fonterra is the world's largest exporter of dairy products, with the ability to shift production over its product lines almost instantly to reflect real or perceived changes in demand. Yes, China did indicate they would reduce their purchases of WMP and increase their purchases of SMP so Fonterra, their largest supplier by far, reduced their production of WMP and increased production of SMP. Why then should buyers of SMP suddenly, again, apparently believe a shortage may be looming for that particular product?

Finally, we see what could be considered payback for the low prices that had been bid for Dairy America's SMP for the first eight months the product was offered. DA's volumes, so far as they have been reported (which is through mid-May) are not large, totaling only about three million lbs in each auction since November. The low volume offered may partly explain why those prices jumped so much (the October delivery price is \$.22 per lb higher than Fonterra's for that month). Bidders, possibly based on anticipated shortages from U.S. suppliers this year, have agreed to pay DA \$1.50 per lb for SMP to be delivered to U.S. ports as early as September 1st, and \$1.55 per lb for deliveries starting October 1st. Hallelujah!

While these price increases are welcome to see, particularly if they are a precursor to U.S. prices, it remains to be seen if they will continue moving upward or even hold where they are. Even with U.S. milk production backing off, there is not likely to be a global shortage of dairy products for international consumption. Milk production in New Zealand through May this year is 11.4% higher than last year and their pasture conditions are reported to be in about the same excellent shape they were in last year; Australia's production is 5.5% higher for the same period; Argentina's is believed to be about 12% higher. We may yet find out if the global auction prices reflect true value or a curious anomaly.