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prices lower also. This week, however, block prices recovered due to stronger supply and demand conditions. It is doubtful that barrel prices will remain at such low levels over the next few weeks.

The sudden surge in cheese prices has not improved the market outlook for Class III prices. The Class III futures settlement prices at the Chicago Mercantile Exchange (as of August 11) shows November Class III prices trading at \$11 per cwt. The market is not expecting cheese prices (block prices) to

strengthen appreciably from current levels as we enter the fall months. The Class IV milk price was \$11.87 per cwt in July. The Class IV futures settlement price at the Chicago Mercantile Exchange (as of August 11) was \$11.74 and \$11.75 for October and November. Thus the market is not expecting butter prices to improve significantly from current levels through the fall months.

Grade AA butter prices remained relatively strong this week, fluctuating between \$1.19 - \$1.20 per pound. USDA reports that butter production is trending

seasonally lower, and butterfat tests are falling. Butter prices should remain at current levels throughout the fall months, assuming demand remains strong.

A new report was released by Penn State regarding the new method USDA is using to price milk under federal order reform. The study attempted to abstract from the level of dairy commodity prices, which today are lower than they were last year. Instead, the study held these constant and focused on federal order reform. The following conclusions were reached:

1. U.S. dairy farmers are more dependent than ever on

dairy commodity prices for farm income. Whereas cheese prices alone used to drive farm-gate milk prices, butter, nonfat dry milk and dry whey prices are now also important.

2. The dairy price support program has taken on new meaning since federal order reform. That 92s because the new class price formulas are directly affected by the price of nonfat dry milk. This study shows farm-gate milk prices will fall significantly if the program is eliminated and nonfat dry milk prices are allowed to fall to market-clearing levels.

3. Whereas Class I, II, and IV prices are now higher under order reform when compared to the previous system, the Class III price has fallen \$0.20-\$0.56 per

cwt due to order reform. Thus dairy producers marketing milk in federal orders that are heavily dependent on Class III sales now face lower income than those with higher Class I and II sales.

4. Federal order reform has resulted in a redistribution of income. Dairy producers in the Northeast, Appalachian, Southeast, Florida, Midwest, and Pacific Northwest have seen increases in farm milk sales. Dairy producers in the Upper Midwest, Central, and Western orders have seen a decrease in farm milk sales.

You can find this study on my website at: <http://www.aers.psu.edu/dairyo/utlook/reports/reform.htm>

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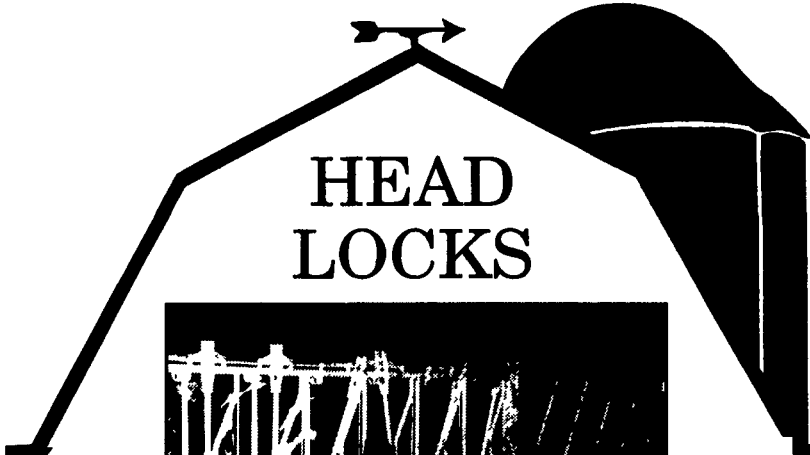
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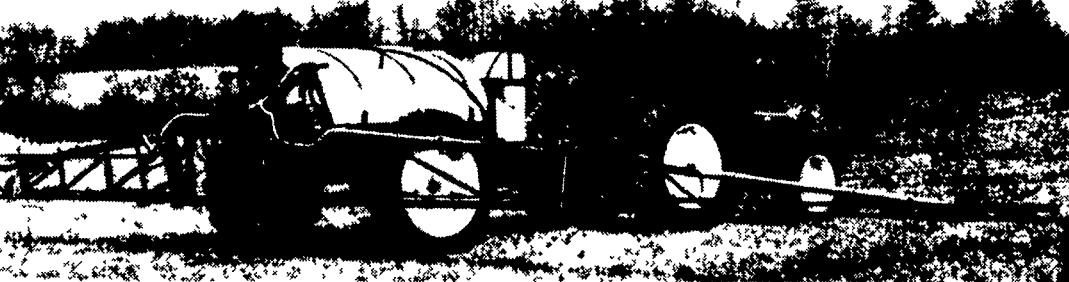
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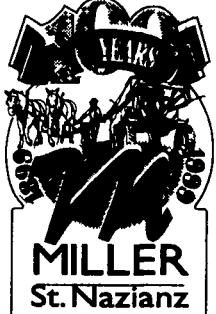
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