



Overview

Prices remain high in a historical context, but buyers are generally more comfortable with their level of pipeline stocks and feel less urgency to fill orders. Concerns over product availability have eased, particularly with a strong production rebound in the Northern Hemisphere this spring and expectations for a good 2010/11 season in the Southern Hemisphere. In addition, the latest Fonterra auction results (prices down 11-15%) have sent a weaker signal to the market. Orders are lighter, as is typical in the summer months.

Rabobank projects prices will face measured downward pressure as supply builds and demand growth slows, but the global ag lender does not expect a crash. Demand growth is vulnerable to reduced economic growth, rising retail prices and substitution pressure, Rabobank says. Butterfat remains tight, but it is particularly expensive relative to other dairy products and alternative fats, it notes. In addition, buyers may be reluctant to commit too far ahead given ongoing concerns about the global economy.

Processors are starting to pass higher commodity prices on to consumers, and this may impact consumer demand. For instance, in China, Nestlé is raising prices for milk powder and fresh milk by 5% next month, the second increase of the year.

With little extra inventory on hand, overall supplies should remain relatively balanced in the third quarter. But increased export volumes could be evident in the fourth quarter when Oceania's production comes on, Rabobank says.

Milk Production Trends

Oceania milk production season is over. **New Zealand** had a weak finish to 2009/10 season and is now working off limited inventory. Producers are gearing up for a big 2010/11; the New Zealand government offered an extremely optimistic outlook for the upcoming season (milk production +14%) but other published forecasts are in the range of +3-5%. ... **Australia** milk production was +2.7% in April, -5.2% for the July-April period. Prospects for 2010/11 have improved due to better weather and higher expected payouts. ABARE projects 2% production growth in 2010/11 after falling nearly 5% in 2009/10 Milk production rebounded in the **EU** in April and May (estimated +1%, and +2-3% in some key countries like Germany, France and UK) after a poor winter. However, production is now past the peak. Production in Eastern Europe is weaker. ... **Uruguay** is on track for record milk production this year if favorable weather continues. ... **India** has received more monsoon rains this month after a slow start to the season, brightening the outlook for

crops and food production. Possibility of drought has been ruled out. ... **U.S.** milk production in May was +1.1% vs. the prior year, following a gain of 1.6% in April. Cow numbers are growing.

World Dairy Product Markets

SMP – Export prices are down about \$200/ton from last month. Supplies are adequate

Dairy Product Prices		
(dollars/metric ton; F.O.B. ship)		
-- early JULY 2010 --		
	Europe	Oceania
Skim milk powder	2800-3050 (-200)	3000-3400 (-200)
Whole milk powder	3400-3625 (-75)	3550-3850 (-300)
Cheddar cheese	4000-4300 (-125)	3800-4200 (-150)
Butter	4100-4625 (+63)	3800-4200 (NC)
Butteroil	4700-5100 (-100)	4600-5000 (-200)
Dry whey	750-875 (-63)	800-1000 (-225)
Whey protein concentrate (34%)	NA	1825-1975 (-188)
Lactose	NA	1000-1100 (-150)

(change from a month ago in parentheses)

in Europe and the United States, and buyers are less aggressive, not contracting as far out. More discounting is reported. Oceania supplies, on the other hand, are fully committed.

Large EU intervention stocks continue to add some uncertainty to the market. On June 17, the EU reported 247,124 tons of SMP in intervention stocks, of which 55,189 tons was allocated to domestic feeding programs. The Commission continues to offer intervention stocks for sell-back, but so far has rejected all bids as too low. On July 8, it turned down bids for 2,788 tons at prices ranging from \$2,331-\$2,709/ton. The refusal to sell below market prices has helped buoy prices a bit, particularly for feed use. About 79,500 tons remain available for sale at the next tender July 22.

Lower prices on the Fonterra auction also are aiding buyers' comfort level. At the July 6 event, the weighted-average price for SMP was \$3,067/ton, down 12% from the June event. This price was down for the third straight month. The auction drew \$3,030/ton for September delivery, \$3,074/ton for October-December and \$3,099/ton for January-March. Beginning in August, the Fonterra auction will trade buttermilk powder and high heat/heat stable SMP in addition to low heat, medium heat, high heat and UHT SMP currently traded. Also, beginning in September, the Fonterra auction will be held twice a month.

South Africa's imports are higher as a result of their worst drought in more than 100 years. However, Algeria is cutting back milk powder import quotas by about 15% to encourage more domestic production.

The U.S. powder market is softer. More resale product is available, selling at a discount to fresh production. Spot sales are lighter. Production has been heavy and stocks have increased, though they remain below a year ago. In January-April, U.S. NDM/SMP exports were 81,185 tons, up 19% from a year earlier.

WMP – Export prices are softening. Buyers are more cautious while they determine the impact of the price decline in the latest

Fonterra auction. Spot supplies are limited because EU output is below earlier expectations, while Oceania production is at seasonal lows and most Oceania inventories are committed. However, some softening of China demand has been reported.

Fonterra auction prices were off sharply in the July bidding. The weighted-average price for the July event was \$3,224/ton, down 15% from June and the lowest since last October. Prices were down for the third straight month. Winning bids for the nearby (September) contract were higher than bids for the deferred months, indicating supply concerns are for more immediate needs.

Cheese – Export prices are down \$125-\$150/ton from a month earlier. European processors continue to push milk into the cheese vat. EU exports were up 20% in the January-April period, helping to clear some production. However, earlier price increases have led to some buyer push-back. Oceania production is seasonally light and suppliers are working off 2009/10 inventory.

The U.S. cheese market is climbing. On July 8, the benchmark CME Group spot cheddar block price was \$3,351/ton, up \$300/ton from a month earlier and the highest price of the year. Production and inventories remain heavy. Commercial cheese stocks on May 31 were 461,965 tons, up 5% from the year before, and the most in 25 years. Cheese production in April was 398,119 tons, up 2.5%. U.S. cheese exports in January-April were 47,313 tons, up 43% from prior-year levels. Through July 6, Cooperatives Working Together (CWT) had accepted bids to provide bonuses on exports of 39,010 tons of cheese for delivery through the end of the year.

Butterfat – In Oceania, the recent upward price trend has stalled. Production is at its seasonal low, and fully committed. Additional supplies will be available in September when the new season starts.

Butter supplies in Europe are still very tight. Stocks of butter in PSA are below expected market needs for the fall. As a result, butter users are concerned about possible

shortages. Only about 46,000 tons of butter was offered into PSA by June 13, less than half the pace of 2009 and 2008.

In first four months of the year, butterfat production from EU, Oceania and the United States was down about 8% from prior year. In the United States, lower component levels have contributed to lower butter production. In Europe, milk is still going into cheese (vs. butter/powder). With large EU intervention stocks of powder hanging over the market, manufacturers don't want to put milk into butter/powder. Meanwhile, butterfat demand from India, Russia and the Middle East has been strong.

Intervention stocks of butter are just about depleted. On June 3 and 17 and July 8, the European Commission accepted bids to sell 23,696 tons of butter back onto the market, most recently at \$4,549/ton. The next tender will be held July 22, and 1,524 tons of butter will be available.

Fonterra auction prices for AMF fell in July. The weighted average price was \$4,620, down 14% from June. Prices were stronger in the front month (September) contract, which garnered a winning average bid of \$5,273. Winning bids in the other six months averaged about 15% less. Beginning in August, the Fonterra auction will trade bulk 1,000kg totes of AMF, in addition to 210kg drums currently traded.

The U.S. butter market is firm. On July 8, the benchmark CME Group spot butter price was \$3,858/ton, up \$364/ton from a month earlier. Butter production was off 6% in the first five months of the year, and has trailed year-earlier levels for 10 straight months. Commercial butter stocks on May 31 were 95,928 tons, down 16% from last year. U.S. butterfat exports in January-April were 13,261 tons, up 97% from last year.

Dry Whey – Oceania whey prices are declining, and expectations are for further slippage. EU whey prices have been up-and-down this year, but are now on a down cycle as well. Production has been heavy, particularly in France, Germany and the

Netherlands. In addition, orders are typically slow at the onset of Europe's holiday months. Buyers are comfortable waiting to see where prices go next, though EU disposal of SMP from intervention is becoming less of a factor.

The U.S. dry whey market is trending lower. Spot loads are increasingly available, but garnering little interest. Technical issues with China remain unresolved, but shipments are still being accepted. Dry whey supplies are running higher this year – production was up 7% in the first five months of the year. Commercial stocks remain above year-ago levels. At the end of May, holdings were 24,434 tons, up 22% from a year earlier. Exports of dry sweet whey have been heavy. In January-April, shipments were 77,903 tons, up 16% from the prior year.

Whey Protein Concentrate – The entire protein complex is weaker and that's putting downward pressure on WPC. Oceania prices are lower. U.S.-sourced WPC prices are steady over the last month. Contract sales of WPC remain good, but spot sales have softened. Lower-priced NDM is putting downward pressure on whey proteins. In the first four months of the year, U.S. exports of WPC were 60,838 tons, up 63% from last year. In the January-May period, production of WPC 50-89 was up 20%, while output of WPC 25-50 was down 8%. At the end of May, manufacturers' inventories were 17,170 tons, down 2% from a year ago.

Lactose – Oceania prices are coming off their high and expected to slide further through opening of the new season. Export prices are weaker. U.S. lactose prices are down slightly from a month earlier. U.S. lactose production is at record levels. In the first five months of the year, production was up 22% from the prior year. Export demand has been strong, though spot orders have slowed. In the first four months of the year, lactose exports were 74,967 tons, up 17%. Still, inventories are building. On May 31, manufacturers' stocks were 34,543 tons, up 6% from the year before.

Currencies in U.S. dollars

	June 8	July 8	change
Euro	\$1.194	\$1.260	+5.5%
Australian dollar	\$0.816	\$0.853	+4.5%
New Zealand dollar	\$0.664	\$0.696	+4.8%

Over the last month, the U.S. dollar weakened significantly.

U.S. Dairy Product Markets

Milk – Milk production in the United States was 7,703 million tons during May 2010, 1.1% more than production during May 2009. The number of U.S. milk cows averaged 9.103 million during May, 4,000 more than during the previous month but 171,000 fewer cows, or 1.8% less, than the average during May 2009. The average cow in the U.S. produced 26.2 liters of milk per day during the three-month period March through May 2010, 3.1% more than daily milk output per cow during the same period a year ago.

SMP – Production of all skim milk powder in the United States totaled 78,000 tons during May 2010, 3.2% less than production during May 2009. At the end of May, manufacturers' stocks of SMP were 67,000 tons, 26% less than stocks at the end of May 2009. At the end of May, the U.S. government held 2,000 tons of skim milk powder stocks, all of it committed to food donation program uses. This was down 1,000 tons from government stocks one month earlier, and 91,000 tons less than government-owned skim milk powder inventories at the end of May 2009. Average SMP prices during May 2010 were 12% higher than the previous month and 51% higher than prices during May 2009. Commercial disappearance of all SMP during February through April 2010 was 211,000 tons, 15% more than disappearance during the same period a year earlier.

Cheese – U.S. production of all cheese varieties was 398,000 tons during May 2010, 2.5% more than was produced during May 2009. The May total included 167,000 tons of American-type cheese, 0.3% more than was produced a year earlier, and 168,000 tons of Italian-type cheese, including Mozzarella, which was 6.8% more than was produced during May 2009. U.S. commercial stocks of all natural cheeses were 462,000 tons at the end of May 2010, 5.0% more than stocks at the end of May 2009. Average wholesale prices for Cheddar cheese during May 2010 were 3.1% higher than during the previous month and 23% higher than in May 2009. Commercial disappearance of all cheese in the United States during February through April 2010 was 1.154 million tons, 1.7% more than during the same period a year ago. Of this total, disappearance of American-type cheese was 465,000 tons, up 1.3% from a year earlier, while disappearance of all cheese other than American types rose by 2.0 to 688,000 tons.

Butter – U.S. butter production totaled 60,000 tons during May 2010, 5.6% less than was produced during May 2009. Commercial stocks of butter stood at 96,000 tons at the end of May 2010, 17% less than stocks a year earlier. Butter prices were 7.0% higher than a month earlier during May 2010 and 30% higher than average prices during May 2009. Commercial disappearance of butter during February through April 2010 was 173,000 tons, 2.6% higher than during the same period a year ago.