

Monthly Dairy Market Outlook, July 2005

Highlights

- June's dairy prices look to be slight flat for the four main products we cover (Figure 1). On a year over year basis, prices are expected to be down for butter and whey, but a slight up tick in block cheese price is expected.
- The June USDA reports revealed increasing production of fluid milk, and higher levels of production for butter and cheese in April.
- July's prices should be down from last year's levels for butter and cheese, but higher levels of exports should increase NFDM prices some.
- The extended outlook for the next few months, calls for higher production levels of fluid milk, which should help to lower prices on many goods. However, we remain cautious due to demand uncertainties in the market.

Figure 1. Estimated Monthly Prices

	Price			
	June 2004	May 2005	June 2005E	June Y/Y % Chg
Block Cheese	\$1.36	\$1.48	\$1.47	8.1%
Butter	\$1.93	\$1.40	\$1.41	(26.9%)
Whey	\$0.29	\$0.26	\$0.27	(8.6%)
Non-fat Dry	\$0.92	\$0.93	\$0.93	1.7%
Class 3	\$17.68	\$13.78	\$13.76	(22.2%)
Class 4	\$13.72	\$12.20	\$12.27	(10.6%)

Source: USDA, CME and Onboard Consulting Estimates

Quick Take on the Current Situation

- Currently, milk production is at high levels. This situation has increased inputs into butter, cheese and NFDM.
- Input prices into these products have appeared to decrease some as well, as discounts on fluid milk are being offered to manufacturers.
- Butter production is greater than demand and cheese production is in-line with demand. Inventories for butter are growing, while cheese inventories are flattish, and some cheese products, like Mozzarella, are having to be discounted.
- Recently, cream supplies have been tightening a bit, due to ice cream demand.

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Information for Decision Makers

June USDA Reports

- April statistics were recently released in the June USDA reports.
- Block cheese and butter production came in ahead of our estimates in April, while whey and non-fat dry milk production came in below our targets (Figure 3).
- Compared to last year, production was higher for block cheese and butter, but lower for whey and non-fat dry milk (Figure 2)
- The greatest changes were for butter and non-fat dry milk. Butter production improved in-part to lapping over tight production from last year and increased milk production.
- Stocks of most products are expected to be down compared to last year. Non-fat dry milk stocks reflect draw down due to several factors, including increased exports, and government aid to the poor.
- Butter stocks continued their downward trend in April. In our *May Outlook*, we expressed concern over this trend. In March and April, butter production was up 23.8% and 15.1%, respectively, year over year, while stocks were down 16.1% and 16.2%. Despite these numbers, we are less concerned about the future prospects, as reports indicate higher than usual input supply and production.
- Compared to last year, prices were down for butter, whey and NFDM in April. Interestingly, cheese prices increased from up 3.9% in March to up 7.4% in April. Unofficial May prices look to continue this trend (up 10.1% in May), but by July, we expect cheese prices to be down year over year.



Figure 2. April Year Over Year Comparisons

	Block Cheese	Butter	Whey	NFDM
Production	1.9%	15.1%	(1.5%)	(18.8%)
Stocks	0.4%	(16.2%)	(2.6%)	(51.8%)
Price	7.4%	(32.7%)	(14.8%)	(0.4%)

Source: USDA, CME and Onboard Consulting Estimates

Figure 3. April Production and Variance to Estimates

	Production (1,000 lbs.)				
	April 2004	April 2005E	April 2005	% Chg	% Var
Block Cheese	325,061	327,108	331,352	1.9%	1.3%
Butter	100,324	111,450	115,467	15.1%	3.6%
Whey	91,816	90,776	90,410	(1.5%)	(0.4%)
Non-fat Dry	134,011	110,030	108,789	(18.8%)	(1.1%)
Milk (mil. Lbs)	14,519	14,643	14,975	3.1%	2.3%

Source: USDA, Onboard Consulting Estimates



July's Outlook



"July's prices should benefit from excess milk production"

- July's prices should reflect the strong level of milk production and weaker than expected demand that we are currently experiencing (Figure 4).
- On a year over year basis, we are estimating that milk production should be up about 4.5%. However, prices for all dairy products should not benefit evenly due to lower demand for primary, intermediate and final products. Factors effecting fluid milk allocation include lower bottled milk orders (school is out), lower than expected commercial use of butter and cheese, and higher than normal exports of NFD.
 - The excess supply of milk has directly aided the supply of NFD. To clear some inventory, NFD producers have lowered prices some and increased exports. However, as supplies become tighter, due to exports, we expect prices to tick up slightly.
 - Butter prices should drift lower, as inventory is currently building rapidly due to a several factors including:
 - Cheese suppliers are not increasing output as fast as milk producers are increasing production. This event has led to the excess milk supplies being funneled into butter and NFD.
 - A decrease in butter utilization due to weak output of some final products.
 - Cheese prices are expected to be down some, as production outstrips market demand, which has been soft.

Figure 4. Estimated July Prices and Production

	Price			
	July 2004	June 2005E	July 2005E	July Y/Y % Chg
Block Cheese	\$1.37	\$1.47	\$1.32	(3.5%)
Butter	\$1.75	\$1.41	\$1.40	(20.0%)
Whey	\$0.25	\$0.27	\$0.25	(1.6%)
Non-fat Dry	\$0.92	\$0.93	\$0.98	6.9%
Class 3	\$14.85	\$13.76	\$12.23	(17.6%)
Class 4	\$13.31	\$12.27	\$12.62	(5.1%)

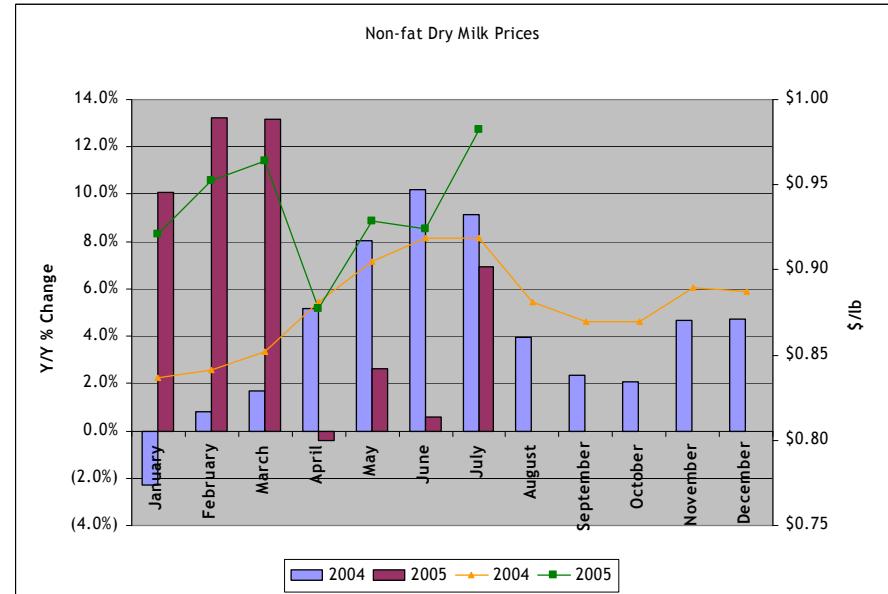
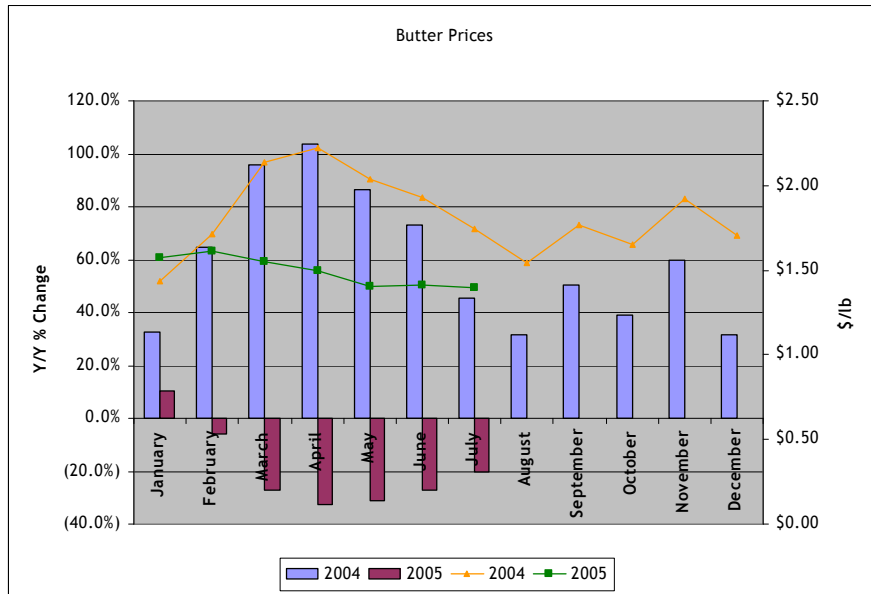
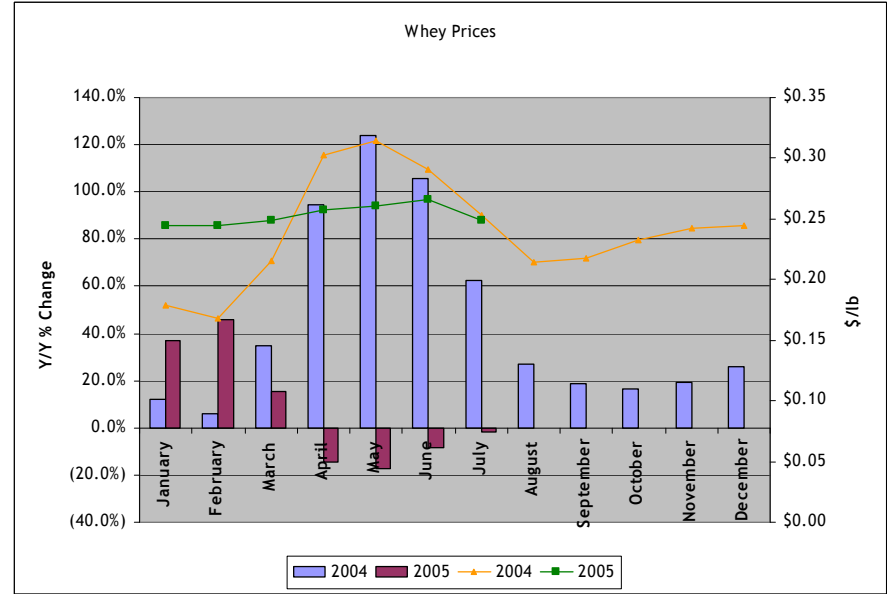
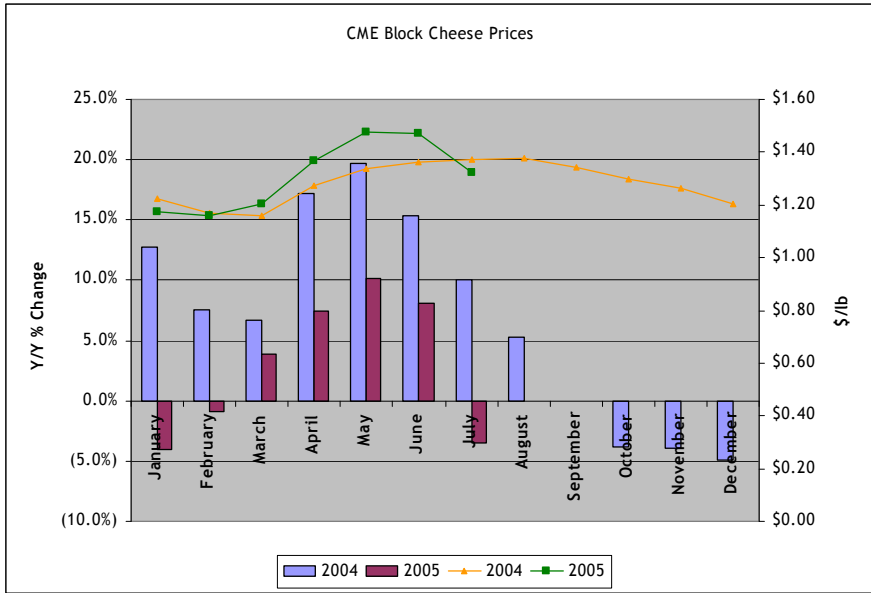
	Production (1,000 lbs.)			
	July 2004	June 2005E	July 2005E	July Y/Y % Chg
Block Cheese	302,724	334,936	334,274	10.4%
Butter	92,615	90,605	87,980	(5.0%)
Whey	83,065	91,170	91,854	10.6%
Non-fat Dry	134,566	138,506	131,787	(2.1%)

Milk (mil. Lbs)	14,405	14,742	14,870	3.2%
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Source: USDA, CME and Onboard Consulting Estimates

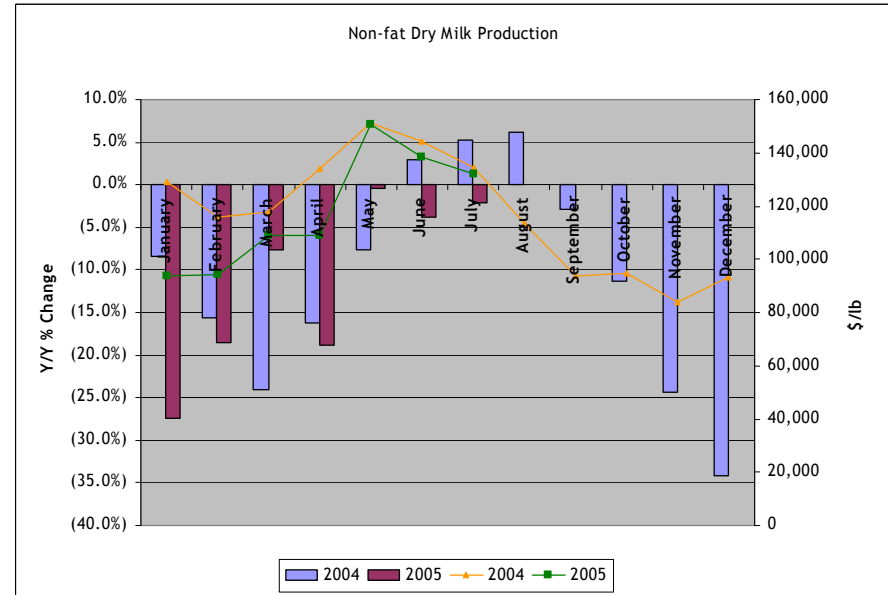
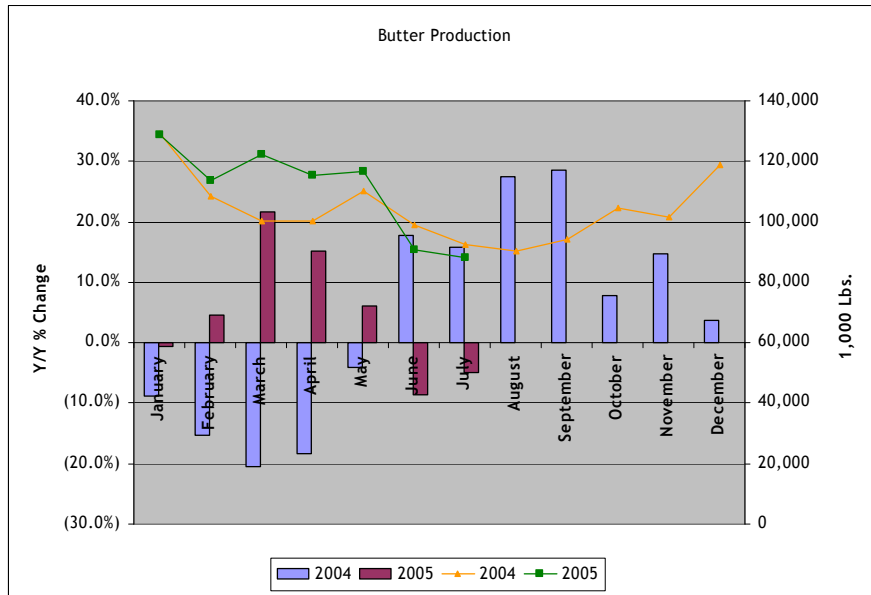
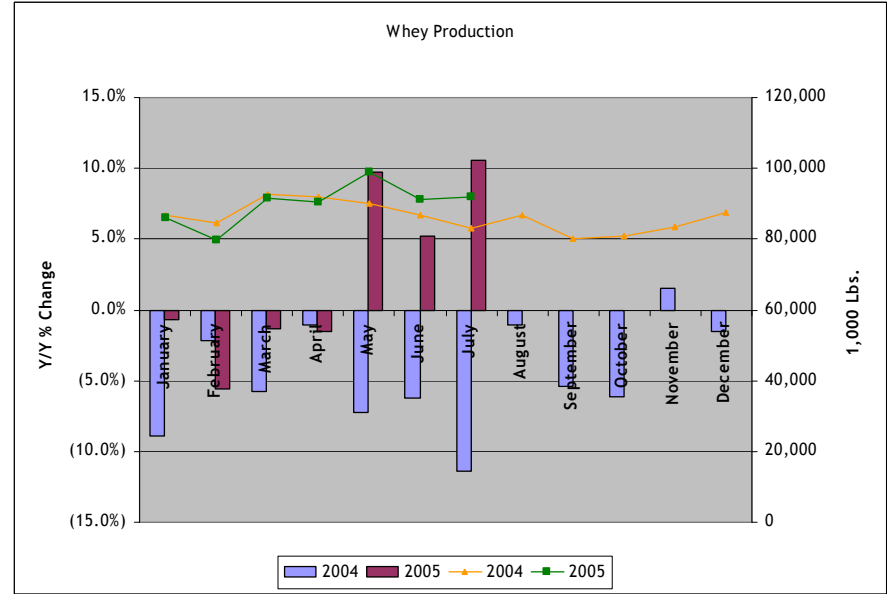
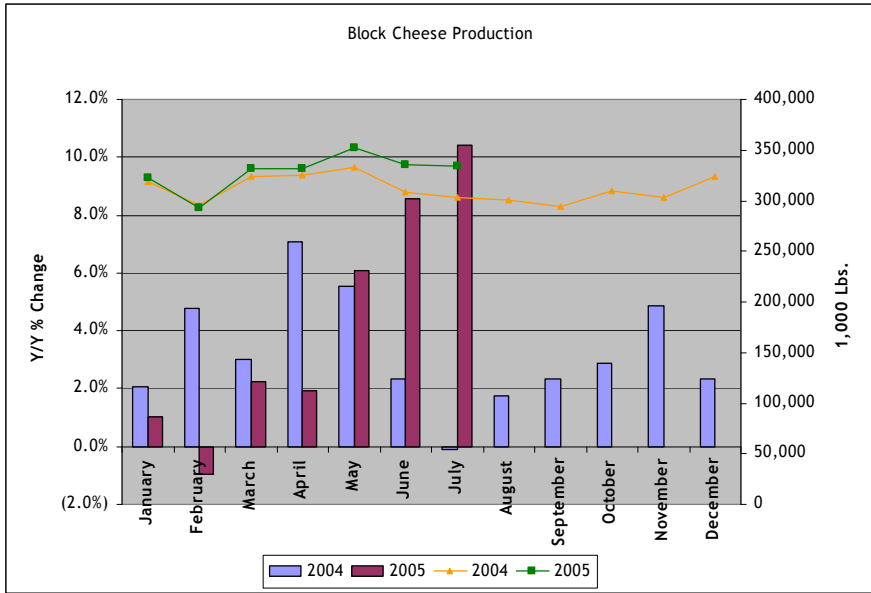


Figure 5. Dairy Prices



Source: USDA, CME, Onboard Consulting

Figure 6. Dairy Production



Source: USDA, CME, Onboard Consulting

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Extended Outlook

- Fluid milk production is expected to grow, as more cows enter the herd and yields per cow continue to increase. However, we are watching input prices for key products, such as wheat and alfalfa. There has been some concern about the supply of these products, especially for the upcoming winter season when they are required.
- Cheese prices are expected to gradually drift lower as producers are not building stocks, demand continues to be muted in the short and long markets, and buyers are watching on the sidelines before making any moves.
- Butter prices are expected to continued their downward trend, even in the seasonally tight Autumn period, as rapid production and high inventories limit price expansion.
- NFDM production is expected to benefit from the higher fluid milk output. However, prices should hold steady, or even increase, as producers are exporting more product than last year.
- We are also closely watching the demand for dairy products. Prices could go higher if demand returns to a level seen at the beginning of the year, but if demand remains sluggish, prices could fall. We believe that the cheese market has the greatest volatility with respect to this fact.
- The current uncertain outlook regarding interest rates and economic growth also has us on guard. There remains a fear among some investors that inflation is higher than calculated, and that the interest rate increases will lead the economy back into recession. Further, as the mountain of consumer debt costs more to service with higher interest rates, there remains the possibility that expenditures for food could decrease.