Milk Producers Council

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TO: DIRECTORS & MEMBERS *HAPPY NEW YEAR!* **FROM: John Kaczor**

MPC FRIDAY MARKET UPDATE

CHICAGO MERCANTILE EXCHANGE

Blocks	+$.0800	$2.0300
Barrels	+$.0800	$1.9800

Weekly Average

Blocks	+$.1560	$2.0050
Barrels	+$.1058	$1.9533

CHICAGO AA BUTTER

Weekly Change	-$.0725	$1.2500
Weekly Average	-$.0583	$1.2717

NON-FAT DRY MILK
Week Ending 12/21 & 12/22

Calif. Plants	$1.8435	6,321,376
NASS Plants	$1.8438	9,256,059

DRY WHEY

NASS w/e 12/22/07 $.4464 **WEST MSTLY AVG** w/e 12/27/07 $.4350

CHEESE MARKET COMMENTS: Prices this week on the CME continued their surprising recovery, which seems to validate the underlying strength of this market. The source of the strength, as mentioned many times before, is the fact that cheese manufacturers have been regulating the amount of production to correspond to the volume of expected current orders. That approach has been helped by the fact that buyers do not want to hold very much product either. It has been amazing to watch this happening, but considering the competitive nature of the business, watch for the opportunists to make some offers at the right time that can't be refused. We welcome cheese prices at or above the $2.00 per lb level, but the uneasiness of brokers and buyers suggests that those levels are simply too high.

BUTTER MARKET COMMENTS: Last week a total of 21 sales on the CME spread over 3 days pulled butter prices down $.015 per lb. In the 3 trading days in this shortened week, butter prices fell another $.0725 cents. The amount of excess cream and milk moving to U.S. churns is heavy and is expected to continue so next week. The NASS weekly sales volume suggests that there is still some product moving off shore, but the majority of current production is going into storage.

NONFAT DRY MILK: Last Friday, an uncovered offer to sell moved the price for grade A nfdm on the CME down 12 cents, to $1.73 per lb. This week the western "mostly" price range was $1.55 to $1.70, unchanged from last week, but some sales are reported as low as $1.45 per lb. Dairy Market News finds that buyers are wary of making commitments, and seem to expect prices to continue to fall. Production continues to be heavy; plants throughout the West are reported to be at capacity. Product inventories continue to rise. The 2 major weekly price surveys reported this week for periods ending last week reported increases: California plant prices increased more than 7 cents and the national price was up just over 2 cents. Do not consider those changes a trend. **Something worthy of comment**: There may by life in the whole milk powder market. DMN reports a slight increase in the small amount that is being produced, and CWT has been helping with its export. Internationally, the market for WMP is as large as the market for nfdm. Presently in the U.S. the cost of dried whole milk is a bit less than the cost for nfdm and the prices are about 30 cents higher. Hum.

WHEY MARKET COMMENTS: Sales have slowed as the end of the year arrives. Production is tracking higher along with cheese output and inventories are rising. Export demand continues quite strong, up 18% for the year so far. Prices for dry whey are now back to where they were one year ago. It was quite a ride. The western "mostly" price this week was unchanged. DMN reports that no one seems to be willing to take committed positions just now. Prices for the other major cheese by-product, whey protein concentrate continued to slip downward, but unlike dry whey, WPC prices are still about 40 cents higher than a year ago. Not so however, for lactose. That high quality product, which has a variety of usages in preparation of foods, doesn't seem to have any friends at the moment.

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FRED DOUMA'S PRICE PROJECTIONS…

Dec 28 2007 Final:	**Quota cwt. $20.78**	**Overbase cwt. $19.08**	**Cls. 4a cwt. $19.16**	**Cls. 4b cwt. $18.58**
Last week:	**Quota cwt. $20.62**	**Overbase cwt. $18.92**	**Cls. 4a cwt. $18.72**	**Cls. 4b cwt. $18.50**

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DAIRY PRODUCT EXPORTS NEEDED TO SUPPORT U.S. MILK PRICES IN 2008: *(By John Kaczor)* Projections of next year's milk prices continue to be made and published, and almost all continue to be very optimistic. Most prognosticators believe the average all-milk price for federal orders next year will be within $1.25 per cwt of this year's all-time average high. Wow! Those projections are based on assumptions about next year's U.S. and international milk production and usage, and projections of U.S. and international dairy product prices.

California's pool prices (at 3.5% butterfat) are expected to average about $17.65 per cwt this year. If the latest national price projections for 2008 are correct and if California's prices follow the same pattern, it would seem that 2008 will be another year to remember. Here's a recap of California's annual average milk prices since 2003. The figure for 2008 is set at $1.25 per cwt below 2007's estimated average.

2003	$11.10
2004	$14.19
2005	$13.56
2006	$11.27
2007	$17.65
2008	$16.40

Before savoring the thought about a $16.40 per cwt average price for next year, the following points are worth considering.

1. The change in the formulas for setting prices for Class 2, 3, 4a, and 4b, which became effective December 1, 2007, results in a permanent pool price reduction of about $.45 per cwt, relative to prices in federal order areas. That means that California producers can expect 2008's prices to average about $15.95 per cwt instead of $16.40.

2. An annual average price of $15.95 per cwt in 2008 does not in any way mean that a "train wreck" in milk prices cannot or will not happen in 2008. **Milk price volatility** has been thoroughly discussed by MPC's Geoffrey Vanden Heuvel, and the reasons for a repeating pattern of sharp price drop-offs following periods of strong prices have been pinpointed in Cornell University's System Dynamics forecasting model. Remember, California's record prices started out with a January overbase price of $12.00 per cwt and rose to $19.00 by June. It is expected to finish out the year above $19.00. That pattern could be reversed in 2008. The Cornell model projects something just like that -- unless certain dairy product exports become surprisingly strong.

3. CWT's last herd retirement program was as successful as it was because it followed twelve months of extremely low milk prices. The next one will likely follow twelve months of very good milk prices. Producers' response to a CWT offer next year could be quite different than the response given to it last year even with the "wrinkle" CWT is now considering.

While it may not be apparent, the above outline suggests that even with increasing costs, milk production in 2008 will likely start out on a very strong note for all the right reasons, and should continue strong **until after milk prices begin to fall**. A milk production increase of 1%, which tracks with the annual increase in U.S. population, is not considered to be a threat to dairy product prices. However, anything much beyond the 1% level can be considered surplus which must be removed in order to avoid falling prices. [Milk production for the 1st 11 months in 2007 is running 2.1% higher than a year earlier.] Because most of the milk price projections for next year are accompanied by projections of milk production increases of two to two and one-half percent (but starting out the year at about three and one-half percent) it follows that **the extra milk production will be converted to products that have no market in the U.S.**

The projections for strong milk prices in 2008 are therefore supported by the belief that U.S. export volume will continue at or above recent levels and export prices will remain about where they are now. That's bold thinking, but it could happen. Here is what it will take:

- A ready supply of the right dairy products in the U.S.;
- A tightening in dairy product availability elsewhere;
- A continuing weak U.S. dollar;
- Continuing demand from developed and emerging economies that do not have a large dairy industry.

According to USDA's Foreign Agricultural Service (FAS), the U.S. is producing a surplus of butter and nonfat dry milk. The U.S. dollar is weak and is not expected to strengthen anytime soon. And growing international demand for dairy products has existed for quite some time. The 4th requirement, a slowing in milk production in Western Europe and Oceania, the world's two major dairy exporting regions, began in 2006, mainly because of weather-related problems. When the supply shortage of butter and nfdm (and to a much lesser extent, cheese) began to impact international buyers, prices began to rise and the U.S. dairy industry benefited. The following table shows the quantities (in million lbs) of the four major U.S. dairy product exports for the past three years.

	Nonfat Dry Milk	**Butter & BF**	**Cheese**	**Dry Whey**
2005	**611.6**	**17.1**	**127.3**	**420.6**
2006	**636.8**	**22.4**	**156.5**	**506.1**
2006 (10 months)	**559.4**	**20.4**	**126.8**	**423.6**
2007 (10 months)	**455.6**	**59.1**	**175.5**	**499.3**

Except for nonfat dry milk, exports of the other three products are sharply higher this year compared to the same period in 2006. NFDM volume is down by 19%. The prices received for all four product groups are averaging higher than in 2006: nfdm up 43 cents, butter and anhydrous milkfat up 28 cents, cheese up 20 cents, and dry whey up 18 cents.

The critical questions regarding exports of these products are what volumes will be required to clear the expected surplus from the U.S. market, and can those sales volumes be reached and held. Because butter and nonfat dry milk have been and will continue to be the "balance wheels" of the U.S. dairy industry, it's essential that surplus production in these two product categories be cleared away at prices that will not adversely effect prices of products used in federal order and California price formulas. **At current rates of milk production, butter production is running about 8 to 10 million lbs per month higher than last year and production of nonfat and skim milk powders about 20 million lbs per month higher**. Inventories of both are now believed to be higher than U.S. manufacturers and their customers are willing to carry. Current rates of increase in butter and nonfat dry milk production are clearly greater than this year's increase in exports of those products.

Prospects for Exports of Butter and Butterfat

The increase in butter exports shown in the table above is explained almost entirely by sales to Europe, and did not begin until June when a shortage became evident and local prices began to sharply rise. A potential problem with maintaining those sales is that milk production in Europe is already recovering from recent bad weather and production quotas have been increased by 2% effective three months from now. **Milk prices have been very good in Europe, and Euro dollars have the same effect on milk producers over there as U.S. dollars have on producers over here**. Milk production in New Zealand, a major supplier to Europe, is also expecting a sizable increase this season, and the two-year drought that has plagued Australia's dairy industry appears to have ended. Europe did not choose U.S. butter before their shortage occurred, and it remains to be seen how much of their future purchases will remain with U.S. sellers. (Tariffs on butter in the EU are about 90 cents per lb.) CWT has announced a plan to devote about $20 million next year for targeted exports of specific dairy products. Frankly, that seems far too little considering the obstacles being faced, but we wish them the best of luck. Prospects for maintaining butter exports at present levels do not look good.

Prospects For Exports of Nonfat Dry Milk and Skim Milk Powder

U.S. exports of nonfat dry milk this year fell almost across the board. Lower sales volume is reported for 12 of the 14 world regions that are established by the FAS. **Were it not for a sales increase to Mexico, this year's exports would be down by about 25%.** No data is available at present on what is happening to actual sales world-wide, but it is likely that there is **a net decrease**. One reason that is given for the across-the-board U.S. decrease is customer reaction to the sharp run-up in prices. In addition to the volume loss, international prices have fallen by about $.45 per lb from their mid-year highs. **With production running at a rate of 20 million more lbs per month and exports running 10 million fewer lbs per month, it is not clear how U.S. prices for nonfat dry milk can be supported where they need to be in order to generate the level of milk prices currently being talked about.** Prospects for regaining the 100 million lbs shortfall in nfdm exports soon enough to ward off further price declines do not look good.

Prospects For Strong Milk Prices in 2008

Except for special situations supported by special trade agreements or geographical advantages, it is beginning to look like U.S. exporters of butter and nonfat dry milk do not get much more business than what their competitors allow them to have. Given the U.S.'s weak export position for butter, powder, and cheese, **it is beginning to look like the maximum amount of year-to-year milk production increase in the U.S. that is consistent with strong milk prices is something less the 2%.** Therefore, milk producers need CWT to announce its next HRP early in the year and to make it known that they are ready to give a repeat performance later in the year; they need cheese manufacturers to continue to manage their product inventories; they need something unexpectedly good to happen in the way of nfdm exports; they need the currently weak U.S. economy to not get weaker; and they need industry leaders to demonstrate their commitment to managing the nation's milk supply in the best interest of all. Under those conditions, prospects for strong milk prices next year are reasonably good.

MPC ENCOURAGES AQMD TO ALLOW REASONABLE MANURE MANAGEMENT OPTIONS: *(By Rob VandenHeuvel)* This week, MPC sent a letter to Barry Wallerstein, Executive Officer of the South Coast Air Quality Management District, urging AQMD to work with the local dairy community to allow reasonable manure composting operations in the South Coast air basin. While several manure composters have been operating in the South Coast region in recent years, one of the largest operations has decided to shut down, due in part to unclear AQMD regulations.

The full letter can be read here: **http://www.MilkProducersCouncil.org/122707aqmd.pdf**

The basic point of the letter is this: when a composting option is no longer available, dairies are forced to haul that manure farther away and apply it directly to farmland. This results in more air emissions coming off that manure, and more miles on the road for those diesel-powered trucks. By AQMD's own calculations, direct land application results in nearly 44 percent more emissions than open windrow composting, and that's without factoring in the added mileage for the trucks!

This is an excellent opportunity for the private and public sectors to work together and formulate good public policy that not only allows a more efficient manure management option for local dairies, but also reduces the emissions in the South Coast air basin. MPC looks forward to working with AQMD on this important issue.

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